EXAMINING THE SETTLEMENT PRACTICES OF U.S. FINANCIAL REGULATORS

HEARING

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EXAMINING THE SETTLEMENT PRACTICES OF U.S. FINANCIAL REGULATORS

Thursday, May 17, 2012

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the committee] presiding.

Members present: Representatives Bachus, Hensarling, Manzullo, Garrett, Neugebauer, Campbell, McCotter, Pearce, Posey, Luetkemeyer, Huizenga, Hayworth, Renacci, Hurt, Dold, Schweikert, Grimm, Canseco; Frank, Waters, Maloney, Velazquez, Watt, McCarthy of New York, Miller of North Carolina, Scott, Green, Cleaver, Ellison, Himes, and Carney.

Chairman BACHUS. The committee will come to order.

Today's hearing of the Financial Services Committee is entitled, "Examining the Settlement Practices of U.S. Financial Regulators." Our first panel consists of: Mr. Scott Alvarez, General Counsel of the Board of Governors of the Federal Reserve System; Mr. Robert Khuzami, Director of the Division of Enforcement for the U.S. Securities and Exchange Commission; Mr. Richard Osterman, Deputy General Counsel of Litigation and Resolution for the Federal Deposit Insurance Corporation (FDIC); and Mr. Daniel Stipano, Deputy Chief Counsel of the Office of the Comptroller of the Currency.

I would like to welcome all you gentleman, and we appreciate the good work you do on behalf of the United States.

At this time, we are going to have our opening statements, and I will begin.

Under our system, Federal agencies that initiate enforcement actions against alleged bad actors have the option of settling their cases before going to trial. Typically, these agencies elect a settlement in order to quickly impose a monetary fine or institute remedial action, rather than proceed with lengthy trials that can have unpredictable outcomes.

Often, the fines and penalties assessed against the defendants are returned directly to the investors who have allegedly been harmed, sometimes months or years before any funds would have been distributed if the case had gone to trial instead.

It is common practice at many Federal agencies, some of which are represented at today's hearing, to permit defendants to "neither admit nor deny" wrongdoing or liability when settling the government's claims. This allows the defendant to avoid providing ammunition to private plaintiffs in suits related to the same conduct at issue in the Federal case, and facilitates settlements where the government concludes that its interests are better served by avoiding the expense and uncertainty of lengthy legal proceedings.

Late last year, their practice came under scrutiny when Federal District Judge Jed Rakoff rejected a $285 million settlement agreement between the SEC and Citigroup Capital Markets in a case involving Citi's marketing of certain mortgage-backed securities. In rejecting the settlement, Judge Rakoff stated that it was neither fair nor reasonable nor adequate nor in the public interest, because the proposed settlement did not include an admission of wrongdoing.

The SEC and Citigroup jointly appealed this decision and in March of this year, the Second Circuit Court of Appeals temporarily stayed Judge Rakoff's order. The Court of Appeals stated that it had no reason to doubt the SEC's representation that the settlement it reached is in the public interest and that it was "commonplace for settlements to include no binding admission of liability." It is not the function of Federal courts to dictate policy to executive administrative agencies. The appellate court concluded that, "The SEC and Citigroup have a strong likelihood of success in their joint effort to overturn the district court's ruling."

While this is a complex issue, I believe that on balance, the appellate court's analysis was the correct one, a policy that has judges micromanaging Federal agencies' exercise of their enforcement authority and requiring the government to engage in lengthy and expensive trials in every instance would not serve the best interests of taxpayers or investors.

As a former trial attorney, I can assure you that the results of a trial are never certain. They are also exhausting in both resources and energy. It therefore makes more sense, in my view, to leave the judgment of whether to try a case or attempt to settle it largely to the agency's discretion rather than shifting that responsibility to Federal judges.

The agency is most knowledgeable about the merits, value, and difficulty of the case they are bringing. One can always second-guess but should do so with caution when second-guessing one in a better position to make that judgment call.

Having said that, I realize that some have raised concerns about these settlement practices, and I am pleased we are able to examine this issue today in a bipartisan way. I thank the ranking member for working in a collaborative way to put this hearing together, and I will recognize him at a later time.

But at this time, I will recognize Congresswoman Waters, the ranking member of the Capital Markets Subcommittee.

Ms. WATERS. Thank you very much, Mr. Chairman, for holding this important hearing today.

Last November, when Judge Rakoff rejected a negotiated settlement between the Securities and Exchange Commission and Citigroup, it captured the attention of the public and really focused us, in Congress, on just how frequently our financial regulators enter into "neither admit nor deny" settlements with the firms they regulate.

These settlements, as you know, result in the defendant paying a fine but not admitting any wrongdoing. I understand that the

Commission is constrained on how many cases they can prosecute because of budget concerns. I know that the SEC is often outgunned in terms of resources when they go up against the industry, and I know that Chairman Schapiro has advocated for legislative changes to empower the SEC to collect additional fines against recidivist offenders.

Finally, let me be clear in saying that I will continue to fight for the SEC to have the resources it needs. But with that said, I remain concerned about the frequent use of the "neither admit nor deny" settlements. While I know the SEC sometimes has a strong interest in settling cases quickly in order to get money into the hands of defrauded investors, the Commission also has a broader responsibility to enforce the rule of law.

Settlements should never be viewed as just another cost of doing business, and I fear that could be the case. When no wrongdoing is admitted, it encourages repeat offenses. In fact, a recent New York Times analysis of enforcement actions brought by the SEC during the last 15 years found at least 51 cases in which 19 firms had broken antifraud laws they previously had agreed never to breach.

Finally, to address our banking regulator settlement practices, let me note that I am concerned about the mortgage servicing concept orders the OCC and the Federal Reserve Board entered into with 14 banks and mortgage servicers, and I am eagerly anticipating the results of a GAO study that I requested on this topic.

I look forward to exploring this topic more fully today and hearing our regulators' perspective on this important issue, as well as the views of the other witnesses, and I thank you.

Mr. Chairman, I yield back the balance of my time.

Chairman BACHUS. Thank you, Congresswoman Waters.

At this time I recognize the chairman of the Capital Markets Subcommittee, Mr. Garrett, for 2 minutes.

Mr. GARRETT. I thank the chairman, and I thank the panel also for coming today. Although I will say this, I am a little bit skeptical as to what the actual motivation is for holding today's hearing. I understand that the Minority wanted to have this hearing to use it as a forum, if you will, to try and pressure the SEC not to exercise its legal discretion to enter into settlement agreements with banks because they think that those cases should be tried in court instead.

This strikes me as nothing more than political opportunism, if you will, especially when one considers that these same individuals on the other side never miss a chance to voice their opposition when Republican bills try to curb any discretion by the SEC in the rulemaking process.

Is this a double standard? I think it is. I think suggesting that Congress interfere with the SEC discretion to determine whether to spend taxpayer money on protracted litigation or to settle a case based on the facts that the lawyers in the Division of Enforcement have evaluated is irresponsible.

According to a Harvard Law School article, over 95 percent of lawsuits in the U.S. courts settle before they go to trial. Why is that? Because trials are time-consuming, expensive, risky, and unpredictable.

The SEC understands this reality, and it acts in the best interests of investors and taxpayers when it settles those cases, despite what some other people might think. The fact that my colleagues on the other side of the aisle are even considering putting pressure on the SEC to use taxpayer money to go to trial instead of trying to reach settlements makes me question the actual motive, as I said at the start.

Do they want to bleed the SEC of funds so that they can come back and justify spending more money elsewhere, or are they letting the trial attorneys know that, well, they haven't been forgotten. Or is this really some sort of a gimmick designed to appease the base of their party that blames all society's ills on the banks?

Whatever the reason, the suggestion that this body should substitute its judgment for the judgment of the SEC lawyers who are privy to the facts and the circumstances of each individual case involving complex financial transactions, in my opinion, is completely misguided.

With that, I yield back.

Chairman BACHUS. Thank you. Mr. Khuzami, since he has been in such a supportive mood of the SEC, you ought to the ask him for some more money.

Mr. KHUZAMI. Can we have some more money?

Mr. GARRETT. You are doing such a good job in this area, I think that—

Chairman BACHUS. Thank you.

I now recognize Mrs. Maloney, the ranking member of the Financial Institutions Subcommittee.

Mrs. MALONEY. Thank you, Mr. Chairman, and welcome to the witnesses today.

While many agree that investors are entitled to restitution as a result of agency actions against institutions, there are still concerns about how to make those investors whole and how to ensure they help prevent future wrongdoing.

One particular case has drawn the committee's attention to this issue and serves as the basis for this hearing, the rejection by the U.S. District Court of an SEC settlement in which there was no admission of wrongdoing. While I believe that admissions of guilt are more likely to be a deterrent, we must keep in mind the needs of investors who have been harmed in their ability to be made whole.

Agency settlements return money to harmed investors quickly and allow the SEC to continue suits against individuals it believes have been fraudulent. However, I am sympathetic to Judge Rakoff's view that we do not want these settlements to be viewed as "a cost of doing business," and that they have little impact on future behavior.

There are many who believe we should follow Judge Rakoff's lead and require companies to admit wrongdoing in these cases, but I will be interested to hear from the witnesses today whether they believe this could lead to fewer settlements and could do a disservice to investors. The reality is that the budget this Congress has allotted the SEC is not enough to fund lengthy legal battles.

Settlements, which happen much more quickly with an expenditure of fewer resources, are often the only available route for the Commission to take. And I would underscore that the SEC's budget has been cut and they have been given greater responsibilities under Dodd-Frank, and they have not even completed the rule-making that they are required by law to do. So they definitely need more resources to handle the challenges ahead of them.

I look forward to the perspectives of the witnesses today on this issue, and I thank you all for being here. And I thank you for calling the hearing, Mr. Chairman.

Chairman BACHUS. Thank you. At this time, I recognize the gentleman from Illinois, Mr. Dold, for 1 minute.

Mr. DOLD. Thank you, Mr. Chairman. I certainly appreciate it, and I want to thank the witnesses for your time, your testimony, and your experience. I appreciate that.

To say the least, I think that most in the legal and regulatory community were surprised when the district court rejected the SEC settlement with Citigroup because Citigroup did not admit wrongdoing as part of the settlement. Of course, nearly all formal regulatory proceedings result in a voluntary settlement with the defendants not admitting to liability. So this district court ruling seems unprecedented.

As I see it, a legal standard that requires wrongdoing admissions from the defendant as a condition of settling regulatory proceedings will diminish the number of settlements to something very close to zero. And the implications of a significant reduction in the number of voluntary settlements would seem to have some meaningful negative implications for all concerned: the victims; the taxpayers; the regulatory agencies; the courts; and the litigants themselves.

So I look forward to hearing from our witnesses today as to what the implications are going to be.

Mr. Chairman, I yield back.

Chairman BACHUS. Mr. Canseco for 1 minute.

Mr. CANSECO. Thank you, Mr. Chairman. Mr. Chairman, the mission of the SEC is to maintain fair, orderly, and efficient markets and to facilitate capital formation.

Needless to say, there remains a serious question as to whether the agency settlement policies help fulfill this mission. Yet, there is a greater question about the direction the SEC has taken over the last several years. Almost half of the agency's budget goes towards enforcement and examination and, in turn, it appears that the agency believes pursuing headline-grabbing settlements is the best way to protect investors.

The measure of a Federal agency's success should not be how much enforcement revenue it brings in after wrongdoing has already occurred; rather, in the case of the SEC, it should be whether fair, orderly, and efficient markets are being maintained.

And with that in mind, I look forward to hearing from our witnesses today on this matter.

I yield back.

Chairman BACHUS. Mr. Green is recognized for up to 4 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I assure you I will not use the entire 4 minutes. I thank the ranking member as well. And I thank the witnesses for appearing.

I think that we are at a point where we have at least one question that has to be answered: Are we going to allow megabusinesses to build into their bottom line acts that constitute violations of the law? A settlement is a good thing, but the question is, are we at a point now where businesses can simply sit and plan and conclude that we will have "X" number of settlements, "X" amount of damages possibly, and as a result, let's prepare for this knowing that we can cover and move on? There has to be some means by which businesses that settle these lawsuits also see themselves as being held accountable for wrongdoing. Wrongdoing cannot take place and become a part of a bottom line.

I look forward to hearing the witnesses explain to us how we can prevent wrongdoing from being a part of the bottom line, and I yield back the balance of my time.

Chairman BACHUS. Are there any other Members on the Democratic side who wish to be recognized? If not, we will hear from our witnesses. Each of your written statements will be made a part of the record, and you will be recognized for a 5-minute summary.

We will begin with you, Mr. Alvarez.

STATEMENT OF SCOTT G. ALVAREZ, GENERAL COUNSEL, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. ALVAREZ. Thank you. Chairman Bachus, Congresswoman Waters, and members of the committee, thank you for the opportunity to discuss the Federal Reserve's enforcement program.

Authority to take enforcement actions is one of the important tools that Congress has provided the Federal Reserve to require financial institutions under its jurisdiction to address serious problems or risks and comply with the banking laws.

The Federal Reserve employs a variety of formal and informal tools for addressing supervisory concerns found at financial institutions under our jurisdiction. The backbone of our supervisory tools is the examination process. Many problems are identified and corrected during the course of regularly occurring examinations while our examiners are still on-site at the institution.

Improper conduct that cannot be immediately addressed may also be noted in the institution's examination report or in a supervisory letter as a matter that requires management's attention and corrective action. If a problem requires a more detailed resolution or is more pervasive at an institution, the Federal Reserve may enter into a memorandum of understanding in which the board of directors commits to specific corrective actions. These informal tools comprise the most common methods for identifying and addressing unsafe and unsound practices and correcting alleged violations of the banking laws.

On occasion, the Federal Reserve has also confronted situations where financial institutions management refuses to correct an improper practice or to comply with applicable laws or where the practice or alleged violation is so serious that normal recourse to informal supervisory methods is not appropriate or sufficient.

In these cases, the Federal Reserve will enter into a formal written agreement or impose a formal order directing the financial institution to cease and desist from engaging in the improper or prohibited conduct. These formal agreements and orders also require the institution to take specified corrective action and, where appropriate, to make restitution to third parties harmed by the wrongful conduct. We may also assess a civil money penalty against the offending party.

Finally, the Federal Reserve may remove an individual from the banking institution and prohibit that individual from participating in banking at other financial institutions.

Over the past 10 years, the Federal Reserve has taken nearly 1,000 formal public enforcement actions. This includes more than 600 written agreements and 100 cease-and-desist orders against institutions subject to our jurisdiction. It also includes the permanent ban of more than 80 individuals from the banking industry. More than 100 of these actions involved imposing civil money penalties and restitution payments totaling more than $1.2 billion.

The vast majority of the Federal Reserve's formal enforcement actions are resolved upon consent. The Federal Reserve typically sets out summary recitations of the relevant facts in whereas clauses. However, like our fellow banking regulators, it has not been our practice to require formal admissions of misconduct.

Requiring admissions of guilt as a condition of entering into a consent action we believe would have a deleterious effect on our supervisory efforts by causing more institutions and individuals to contest the requested relief in formal administrative proceedings, which typically take years to reach resolution. That would substantially impede and delay implementation of necessary corrective action and potentially harm the financial institution and the financial system.

Moreover, safety and soundness concerns typically do not give rise to third-party claims. Thus, the effectiveness of the regulatory framework established for financial institutions does not depend on actions brought by third parties to enforce their rights under the regulatory scheme. In those few cases where an enforcement action cannot be resolved by consent, the Board may issue a formal notice of charges that sets forth the factual basis for the remedies sought by the Board.

The respondents in these cases are then accorded the opportunity to request a formal trial-like hearing before an administrative law judge. Only 11 of the nearly 1,000 enforcement actions taken by the Federal Reserve in the last decade were challenged by an administrative law judge. Only one of these actions has been contested in court.

The Federal Reserve works closely with other Federal and State banking regulators as well as Federal and State law enforcement agencies on enforcement matters that raise issues that straddle our respective jurisdictions.

We also refer matters to other appropriate Federal and State agencies, including law enforcement authorities. The Federal Reserve's enforcement authority is a critical component of our ability to encourage safe and sound banking practices in compliance with the banking laws, and I thank the committee for the opportunity to provide this information. I am happy to answer any questions.

[The prepared statement of Mr. Alvarez can be found on page 58 of the appendix.]

Chairman BACHUS. Thank you. Mr. Khuzami, before I call on you, let me say this: I am aware that we have a panel with three safety and soundness agencies and one disclosure agency. So there are some differences there. But while we are discussing this, there are also many similarities, so we have put the panel together but there are differences, which I recognize.

Mr. Khuzami?

STATEMENT OF ROBERT KHUZAMI, DIRECTOR, DIVISION OF ENFORCEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. KHUZAMI. Thank you, Chairman Bachus, Ranking Member Waters, and members of the committee. Thank you for the opportunity to testify on behalf of the United States Securities and Exchange Commission on the subject of our settlement practices.

The Division of Enforcement recommends a settlement to the Commission only where we believe the settlement agreement that we have negotiated after months or years of painstakingly detailed investigative work is within the range of outcomes that we reasonably could expect if we litigated the case. In making that decision, we consider many factors, including the strength of the evidence and the potential defenses, the delay in returning funds to harmed investors caused by protracted litigation, and the resources required for trial, including the opportunity costs of litigating rather than using those resources to investigate other cases and protect other victims.

This approach serves the goals of the Commission's enforcement program by first protecting investors, by returning their money with increased speed and certainty, and by more quickly getting bad actors out of the business by imposing bars that prohibit them from continuing to work in the industry or serving as an officer or director of a public company.

Second, it enhances deterrence and accountability because we outline publicly in detail both the wrongdoer and the wrongdoing, which the wrongdoer is prohibited from denying, by obtaining large sums of money in disgorgement and penalties, by frequently barring wrongdoers from working in the industry, and by imposing, where appropriate, business reforms to prevent companies from engaging in future wrongdoing, all accomplished while the misconduct is fresh in the public's mind as opposed to years later after a trial.

This package of sanctions leaves little, if any, doubt in the public's mind that the securities laws have been violated and that other would-be violators should think twice before crossing the line. In our view, going the further step of requiring admissions of liability in every case from defendants would come at a high cost of delay: delay in bringing wrongdoers to justice; delay in returning funds to harmed investors; and delay in investigating other frauds and protecting other victims, all for a purported benefit that we believe is largely already achieved through our settlements.

For example, in the Citigroup settlement, the Commission obtained most of what it could have obtained after a successful trial, including injunctive relief, business reforms, charges against the person responsible for the transaction, and a $285 million payment to be returned to harmed investors, an amount which represented 81 percent of what we could have gotten in the best case had we prevailed at trial and been awarded full remedies.

And the bank issued a statement in connection with the settlement saying, in effect, that, "We hope to be a stronger bank with better risk management controls in the future." Given that statement and given the totality of the settlement, it is not clear to me what an admission would add or whether it would be worth the cost of delay and resources.

Nonetheless, the district court rejected our proposed settlement because it claimed we lacked facts obtained by admissions or by trial. But in granting our motion to stay the proceedings, the court of appeals ruled that it knew of no precedent for requiring admissions, that the SEC correctly considered the value of the settlement, the perceived likelihood of obtaining a still better settlement, the prospect of coming out better or worse at a trial, and the resources it would need to be expended in that attempt, and that it saw no reason to doubt that the Citigroup settlement was in the public interest.

Whether in the Citigroup case or in any of our other financial crisis cases, where today we have filed actions against 102 individuals and entities, including 55 CEOs, CFOs, or senior corporate officers, and we have obtained orders of more than $2 billion in disgorgement, penalties, and monetary relief, we will recommend a settlement only where it makes sense and it serves the public interest, not because we lack options.

If the settlement doesn't reach our standards, we will not recommend it or the Commission will simply reject it. In either case, we will litigate.

In our financial crises cases, 75 percent of our cases against individuals were filed as litigated matters. Since June 2011, our trial unit in Washington has seen an increase of over 50 percent more actively litigated matters.

And when we litigate, we typically prevail. Our record in litigation victories—we have prevailed in over 80 percent of our trials since the beginning of Fiscal Year 2011—sends a strong message to defendants and enhances our settlement negotiating posture.

However, litigation requires resources. The cost of trials, both in terms of the thousands of staff time hours and other out-of-pocket costs such as expert witnesses, can be exorbitant. That is why we believe it is wiser to save our resources by demanding settlements approximating what we could expect to achieve at trial and spending those saved resources on fighting other frauds or litigating when a settlement does not meet our standards. With this approach, more investors get more protection more of the time.

Thank you, and I would be happy to answer any questions.

[The prepared statement of Mr. Khuzami can be found on page 74 of the appendix.]

Chairman BACHUS. Thank you. And let me apologize, I am always calling you "Khuzami," instead of "Khuzami," and my staff corrects me every time. Obviously, it didn't do any good. I will practice in front of a mirror before the next hearing.

Mr. KHUZAMI. That is all right. It happens a lot.

Chairman BACHUS. Mr. Osterman?

STATEMENT OF RICHARD J. OSTERMAN, JR., DEPUTY GENERAL COUNSEL, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. OSTERMAN. Good morning, Chairman Bachus, Congresswoman Waters, and members of the committee. Thank you for the opportunity today to testify on behalf of the Federal Deposit Insurance Corporation about our settlement practices.

In my testimony today, I will discuss the FDIC's approach to enforcement and the tools we have available, as well as the public interests benefits derived from our enforcement policies and procedures. The core mission of the FDIC is to maintain stability and public confidence in the Nation's banking system.

As recent events have reminded us, the financial condition of banks influences the economy in direct, substantial, and often immediate ways. Mindful of this, the FDIC's supervision of insured depository institutions focuses on promptly correcting unsafe and unsound practices, violations of law, and breaches of fiduciary duty.

Among the banking regulators, the combination of FDIC's responsibilities as supervisor, insurer, and receiver is unique. As supervisor, the FDIC is the primary Federal regulator for approximately 4,100 State nonmember banks, as well as over 400 State-chartered savings associations, and ensures the FDIC has backup enforcement authority for the rest of the over 7,000 FDIC-insured depository institutions.

In addition, the FDIC acts as receiver for all failed insured depository institutions, and under Dodd-Frank we have substantial responsibilities for large, complex financial companies that may pose a systemic risk to our financial system. The FDIC, like the other Federal banking agencies, has been given very strong enforcement powers under Section 8 of the Federal Deposit Insurance Act. These powers are used when corrective action is needed to protect the public interest.

The vast majority of our cases are resolved through stipulated settlements which achieve our statutory responsibilities and protect the public interest without admissions of liability. Indeed, requiring a respondent to specifically admit the alleged conduct in a settlement may have the unintended consequence of delaying prompt relief and corrective action.

One of the corrective actions Congress has granted the agency is the authority to remove and prohibit individuals from banking when warranted under statutory authority. Under this authority found in Section 8(e) of the Federal Deposit Insurance Act, the agency has issued hundreds of removal and prohibition orders against insured affiliated parties who were determined to have dishonestly or recklessly engaged in violations of law.

An AE order prohibits the individual from participation in any manner in banking under a lifetime industry ban. This powerful tool serves to address past conduct while also protecting the industry as a whole. Furthermore, a person subject to stipulated removal and prohibition is precluded from participating in banking immediately upon the order's issuance.

Stipulated civil money penalty orders often accompany removal and prohibition actions as a means of further deterrence. The FDIC uses its enforcement authority to assess C and Ps against institutions and institution-affiliated parties where we have found violations of law and unsafe and unsound practices or breach of a fiduciary duty, under a progressive increase in the penalty amount based on the egregiousness of the conduct involved.

Cease-and-desist orders are used as another enforcement tool for corrective action. For example, when banks are in troubled conditions, such orders allow us to quickly implement a detailed corrective program, which serves as a virtual roadmap for the institution to follow to correct practices and to raise capital to return the institution to a safe and sound condition. We believe that prompt action in such cases is essential to avoid loss to the insurance fund and cost the communities into the economic system as a whole that arise when a bank fails.

Additionally, we have the power through cease-and-desist actions to order affirmative relief, including ordering an institutions or an institution-affiliated party who has unjustly been enriched to make restitution. And the power to seek restitution can be particularly important when an institution or institution-affiliated party violates consumer protection laws and regulations.

In these consumer cases, orders for restitutions are vehicles for consumer redress and the FDIC has an interest in issuing such orders as quickly as possible.

The FDIC also brings professional liability cases as a receiver for banks that have been closed by Federal or State regulators where our investigations uncover facts that support such actions. These cases, which promote good corporate governance and discipline, serve a very different purpose than the enforcement cases that I have addressed thus far.

The professional liability cases are civil tort and contract actions and are intended to maximize recoveries for the receivership at stake in keeping with the statutory priorities set out by Congress.

In conclusion, we believe the FDIC's process accomplishes its statutory responsibilities and purpose while ensuring that actions it takes serve the public interest promptly and effectively.

We would be happy to answer any questions. Thank you.

[The prepared statement of Mr. Osterman can be found on page 84 of the appendix.]

Chairman BACHUS. Thank you.

Mr. Stipano?

STATEMENT OF DANIEL P. STIPANO, DEPUTY CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. STIPANO. Thank you, Mr. Chairman, and members of the committee.

I welcome the opportunity to appear before you today to discuss the OCC's supervisory and enforcement authorities and process.

The OCC vigorously uses its authorities to protect the safety and soundness of national banks and Federal savings associations and to ensure fair treatment of customers. The OCC and the other Federal bank agencies have a broad range of supervisory and enforcement tools to achieve this purpose.

My written statement today covers the OCC's activities and perspectives on enforcement in three areas. The first is our overall approach to enforcement. The OCC's enforcement process is intertwined with our supervision of the institutions we regulate. These institutions are subject to comprehensive, ongoing supervision that, when it works best, enables its examiners to identify problems early and obtain corrective actions quickly.

Once problems or weaknesses are identified, we expect management and the board of directors to correct them promptly, and institutions usually take the corrective steps necessary to address problems or weaknesses before they develop into more serious issues problems that adversely affect their financial condition or their responsibilities to their customers.

That is not always true, however, and in some cases the seriousness of the problem requires a heightened enforcement response. In those circumstances, we have a range of enforcement tools at our disposal, from informal enforcement actions such as a commitment letter or memorandum of understanding to formal enforcement actions such as a formal agreement, cease-and-desist orders, or removal and prohibition order.

We use all of these tools, depending on the circumstances, to swiftly and forcefully require correction of unsafe or unsound practices and violations of law. These include actions taken to address a wide range of issues including capital adequacy, managerial competency, asset quality, earnings, and fair treatment of customers.

The second part of my testimony describes the process we employ to initiate and resolve enforcement actions. When circumstances warrant enforcement actions, it is important that the OCC take such actions as soon as practical. Prompt and effective action is critical to ensuring that institutions take immediate corrective and remedial measures to ensure safety and soundness and protect depositors and customers. The OCC follows a well-established process for initiating and resolving enforcement actions that promotes its supervisory goals.

In resolving cease and desist, civil money penalty, and removal in prohibition actions, it is the OCC's long-standing practice to present the actions in the form of a proposed order or a proposed order and stipulation in the case of C&D. A proposed order or stipulation includes the Comptroller's findings supporting an action and a statement that the institution or individual neither admits nor denies wrongdoing.

In the vast majority of cases, OCC enforcement actions are resolved by consent. However, in those relatively rare cases where a negotiated settlement cannot be reached, the OCC will initiate an administrative proceeding by serving a notice of charges on the institution or individual.

Permitting the institution or individual to settle the case without admitting or denying wrongdoing facilitates the imposition of an enforceable order at a point where, in many instances, the problems are still manageable and can be corrected.

If the OCC were to insist on an admission of wrongdoing, it would prolong settlement negotiations and increase the number of respondents who choose to litigate the merits of the action. Even if the OCC is successful in litigation, it could be several years before an order is issued.

In the meantime, the institution's condition could continue to worsen and the institution might ultimately fail if the institution continues to engage in unsafe or unsound practices, or in a consumer protection case restitution owed to victims could be substantially delayed while new victims arise each day that the violation goes uncorrected.

In either case, resources of an institution that could have been used to fix the problem are instead diverted to financing litigation.

The third part of my statement describes how the OCC coordinates with State and Federal regulatory agencies and with law enforcement agencies in enforcement cases. As further explained in my statement, the OCC coordinates closely with many Federal agencies and regularly shares information with State and Federal agencies pursuant to interagency information-sharing agreements.

Thank you very much. I will be happy to answer any questions you may have.

[The prepared statement of Mr. Stipano can be found on page 109 of the appendix.]

Chairman BACHUS. Thank you. I would like to compliment the entire panel for your opening statements. I thought they were very educational.

Mr. Khuzami, can you give me an estimate of the length of time between bringing an action and a consent settlement and then the amount of time between bringing an action and, if it is litigated, and the final judgment?

Mr. KHUZAMI. The time from opening an investigation to completing it and coming to a settlement is largely a function of the complexity of the case. But leaving aside those matters that we bring on an emergency basis to halt ongoing fraud or wrongdoing, it is typically in the 1- to 3-year range, I would suspect.

If you file it as a litigated case, the time from that point through trial, I think that we are in the range of the general stats for civil cases generally, which tend to be more in the 2- to 4-year range, which does not include appeals.

Chairman BACHUS. And with the appeals, how much does that prolong recovery by the investors?

Mr. KHUZAMI. If the appeal was taken, that typically can be another year to 3 years as well.

Chairman BACHUS. So the investor recovers much quicker in the case of a settlement, consent settlement, in most cases, in two comparable cases in complexity?

Mr. KHUZAMI. That is absolutely right.

Chairman BACHUS. How about the cost of enforcement or the cost of obtaining a consent settlement as opposed to the cost of litigating just in two similar cases?

Mr. KHUZAMI. Obviously, you would have to spend the resources to get the settlement, but if you didn't, you chose to litigate rather than settle, we don't quantify it in that way, but I can tell you that it is thousands of hours of staff time in a complicated matter, expert witness fees, which are just one expense in the litigation, particularly in complicated financial transactions. It is not unusual for that to cost seven figures, and I can tell you that there are probably better metrics on the defense side where I have seen statistics that indicate the defendants can spend $5 million or $10 million or $15 million litigating a case. So it is a considerable expenditure of resources. If it is a small case with half a dozen witnesses in a 3-day trial, obviously it would be less.

Chairman BACHUS. What are the factors in deciding whether to settle an enforcement action or procedure?

Mr. KHUZAMI. As I indicated, it really comes down fundamentally to whether we can get in a settlement everything that we reasonably could hope to get if we were to go to trial and win, taking into account, as we must, the strength of the evidence, the defenses, the judge and all the other factors. And it is only when we meet that standard, really, do we settle a case.

If we don't meet that standard, we will litigate, because obviously if you don't have a legitimate trial threat, if you don't communicate to the targets of your investigation that you are prepared to go to trial, then you can be exploited, defendants will simply hold off for a softer settlement and not fear the alternative. But in our case, we are fully prepared to litigate, and we are doing more of it.

Chairman BACHUS. All right. Thank you. Congresswoman Waters?

Ms. WATERS. Thank you very much, Mr. Chairman.

Mr. Khuzami, I would like to ask you about the Residential Mortgage-Backed Securities Working Group. There is some more information in the newspapers, I guess as of today, where Elizabeth Warren expresses no confidence in the current bank accountability measures. On April 26th, I led about 40 Members of Congress in writing to you and the other co-chairs of the Residential Mortgage-Backed Securities Working Group about my concerns that this important task force was stalled, that you didn't have the resources you required, and about the need for a strong executive director, to be clear. Does the RMBS Working Group have the resources you need to carry out your mission?

Can you tell me as part of this RMBS task force work what—can you say whether if SEC will enter into these "neither admit nor deny" settlements. With the firms you are investigating, I believe that it is important for the SEC to litigate some of these cases under the umbrella of this task force, given the commitment to justice and the promises that were made about this task force when the President made his State of the Union Address.

Are you concerned that the task force still has not appointed an executive director? When can we expect an announcement on this? Your budget justification requested a total of 56 new full-time equivalent provisions in your Enforcement Division. Are any of these positions being specifically assigned to this task force and are any of the existing SEC employees being shifted to exclusively work on this task force?

The reason I am pressing on this is that we have had this subprime meltdown in this country which created this recession. We have all of these foreclosures, and we don't have loan modification standards that services are employing. We are trying to keep homeowners in their home. We want to know what went wrong in many of our financial institutions.

We have been making a lot of promises. What is happening with this task force? Is it working? Where is the executive director? Can you explain to me what is going on?

Mr. KHUZAMI. Sure, Congresswoman. First, from the Securities and Exchange Commission's perspective and, as you see from our statistics, we have brought a significant number of financial crisis-related cases, 101 entities and individuals, 55 high-ranking CEOs and officer—

Ms. WATERS. Yes, but now you are part of a task force.

Mr. KHUZAMI. Understood. I just want you to know that there is a record of productivity.

Ms. WATERS. Yes, but I want you to know I only have so much time.

Mr. KHUZAMI. Okay. With respect to the task force, we have a significant amount of resources. The five agencies that make up the task force have all contributed significant resources. We have a 40 to 50 member Structured and New Products Group, large portions of which are dedicated to these cases. Resources are being supplied by the Department of Justice and the New York State Attorney General. We have just hired a coordinator to help coordinate some of this activity. There is a lot of activity, a lot of investigation.

Ms. WATERS. What is happening with the executive director? Do we have one coming soon?

Mr. KHUZAMI. Congresswoman, I think we are preparing a draft to respond to a letter that you sent. We hired a coordinator, but most of the investigative work being done here is not really being done by a staff that belongs to the task force; it is being done by the individual investigative groups that make up the task force.

Ms. WATERS. So, are you going to proceed with some investigating that is going to lead to some litigation, or are you going to continue to work in ways that will allow those who are being accused to "neither admit nor deny" and just keep settling and settling and settling as usual?

Mr. KHUZAMI. Like I said, if we get offered a settlement in this or any other case that comes close to what we could hope to get in the best-case scenario at a trial, then I think we would be unwise not to settle under those circumstances. If we don't, then those cases will be litigated. We will follow the same procedures in all of our cases that we do for the RMBS task force, at least as far as the SEC is concerned. The other agencies may take a different view.

Ms. WATERS. Since you are here today, for all of the others who are involved in the task force, I think it would be wise to share with them that a lot of people are watching to see what is happening with this widely announced task force that is supposed to do all of these investigations and bring about some justice for many of these homeowners who got into mortgages they couldn't afford because they were all exotic and they were products that really could lead only to disaster.

But let the task force know. We anxiously await what they are going to be able to accomplish and we think it is taking too long for them to get up and going and showing us what they can do.

I yield back the balance of my time.

Mr. GARRETT [presiding]. The gentlelady yields back. The gentleman from Texas is next, I believe, for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. I think one thing that is obvious is that if this proposal actually becomes policy to force those subject to enforcement actions into admissions, there will be an explosion of litigation, civil litigation, litigation by our regulatory agencies.

So when I first heard of this proposal, knowing that the Administration, both the worst employment record since the Great Depression, my immediate thought was, well, this was a trial attorney's relief act and that maybe this is another failed jobs program so that we can somehow reemploy trial attorneys.

But, Mr. Chairman, as I look before me and I see the representatives of these agencies, I believe the head of every agency has either been appointed or reappointed by the President, in which case that is clearly a false conclusion because what I think I heard from all four witnesses and on behalf of their agencies, is they would oppose this policy.

Mr. Chairman, I think I have just a few simple questions to make sure what I thought I heard, I actually heard, and so the first question I have for our panelists is, in your professional opinion, on behalf of your agency, will enforcement be more effective or less effective if you are forced in your enforcement actions to have parties admit guilt?

Mr. Alvarez, less effective or more effective?

Mr. ALVAREZ. I think it would be less effective.

Mr. GARRETT. Mr. Khuzami?

Mr. KHUZAMI. I agree.

Mr. GARRETT. Mr. Osterman?

Mr. OSTERMAN. It would definitely be less effective.

Mr. HENSARLING. Mr. Stipano?

Mr. STIPANO. I agree with my colleagues.

Mr. HENSARLING. Okay. Well, then, my ears did not deceive me.

The next question I have is, in your professional opinion, would investors that you consider to have been wronged—do you believe if this becomes policy, that investors would end up with more resources or fewer resources to redress their grievances? Do you have an opinion on that, Mr. Alvarez?

Mr. ALVAREZ. Sir, of course, the banking agencies look at things not from the investor point of view, but from the safety and soundness of financial institutions, so we are considering customers of the banks, depositors of the banks, the taxpayers who stand behind the deposit insurance.

Mr. HENSARLING. Let's go to the SEC, then. Mr. Khuzami.

Mr. KHUZAMI. I think that while there might be some cases where they would get marginally more, that it would come at the cost of delay and at the cost of our inability to investigate other cases and bring money back to other victims.

Mr. HENSARLING. Let's go back, Mr. Alvarez, to safety and soundness.

My guess is that, again, those who are being asked to admit to guilt, frankly, are going to be very loath to do so in an enforcement action.

I think what I heard in your testimony, and I don't wish to put words in your mouth, is that—and I think I might have heard it from you, too, Mr. Osterman, that in enforcement actions, particularly dealing with safety and soundness, that it is quite often important to move quickly. Litigation is something that doesn't move quickly historically.

So will our financial system be more safe and sound or less safe and sound? Should this policy be enforced upon you to require parties in enforcement actions to admit wrongdoing? Greater safety and soundness or less safety and soundness?

Mr. Alvarez.

Mr. ALVAREZ. Oh, I think our system would be safer and sounder if we had the flexibility—

Mr. HENSARLING. If you had the flexibility. Therefore the flip side of the coin is less safe, less sound if you did not have the flexibility.

Mr. ALVAREZ. I think that is correct.

Mr. HENSARLING. Mr. Khuzami, same question.

Mr. KHUZAMI. Yes.

Mr. HENSARLING. Which of the two, since Mr. Alvarez kind of restated it?

Mr. KHUZAMI. Again, we are less about safety and soundness than we are about investor protection. But if we were required to have the admissions, I do think that we would have more delay and fewer victims would get their money back.

Mr. HENSARLING. Mr. Osterman?

Mr. OSTERMAN. Yes, I think the system would be less safe and sound if we required an admission of liability, because we wouldn't be able to take the corrective actions as quickly.

Mr. HENSARLING. Mr. Stipano, take a full 12 seconds to answer the question.

Mr. STIPANO. I have the same view. If we required an admission of wrongdoing, that would delay the imposition of an enforcement action that could adversely affect safety and soundness.

Mr. HENSARLING. Thank you, gentlemen. I yield back my 1 second.

Mr. GARRETT. The gentleman yields back. Mrs. Maloney is recognized.

Mrs. MALONEY. Thank you, Mr. Chairman.

Mr. Khuzami, you said in your testimony that your decision to settle is based on whether or not you believe the settlement is equal to what you would achieve with a trial.

I would like to ask you to elaborate on how the appropriations process and your funding level impacts on your decision, and would you be more likely to initiate more actions if you had independent funding and more resources similar to other banking regulators?

Mr. KHUZAMI. Oh, I think independent funding would help us greatly across the Enforcement Division. We would be able to litigate more cases. We would be able to investigate more cases. We would be able to have better technology which would make us more efficient, and more trial lawyers. It would help us across-the-board.

Mrs. MALONEY. One of the persistent criticisms is that many people belief that the SEC's penalties do not deter bad actors. And one of the criticisms is that the settlement penalties amount to pocket change or, as the judge said, "the cost of doing business." And how does such a penalty deter bad actors?

Mr. KHUZAMI. Congresswoman, candidly, I don't agree with those assessments at all. Within the statutory limits that we have with respect to penalties, we impose significant and substantial penalties.

The Goldman Sachs case was identified as one where the penalty was deemed to be insufficient. In fact, the company paid 37 times what they expected to make in a fee for that single transaction and a penalty.

So our penalties are substantial, they send a strong message, but they are limited by the transaction at issue. When we impose a penalty for financial crisis-related conduct, we can't assess a penalty based on all the wrongs arising out of the financial crisis. It has to be based on the evidence of the particular transaction at issue.

And second of all, we can't get investor losses as a penalty. We are limited to disgorgement, which is the amount the company earned on the transaction and a penalty equal to the amount of the disgorgement. We can't get the investor losses. So if a company only earned $20, we can get that $20 in disgorgement and another $20 in penalty, but we can't get the $100 that the investors might have lost. That is why Chairman Schapiro has written Congress and asked for expanded penalty authority.

Mrs. MALONEY. Okay, so basically you are limited by statute, the penalty that you can charge, is that correct, you are limited, and it is outlined? So would you describe some legislative changes that would permit the SEC to levy larger penalties?

Mr. KHUZAMI. Chairman Schapiro proposed that we have various penalty mechanisms. The first is sort of a tiered approach, and Tier 3 is the most substantial penalty category. It currently is $725,000 per violation, per institution. She proposed that it be increased to $10 million.

She also asks that we could use investor loss as a gauge to measure penalty or 3 times the gain. And that is really for those situations—it wouldn't come into play in every case, but there are some cases where the investor loss so dwarfs the amount of disgorgement and the gain that we could get that you would like some more authority.

We also asked for authority to add additional penalties in the case of recidivists, those who have been previously convicted of a criminal violation or an SEC order or decree and those who violate injunctions. Those remedies would help us a great deal.

Mrs. MALONEY. Thank you. And the bank regulators—in one of your testimonies, you noted that consent agreements allow the banking regulators to enforce compliance with banking rules and make corrections that can prevent a bank failure.

So if the banking regulators were prevented from allowing the defendant of an enforcement order to "neither admit nor deny" the allegations in the order, how would enforcement change for the banking regulators?

Any banking regulator who wants to answer?

Mr. ALVAREZ. Congresswoman, as I mentioned in my statement, I think that it would substantially delay our ability to get effective changes at the organization and put in jeopardy, then, the safety and soundness of the institutions themselves, and put the taxpayers at greater risk.

Mrs. MALONEY. Would anyone else like to add anything?

Mr. OSTERMAN. I would just add that we do have several tools in our arsenal on the enforcement front, including removal and prohibition. So if we do see continuous action or egregious action, we actually can remove the individuals from banking, which doesn't require them to admit or deny any wrongdoing.

Mr. STIPANO. The only think I would add is just that the consequence, the primary consequence of requiring admission is delay. So our enforcement documents, which are remedial documents in nature, they are designed to rehabilitate the institution, would not get in place very quickly or as quickly as they do now, and that could affect the safety and soundness of the institution.

Mr. GARRETT. Thank you. The gentlelady's time has expired. The gentlelady yields back. I recognize myself.

First of all, just very quickly, Mr. Khuzami, with regard to the practices and enforcement and settlement practices that you are talking about today, these are current practices that you are discussing?

Mr. KHUZAMI. That is correct.

Mr. GARRETT. But these are also longstanding practices at the SEC as well?

Mr. KHUZAMI. The "no admit, no deny policy" goes back to the 1970s.

Mr. GARRETT. So if the SEC had been funded at the level that the President has requested in Fiscal Year 2013, would these longstanding practices change in any way, shape or form?

Mr. KHUZAMI. With respect to "no admit, no deny" in settlements?

Mr. GARRETT. Yes.

Mr. KHUZAMI. The practices wouldn't change, we just would be able to bring more cases.

Mr. GARRETT. Did the SEC enforcement actions change? Did the practices themselves change or were they any different when the Democrats controlled the House?

Mr. KHUZAMI. No. We had the same policies in place.

Mr. GARRETT. Thanks. So what we are talking here in general is about enforcement of when financial institutions are accused of breaking specific rules and regulations. So maybe I was going to go a little bit off from that but just talk about some of the new rules and regulations that are currently being proposed and developed out there.

Mr. Alvarez, I will turn to you on that. One is in the area of money market funds. There are new proposals to deal with them and it is in summary reports, in the paper, that if the SEC fails to act in this regard, to provide additional regulations with regard to money market funds, the Fed, FSOC, may step in and engage in that process and supersede the SEC's regulatory authority and basically exert its authority over the industry individually or designate the entire industry as systemically important.

When I read those reports, one of the things that came to mind, and what I have seen in some of the papers on this, is that regulating the money market funds would be one way to basically put money market funds effectively out of business and then to have the funds in that segment of the economy flow from them, and where else would they go but to the banking institutions, which would be a way for them to backfill some of the banks that are out there, which would be a way to then provide for additional capital for them to make them more safe and sound, which of course is what you have been saying is, rightly so, the responsibility of the Fed.

Is that the avenue or the approach that the Fed takes to this regulation?

Mr. ALVAREZ. Sir, I read a lot of things in the newspaper, too, and sometimes I believe them and sometimes I don't.

Mr. GARRETT. So I shouldn't believe any of those reports?

Mr. ALVAREZ. I think that the FSOC has made clear that money market mutual funds are an area that requires attention. That was in the report issued last July. The FSOC made some recommendations in that area, and the SEC is moving forward on taking steps to improve the safety and soundness and the strength of money market mutual funds, and we all, I think, await the SEC's action on that. That is as far as the Federal Reserve has made any statements or participation at this point.

Mr. GARRETT. Let's look at one other area. The area of risk retention which Dodd-Frank talked about, but outside of Dodd-Frank and some of the proposals that are out there that was not contemplated in Dodd-Frank is the PCCRA, which is the Premium Capture Cash Review Account, many people state, again in reports but I agree with these reports, that if this is implemented, it would basically put capital on the sideline, it would freeze up the markets, the securitization markets which are already frozen and basically keep the Federal Government on the hook as far as providing financing for the marketplace, the housing marketplace. Mark Zandi estimates that the cost of this would be 1 to 4 percent in additional financing costs for consumers, which I have read and agree with.

Now, Chairman Bachus and myself have written to the Fed twice asking, are those numbers correct, or more specifically, has the Fed done a cost-benefit analysis or any analysis on the cost? I think my last letter was back around March 26th. So I will ask you a couple of questions along those lines. Has the Fed done such an analysis? Does the Fed intend to reply to either one or both of the letters that Chairman Bachus and myself sent to the Fed inquiring about this?

Mr. ALVAREZ. Obviously, we will reply to your letter.

Mr. GARRETT. That is good.

Mr. ALVAREZ. The question of premium capture—as you recall, the risk retention rule is not a Federal Reserve rule alone. This is a multiagency rule.

Mr. GARRETT. My time is short. What is the Fed doing? Will you reply? And will you reply with an analysis?

Mr. ALVAREZ. We will reply as best we can during the comment period. We have gotten a lot of comments on the premium capture accounts and the concerns people had with how the proposal was designed. And so we are analyzing your comments, as well as other comments.

Mr. GARRETT. Have you done an analysis yet?

Mr. ALVAREZ. We are in the process of doing an analysis.

Mr. GARRETT. And when is the completion date on that supposed to be?

Mr. ALVAREZ. We are working on that as best we can.

Mr. GARRETT. Do you have an estimate on the completion date on that?

Mr. ALVAREZ. I do not.

Mr. GARRETT. Like this week? This month? This year after the elections?

Mr. ALVAREZ. It will not be this week. I am sorry, Congressman. That is the best I can do at this time.

Mr. GARRETT. It will be done before the rule goes out?

Mr. ALVAREZ. Absolutely.

Mr. GARRETT. We will be anxious, I think the chairman and I will both be anxious to hear back to either one or both of our letters.

With that, I yield back. And I recognize Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Osterman, the U.S. District Court for the Southern District of New York rejected a proposed settlement between the SEC and Citigroup and specifically criticized the SEC policy in consent judgment, stating the policy does not serve any interest other than those of the party. How would the FDIC's enforcement and compliance process be affected if you were prevented from allowing institutions to enter into consent decrees without having to admit or deny any allegation?

Mr. OSTERMAN. I think the decision would have a negative effect on our ability to carry out our statutory functions. As has been discussed by several of the panelists, if we were required to get an admission or denial of liability, the other side is quite likely not going to agree to that without a long litigation and possibly until after a judgment has been entered. They may not agree to it at all. And so, we could be talking about rather than getting the corrective action taken care of within a matter of months or a shorter period of time, looking at years.

Ms. VELAZQUEZ. How do you address the troubling aspect for average Americans who are watching this proceeding, and how would you discourage or be a deterrence if people know that they don't have to admit guilt?

Mr. OSTERMAN. I think the process actually has been working. The fact is we have been able to effectively police the industry and to make corrective actions through this policy. If you look at our actions in the last 5 years, we have brought over 2,000 enforcement actions, and we have removed 377 individuals from banking who had engaged in improper activities. We have issued over 753 civil money penalty orders.

And so, I think the process is working as it is. We are not afraid, and we are certainly ready to litigate if that is necessary. But one of the things about our powers is that our process works through administrative process, so when we issue the order, it is effective immediately.

Ms. VELAZQUEZ. So what is the criteria for you to determine when it is necessary?

Mr. OSTERMAN. The criteria is, has our statutory mission been achieved? Has the action that was improper been corrected?

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. GARRETT. And the gentlelady yields back. Mr. McCotter is recognized.

Mr. MCCOTTER. Thank you, Mr. Chairman, I have a couple of questions. I hope that they are not repetitious. If they are, I apologize.

When structuring a settlement, do we address the concerns, as colleagues like my colleague Representative Green have raised, where you make sure that an entity that is entering a settlement does not net out a profit despite the fact of the payment? Because you would hate to have a situation where someone is engaged in an act that you have taken them to court over, and at the end of the settlement process, the bad act still nets out a gain for the entity? Is that something you factor into when deciding how the settlements go?

Mr. KHUZAMI. From the SEC's perspective, the first thing we are entitled to obtain in a settlement or in a trial is disgorgement, which means all of the ill-gotten gain can be obtained by us. So if you get all of the ill-gotten gain, then you have eliminated that issue, and then you get a penalty on top of that. That way, you make sure that it is not a wash from the defendant's point of view. These are additional amounts that they are paying to be punished, if you will, for engaging in the misconduct.

Mr. MCCOTTER. So on your part you do consider that a factor?

Mr. KHUZAMI. Yes.

Mr. MCCOTTER. You want to make sure they don't net out at the end of the day the cost of business argument?

Mr. KHUZAMI. That is correct.

Mr. MCCOTTER. Where does the money—would anybody else like to address that? You all do the same thing?

Mr. ALVAREZ. At the Federal Reserve, we do the same thing with one variation. We don't have express authority to achieve disgorgement of the profit. We have a specific statutory schedule of fines that we are allowed to impose, but we take into account the amount of the profit that is made in assessing how to employ those fines and we do the best we can to ensure that there is no profit-taking from illegal activity.

Mr. MCCOTTER. Where do the proceeds of the settlement go, again? I am sure it was asked and I might not have been cognizant of it. Generally, where do they go?

Mr. KHUZAMI. From the SEC's perspective, we obtained the so-called Fair Fund authority under Sarbanes-Oxley, so we are now able to take the disgorgement and the penalties and return them to harmed investors.

If there are no harmed investors, or more amounts are obtained than there is harm, then it goes to the U.S. Treasury.

Mr. MCCOTTER. Does that hold true with everything else?

Mr. ALVAREZ. For the Federal Reserve, we are required by law to provide the fine portion of an assessment directly to the Treasury. However, we also have authority to require restitution to customers, and we do that as well.

Mr. MCCOTTER. The reason I ask this is, and maybe this is not necessarily in your instance but there have been reports of other instances where you have had bad acts reported by an entity, voluntarily, prior to the government being aware of them. They would then go into a settlement with the agency they were involved with, and the money would remain within the agency's budget.

I am not saying, and again, I take you at your word, I believe you that yours is not the agency I am discussing. So I am just glad to see that from you individuals and from your agencies' entities that we have not gone from a point where these banks are no longer just too-big-to-fail; they have become "too-big-to-jail." And I thank you for that.

I yield back.

Mr. GARRETT. The gentleman yields back.

Mrs. McCarthy is recognized for 5 minutes.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman, and I thank the panel. It has been very interesting clarifying—I am one of those who, over the years when I would read in the paper about the settlements, and to be very honest, why didn't somebody go to jail? I have a better understanding from all of your testimony. I just want to follow up because I have almost the same question as Mr. McCotter.

On the Citi settlement, it was $285 million. So no money went back to your agencies to pay for what it cost to bring the settlements to that point?

Mr. KHUZAMI. We have absolutely no ability to use the money that we obtain in fines, penalties, or any other monetary sanctions and use that money for our own purposes. It either goes to investors or it goes to the Treasury.

Mrs. MCCARTHY OF NEW YORK. So technically, the American taxpayer is paying you to go against the bad guys, but we don't get any money back.

Mr. KHUZAMI. The Treasury gets money back but we—the SEC does not. We then get appropriations, obviously.

Mrs. MCCARTHY OF NEW YORK. What does the Treasury do with the money?

Mr. KHUZAMI. I am not quite sure. You would have to ask them.

Mrs. MCCARTHY OF NEW YORK. Obviously, we are not sure either.

And one other question to you, after settlement and after the court cases but before the Second Circuit came to their decision, on January 7, 2012, you modified settlement language by bringing in language for cases involving criminal convictions where a defendant has admitted violations of the criminal law, and if the defendant has been convicted in a parallel criminal proceeding, the SEC will no longer allow that defendant to settle the SEC enforcement action without admitting wrongdoing.

Could you explain that a little bit more to me on how that works and how is that going to affect what you said earlier in your testimony and from the beginning of this hearing that sometimes it is better to settle than to prosecute?

Mr. KHUZAMI. Sure. We constantly review all of our policies, and that change was a result of our review, and those circumstances are where there is a parallel criminal case, and in the criminal case, the defendant has either pled guilty or been convicted at a trial. So there already exists, if you will, an admission, and then he or she settles the SEC civil case. Under those circumstances, extracting the admission makes perfect sense because the admission has already been obtained, and by us demanding the admission we are not causing delay or more litigation or any of the other evils that we are trying to prevent through the "no admit, no deny policy." So it just makes sense because the admission has already been obtained. It doesn't apply in that many cases because there are not criminal convictions or criminal pleas in a large majority of our cases.

Mrs. MCCARTHY OF NEW YORK. Okay. And just one more question to all of you, when proceeding with enforcement action against an institution engaging in wrongdoing, is there ever a time when "neither admit nor deny" is not an option?

Mr. KHUZAMI. The whole range of options are already there. We can choose to stray from our policy and demand admission. It is our view that the best approach is to use the "no admit, no deny" approach for the reasons I have stated today. But it is not a law that we are required to use; it is an informed policy that we choose to use.

I will also say that, just to keep in mind for "no admit, no deny," everyone focuses on the "no admit," but there is also a "no deny" aspect, which means in our settlements, individual entities can't then after the settlement get on the courthouse steps and say, "We deny liability." There are other Federal agencies including the FTC, the Department of Justice—the FTC just settled cases with Facebook and with Skechers yesterday, I think, and DOJ settled a civil case with Countrywide and Fair Lending where it is only a "no admit" policy, which means the defendants can deny liability. We do not permit that, and we monitor that very closely because we think that would undermine the integrity of the process and the deterrent impact.

Mrs. MCCARTHY OF NEW YORK. Thank you, and I yield back the balance of my time.

Mr. GARRETT. I thank the gentlelady, and I thank you for that point. I had not ever recognized that.

Mr. Posey is recognized for 5 minutes.

Mr. POSEY. Thank you very much, Mr. Chairman. I dDefinitely believe there is a place for consent decrees, no doubt about it, but I think when we have consent decrees where nobody admits any guilt and they only pay a relatively minor fine, that it will not change bad behavior.

I think when you prosecute people and the penalty is severe, that changes behavior. Under the RICO laws, you don't just fine the company $40 million for $40 million worth of bad behavior. You fine them $80 million for $40 million worth of bad behavior, you take the Mercedes, you take the office building, you take the Rolex watch, and that changes behavior. The only way you change behavior more than that is when you put somebody in jail. That really is a game changer. I don't see anybody going to jail. With all the criminal activity we have seen from Wall Street, I just see a real lack of accountability and prosecution.

I don't expect any of you to be able to answer this today, so with the chairman's permission and the other Members' permission, I would like to ask each of you to please submit in the next week information to us about how many criminal prosecutions for wrongdoing you have actually pursued and how many convictions you have. We have some notations in here. Some of you submitted that but they didn't get that explicit.

I would like to know how many stipulated settlements you have had, I would like to know the amount of the settlements, and also the amount of damages that the settlement was pertaining to or been established. Please do not send me any of those stupid brochures that the public relations department does for you guys that talks about how great you are and just highlights a couple of wonderful things that you did. All I want is the facts, simple, pure, nothing more, nothing less and nothing else. I think the other Members would appreciate that too.

Mr. Stipano, I think overregulation is a problem. I think when your regulators go into a bank and they say, we are going to put this loan on nonaccrual because the parents made the payments while the kids were unemployed, I think that is improper. When they say, we are going to put this loan on nonaccrual because it was modified, it was renewed, and the interest rate was changed, I think that is bad behavior. The most egregious thing I have ever heard is when your regulators go into the bank and say, we don't think these people should be able to make their payment given this economy even though the loan has been in existence for 7 years and they have never been more than one minute late, they found a way to make the payment.

I think it is egregious when your regulators break the rules provided by the Fed that says you shouldn't mark down a loan or put a loan on nonaccrual just because the appraisal is upside down. We have a lot of bad behavior by regulators, too, and I would like to know who holds them accountable? The old appeal used to be to their boss. But I want to know if there is an outside agency that objectively looks at abuse by regulators, because I think that is happening. We have talked about it in here. We have nodding of heads from the Secretary of the Treasury, the Chairman of the Federal Reserve, and the former Chairwoman of the FDIC. So this is not something that we are all imagining up here. That is just the reality outside the Beltway where a lot of people in the real word have to live and make a living every day despite what is happening in Washington.

So I would like to know if any of you have investigated any investigations or compensation committees who have awarded the prima donna CEOs multimillion dollar bonuses as they have the helm of the sinking ship all at the stockholders' expense. I think it was Andrew Jackson who said something to the effect of, it should be a crime when people profit by investors' money and gobble up the proceeds in their own bonuses and then turn around and stick the stockholders, the investors with the losses. They don't count those.

And I would like to know, also put in your reference to us, how many compensation committees you have investigated for impropriety in abusing stockholders' money.

I have actually been involved once with a false charge, and the other side attempted to intimidate me, so that even though it may have been wrong, it would cost me so much in legal fees, and for 25 percent of that, they would be glad to settle. And I basically told them, at the end of the day you are going to own everything I have or you are going to have nothing, and they didn't have a good enough case to pursue it. But I can't think that I am an exception to the rule; I am sure there are a lot of people being shaken down across America every day, wrongfully shaken down. I want to see some wrongdoers go to prison. I think it is an obligation of yours to see that happens because it is the best way, the surest way we are going to change the process, we are going to change the paradigm, we are going to change the behavior of people who have been getting away with wrongdoing for way too long in this country.

And I thank you, Mr. Chairman.

Mr. KHUZAMI. If I could just respond briefly, we will pass your request along to the Department of Justice but we don't have criminal authority; we can't put anyone in jail and I don't believe my colleagues here can, either. That is the province of the Department of Justice, but I will be happy to pass along your request.

Mr. POSEY. Mr. Chairman, I have asked the Department of Justice for the exact same information I have asked you for, and I am having difficulty getting it from the Department of Justice. So you should know what referrals you have given to the Department of Justice and what the outcome of that referral is. And I should be able to get that information from you even if the Department of Justice has not been that forthcoming so far.

Thank you.

Mr. GARRETT. The gentleman yields back.

Mr. Miller?

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

Mr. Khuzami, I think you said all the right things about the decision to settle cases. And I know just about every lawyer who actually goes into court says that a bad settlement is usually better than a good trial.

But you also said the right thing, that if your reputation is of being unwilling to try cases, you will never get a decent settlement, and that was also my observation in practicing law.

It is hard to measure, it is really hard from our perspective, without being submersed in the facts of the law as you are, which obviously cannot possibly happen to decide, to determine whether you are settling cases on the right basis or settling for enough or going after the right people.

The Inspector General of the FHFA, the Federal Finance Housing Agency, reviewed the settlement of Freddie Mac with Bank of America and Countrywide, it has probably been a year, and issued a very critical report that they had settled too cheaply, they had settled on the wrong basis for the wrong reasons, their emails suggested that they wanted to protect the business relationship with Bank of America and pushing too hard might damage their relationship, like they aren't the entire market for buying mortgages. Is there anyone who can review or has reviewed your settlements?

Do you have an Inspector General? Is there some third party who can review the settlements that you have entered into?

Mr. KHUZAMI. We do have an Inspector General. The position is currently vacant. But we will have one shortly. There hasn't been an overall review of settlements. Settlements have been reviewed, I think, episodically. But I will tell you there is a great deal of scrutiny and review within the Commission, not just from the Enforcement Division. When we investigate a case and come up with a recommendation, that recommendation is the defense counsel gets all the opportunities to put all their information—

Mr. MILLER OF NORTH CAROLINA. But the idea behind an Inspector General, which I have come to admire, is that there is an independent watchdog within agencies that have Inspectors General that report to the head of the agency and to Congress, and I think they give a slight headstart to the head of the agency, but they report both to Congress and the independent agency. So, they have an open transom for any employee to tell them about things at that agency that someone should look at, and it is a pretty useful management tool both for Congress and for the executive agencies, and it was certainly very useful, I think very useful, that the IG at the FHFA is examining their litigation to make sure that they are not being settled too cheaply or not being pursued as vigorously as they should be, and they are independent.

I understand that you have a lot of eyes within the SEC looking at these cases, but do you have anyone independent, who will provide a fresh set of eyes that may be critical?

Mr. KHUZAMI. No. There is no ongoing general review of settlements.

Mr. MILLER OF NORTH CAROLINA. Okay. And I know that you do not have criminal authority, but—and a lot of the calls for putting people in jail have sounded like Judge Roy Bean, the Old West judge, who said, "We'll give the man a fair trial, and then we'll hang him." I understand that there is due process. But I think there has only been one criminal prosecution for conduct that was really part of the financial crisis. I am not talking about prosecuting a homeowner or a broker for exaggerating income on their application, but I am talking about actually in the securitization process, and those are the two guys at Bear Stearns, which resulted in an acquittal.

Have there been others? And there have been referrals from the Levin commission, the Levin committee, to the Department of Justice, the Financial Crisis Inquiry Commission also made criminal referrals. Do you know if anything has come of those and have you made other criminal referrals?

Mr. KHUZAMI. There have been some other prosecutions. There are indictments of high-ranking traders at Credit Suisse for mismarketing their subprime portfolio. There was successful prosecution of Colonial Bank for mortgage-related fraud. We have made referrals and, look, I was with the Department of Justice for 11 years as a prosecutor in New York. I can tell you the Department is focused and committed to these cases and is looking very hard at them. They are challenging criminal cases to make for a variety of reasons, primarily because the securities laws are premised on disclosure, and if you sell a RMBS security or a CDO and it has dozens of pages of risk disclosures and someone buys it nonetheless, you have to be able to prove that what was concealed from an investor was something that was not disclosed.

They are just challenging cases to make for a variety of reasons, but that shouldn't be taken as evidence of a lack of commitment on the Department of Justice, from what I see.

Mr. GARRETT. The gentleman's time has expired. Mr. Dold is recognized for 5 minutes.

Mr. DOLD. Thank you, Mr. Chairman, and I certainly want to thank you all again for your time and your testimony today. I just have a series of questions and it should be pretty quick. For the entire panel, what percentage of your case load is settled before trial? Just a rough idea, just a quick—

Mr. ALVAREZ. About 99 percent.

Mr. DOLD. About 99 percent. Mr. Khuzami?

Mr. KHUZAMI. I think about one-third of them are litigated, so about two-thirds are settled.

Mr. DOLD. So 66 percent. Mr. Osterman?

Mr. OSTERMAN. High 90 percent.

Mr. STIPANO. Ninety-eight, 99 percent.

Mr. DOLD. If this policy is put in place where it is required that wrongdoing must be determined or admitted in a settlement, do you think the percentage of settlements is going to go up or down?

Mr. Alvarez?

Mr. ALVAREZ. The percentage of settlements would definitely go down.

Mr. KHUZAMI. They would go down.

Mr. OSTERMAN. They would go down.

Mr. STIPANO. Fewer settlements.

Mr. DOLD. I have put in my opening statement that I think it is going to go down significantly.

Does anybody think it is not going to go down significantly?

Mr. KHUZAMI. I think they will go down significantly. I think what you also would see is settlements may eventually happen, but there would also be a significant amount of delay even if they ultimately settle.

Mr. DOLD. In your various agencies, will you be able to handle more cases or less cases if this policy were to be put in place?

Mr. Alvarez?

Mr. ALVAREZ. We would likely require much more staff to handle the same amount of cases.

Mr. DOLD. So, ultimately, if you had the same amount of staff you have right now, you would be able to handle less cases, right, is that right?

Mr. ALVAREZ. I think that is right.

Mr. KHUZAMI. I think that is right, fewer cases.

Mr. OSTERMAN. It definitely would tie up staff, and we would be able to handle fewer cases.

Mr. STIPANO. We would operate less efficiently, we would need more staff.

Mr. DOLD. Less efficiently, fewer cases. Okay. So will victims, the taxpayers, the litigants themselves be better of or will they be set back if this policy were to go into place?

Mr. Alvarez?

Mr. ALVAREZ. Sir, I think from our perspective, the taxpayer and the depositors' financial institutions would be less safe and sound than they are under the current policy.

Mr. KHUZAMI. I think the investors would receive not as much by way of funds in exchange for their losses, and they would get it on a much delayed basis.

Mr. OSTERMAN. Institutions and depositors would be much less safe and sound. We wouldn't be able to take as many actions.

Mr. STIPANO. The safety and soundness of our institutions could be compromised. Also, I think there would be substantial delays in some cases, and less restitution paid to consumers who are victims.

Mr. DOLD. And I certainly agree with my good friend and colleague that we are looking to make sure that those who have done illegal things, we want to make sure that they are held accountable, that they are put away, in those instances going to jail, because I do think that does send a shock wave in terms of wrongdoing.

Another question for the panel is, do you think you have competent staff attorneys who work for the agencies?

Mr. ALVAREZ. Absolutely.

Mr. KHUZAMI. I think they are highly professional and competent and dedicated, and I am proud to be associated with them.

Mr. DOLD. I am glad to hear that.

Mr. OSTERMAN. Yes.

Mr. STIPANO. Yes, sir.

Mr. DOLD. So good, competent staff attorneys. In your opinion, do you think they understand the complexities in the implications of settlement?

Mr. ALVAREZ. Yes, I think we do.

Mr. KHUZAMI. Yes.

Mr. OSTERMAN. Yes.

Mr. STIPANO. Absolutely.

Mr. DOLD. Are you forced, does anybody force your staff attorneys to take a settlement? So in the implication, you say, you know what? We really want to take this one to trial, this is a big case, we have to take this to trial. Is anybody forcing them to take the settlement if it is not the right mix or it is not right for the agency?

Mr. ALVAREZ. No, we only settle cases in the way that we think is appropriate for the action and gets the kind of remedial action that we think is appropriate.

Mr. KHUZAMI. No, we have internal debates and discussions about the strength of the evidence and evaluate the case, but no one is forcing a settlement.

Mr. OSTERMAN. No one is forcing a settlement. We look at the merits of the case and decide to go forward where it is appropriate.

Mr. STIPANO. No, we only settle cases when it achieves our supervisory goals.

Mr. DOLD. And so, at least I am glad that I heard you all properly. I thought that was the case, and so I am just trying to get a better handle on the policy.

If this policy were to move forward, it seems to me that we are going to take an enormous step backwards, a step backwards for the taxpayers, for the litigants, for everyone. And we have competent staff attorneys out there who are weighing the pros and cons and whether they want to settle. I certainly appreciate your comments here today, and I hope that we have shed a little clarity for those who are watching all across the country.

Mr. Chairman, I yield back.

Mr. GARRETT. The gentleman yields back. The gentleman from Massachusetts is recognized for 5 minutes.

Mr. FRANK. Thank you, Mr. Chairman. I apologize, I had a previous engagement that I had to deal with at the World Bank. And I am grateful to Chairman Bachus. I had asked him if we would have this hearing because this is a case where there are important public policy questions that needed to be addressed. And I apologize if I am being—I will try not to be repetitive.

I will say once again, and I gather my colleague Mrs. Maloney asked Mr. Khuzami about this, given the Federal budget, the enormous amount that is spent in so many other areas, I think it is deeply regrettable that fiscal constraints drive some of this, and when people are critical of the agencies they ought to factor in what is inadequate funding on the part of the Congress. Money is a lot or a little depending on the context. When we talk about hundreds of millions of dollars for the Securities and Exchange Commission or the Commodity Futures Trading Commission, which isn't represented here, for their carrying out law enforcement, we sometimes call that a lot of money. Of course in another context, specifically JPMorgan Chase, with $2 billion, we are told there is nothing to worry about, and I think maybe there is a happy medium there.

Mr. Khuzami, I take it you have said that one of the things you have to factor in, in deciding whether to prosecute or settle is financial constraints, is that correct?

Mr. KHUZAMI. That is correct. If you are doing case "A," you are not doing case "B," and so there are opportunity costs with everything.

Mr. FRANK. There obviously is not an infinite amount of money, but I think there is more money out there that we should make available to the SEC. I think if in fact we were to make some more money available, even an increase of a couple hundred million dollars, which again in the context of—we are talking about the defense budget today. I read a New York Times article the other day that said a $500 million investment in teaching Iraqis how to be policemen turns out to have been largely wasted and it is going to be aborted. That is, of course, far more in total than the budget of the CFTC, and half of that would have gone a long way in enforcing this.

The other question I have is—and again if it has been asked, just tell me that, and I will apologize, but one of the things that has frustrated people is seeing people promise not to do it again for the second, third, fourth or fifth time. Is there reasonable doubt, the three strikes and you are out rule, not out but three strikes and you can't settle again, and how do you address all of those who are frustrated by the repeat offenders who for the fifth time say, I am sorry, I won't do it again, and that is the end of it?

We will start with you, Mr. Khuzami.

Mr. KHUZAMI. I would say first that our recidivism rates for individuals are extremely low. That is anecdotally, just based on cases that I see, but there are very few repeat offenders who are individual persons, and when they do, those are most often the ones that we would work closely with the Department of Justice—

Mr. FRANKS. What about entities?

Mr. KHUZAMI. Institutions are a different story. Although even then, to understand whether or not an institution that has had more than one violation deserves a higher sanction because of the second violation, it is a little—

Mr. FRANK. You make a distinction there that some people in our society don't accept; you are distinguishing between individuals and institutions. But there are those who believe that corporations are people, in which case the distinction you are making wouldn't hold. But, please continue.

Mr. KHUZAMI. I understand. All I am saying is if in year 1, you had a mortgage violation in Seattle in an institution, and in year 3, you had a currency violation with the peso in Mexico in year 3, whether or not that is deemed to be a recidivist institution, you have to look to see whether or not there are common links between the misconduct there. But your point is well-taken. That is why Chairman Schapiro has asked for additional penalty authority for recidivists.

Mr. FRANK. Do we have to give you that? Is that statutory?

Mr. KHUZAMI. Yes.

Mr. FRANK. I hope we will take that up. And then let me say finally, I understand that if it is a different part of the entity, it is a different type of thing, it is not 100 percent repeat, but neither is it zero. And an institution that does one thing wrong in one place one year and 2 years later does another thing wrong in another place, that ought to be at least a percentage; the recidivism shouldn't be all or nothing. But I appreciate that and I will be working with the staff on our side and will be talking to the chairman. I would hope that people who have been at all critical of you would agree that giving you the power to increase the penalty for recidivism, appropriately defined, would be a very important thing to do.

Thank you.

Mr. GARRETT. The gentleman yields back. Mr. Luetkemeyer for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I am just kind of curious, gentlemen, whenever your agency is proposing new rules, do you do a cost-benefit analysis on each one of those rules?

Mr. Alvarez?

Mr. ALVAREZ. Yes, we do. There are certain kinds of cost-benefit analysis that we are required to do by statute, the Regulatory Flexibility Act for example, the Paperwork Reduction Act we do particular analysis there, but in addition to that as part of our rulemaking process, we consider various alternative approaches to implementing the rules and the relative costs and benefits of those different alternatives.

Mr. LUETKEMEYER. Mr. Khuzami?

Mr. KHUZAMI. Congressman, in the Enforcement Division we really don't have rules, in Dodd-Frank we had—

Mr. LUETKEMEYER. I understand. I have someplace to go with this.

Mr. KHUZAMI. Okay.

Mr. LUETKEMEYER. Generally, you don't, though?

Mr. KHUZAMI. We don't. We have the whistleblower rule in Dodd-Frank. That was it.

Mr. OSTERMAN. We do consider the costs and benefits in looking at—we are statutorily required to do so.

Mr. LUETKEMEYER. For every rule?

Mr. OSTERMAN. We do look at alternatives and the way things can be done, yes.

Mr. STIPANO. I am not normally involved in the rulemaking function at my agency, but my understanding is that we do consider the costs and burdens to the industry of specific rules.

Mr. LUETKEMEYER. Quite frankly, I sit on this committee, I have been here a long time now, and all of your colleagues have been coming through here, and I have gotten different answers from them on that particular issue. And it is disturbing because you can do a cost-benefit analysis on your cases to decide when you need to go, when you don't need to go, who you need to go after, when you need to settle. So you can do it, but you don't do it on every single rule that you promulgate. That is a problem, and I am frustrated with that because quite frankly especially with the smaller institutions, they can't survive with this continued onslaught of rules and regulations that you are promulgating that are really not necessary and yet they are costing them an arm and a leg to comply with. And I am frustrated with that.

But moving on, I am just kind of curious. You believe that each one of you has enough authority, I know, Mr. Khuzami, you have mentioned a few things already that you would like to see more flexibility with and more things.

What about the other three of you? Do you see some things that you would like to see where you would have more tools in the toolbox to be able to go after the bad guys spoke, so to speak?

Mr. ALVAREZ. No, I think at this point we think Congress has already addressed many of the concerns we have had.

Mr. LUETKEMEYER. Mr. Osterman?

Mr. OSTERMAN. I would agree. We have quite a few tools in the toolbox, which we talked about in our testimony.

Mr. STIPANO. At this stage, it is a very big toolbox.

Mr. LUETKEMEYER. It is a very good toolbox. Thank you. I think you are doing a good job. I don't have a problem with what you are doing I am just a little frustrated with some of the other things.

Do you believe that by having all the tools that you have, that your enforcement presently is adequate, or do you need to do more or do less? Are you okay where you are at? What do you think? Do you think that—as we go through and somebody has a problem, like JPMorgan lost some money the other day but obviously a bank is in business to take risks. And the first thing everybody does is run out and ask, has somebody done something wrong? Is the penalty too far? Are we doing enough investigation? What do you think?

Mr. ALVAREZ. During the 4½ years of the financial crisis, beginning in 2008 up to the present, we have done 3 times more formal enforcement actions than the 5 years prior to that. And that is driven, I think, a lot by the behavior of the institutions and the concerns that are raised at the institutions.

My hope is not so much that we will raise the number of enforcement actions to try to achieve a certain number, but that the industry will get back to a better, more coherent and more safe and sound and compliant mode.

Mr. LUETKEMEYER. Mr. Khuzami?

Mr. KHUZAMI. I think we could certainly use more. We understand the importance of using what we have efficiently and appropriately because it is taxpayer money. But having said that, the SEC oversees 35,000 registrants, investment investors, broker dealers, public companies, transfer—

Mr. LUETKEMEYER. You think we need to go after more people?

Mr. KHUZAMI. I think we need to be able to investigate and survey the landscape more thoroughly and bring more cases.

Mr. LUETKEMEYER. Mr. Osterman?

Mr. OSTERMAN. You can always improve processes but I think, as with my colleague at the Fed, our enforcement actions have increased substantially. I think that is as a result of what has been happening in the industry, but I think we do have the tools necessary to address these issues that we are doing.

Mr. LUETKEMEYER. Mr. Stipano?

Mr. STIPANO. The OCC has taken about 2,200 enforcement actions in the last 4 years. We think that those actions, coupled with our supervision, our supervisory actions, help promote the safety and soundness of the system and improve compliance with the law.

Mr. LUETKEMEYER. Thank you all for trying to squeeze in one more question quickly. With regards to Mr. Osterman, one of the things that the FDIC has is an insurance fund to back up and pay for some of the wrongdoings or the misgivings of some of the institutions. Right now, the investment banks are being merged into the depository banks. Do you feel that is a threat to the insurance fund?

Mr. OSTERMAN. It is certainly something that we would need to look at very carefully. To any extent that you have exposure of the insurance fund, it creates a risk. And so, it is something that we would have to be concerned about.

Mr. LUETKEMEYER. I see my time is up. Thank you very much. Thank you, Mr. Chairman.

Mr. GARRETT. And the gentleman yields back.

Mr. Watt is recognized for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman. I had to step out, and I lost my place in the queue.

Mr. GARRETT. So, never step out is the rule.

Mr. WATT. Don't ever step out of the room, that is the lesson to be learned from that. But in a sense I am kind of glad I did because I had the opportunity to hear Mr. Posey's line of questions and was relieved that he blew up the theory that Mr. Garrett had advanced that this was somehow; this hearing was somehow a Democratic conspiracy and that there is somehow some partisan position on this issue.

This is a very difficult issue, the extent to which we require people to litigate or settle, or oversee settlements. My views on this are informed by 22 years of practice of law, I guess, in which I both litigated numerous cases and settled numerous cases and never walked away from a case not having second thoughts about whether I did the right thing or the wrong thing whether I litigated it or settled it. It is a very complex set of things that go into that, having to do with the cost of litigation, the prospects of winning or losing, the whole myriad of issues. And I don't think there is any partisan position on that, as Mr. Posey has in his comments indicated.

Mr. Alvarez, you were kind enough to make the distinction between your job as the Fed's job is protecting the safety and soundness of institutions versus protecting customers, which is a lot different, I take it, from what the SEC's responsibility is, and I appreciate you making that distinction.

Mr. Khuzami, you mentioned that the SEC has the right to require disgorgements of profits that were obtained improperly, but there are some limitations on the extent to which you can recover lost investor investments as a result of wrongdoing. Can you elaborate on that and tell us a little bit more about the request that the SEC has made for additional authority in that area?

Mr. KHUZAMI. Certainly. We are entitled to obtain disgorgement, which is ill-gotten gains, plus a penalty equal to the amount of that disgorgement. And so, to take a simple example—

Mr. WATT. Tell me what you are not entitled to do.

Mr. KHUZAMI. What we can't do is look at how much the investors lost in a transaction and get that amount as a penalty.

Mr. WATT. And can you give any of that disgorgement or the penalty back to investors?

Mr. KHUZAMI. We can give it all back, but there are cases where it falls short of what they lost.

Mr. WATT. Okay, and so what is the remedy, the additional authority that you have requested?

Mr. KHUZAMI. Chairman Schapiro has requested that our penalty authority be increased in a couple of different ways; one, just using up to the amount of the investor loss as an amount that we can obtain in a penalty. As an alternative, to get 3 times the gain as a penalty if it turns out that that amount might be greater than the investor loss and it would be appropriate to get it. And third, to increase the tiers, which are the statutory ways that we can get penalties on an alternative calculation.

Mr. WATT. And to complicate this even further, that would be as an alternative to some kind of private right of action in which individuals would be able to go in and do their own enforcement actions, I take it, is that correct?

Mr. KHUZAMI. That is correct, although a private plaintiff who won at trial and lost $100, if they had received $50 of it from the SEC as part of our distribution presumably would only be entitled to get the remaining $50 in the private litigation.

Mr. WATT. My time is about up. But I will just say that this is a very tricky area here that we are dealing with and if there is some partisan Republican position on this, I hope you will communicate it to your colleagues on the Judiciary Committee because they have been all over the lot on whether settlements are appropriate, regulatory enforcement is the appropriate remedy, private rights of action they hate with a passion, I don't know how they sit on the Judiciary Committee and take that position, but posturing this as a partisan issue is I think not a good thing to do, Mr. Garrett. I am directing that comment to you.

Mr. GARRETT. And I appreciate that.

The gentleman's time has expired.

The gentlelady from New York is recognized.

Dr. HAYWORTH. Mr. Chairman, I am happy to yield to 2 minutes to you or—

Mr. GARRETT. I appreciate that. I won't use all that. Just two quick points. Mr. Khuzami, during the panel you mentioned on at least a couple of occasions with regard to the issue of civil penalties and the potential for changing that—my understanding is that Chairman Schapiro has written to Congress on that suggesting that it should be done, but the request on that letter has only gone to the Senate and has not been directed to the chairman of the committee or myself, is that true? And if so, is there a reason why we are not in the loop on this?

Mr. KHUZAMI. I believe that is the Senate—the letter was addressed to Senator Reed. I am sure we would be happy to send it along here as well.

Mr. GARRETT. The ranking member brings it up, and others have brought it up as well, but if it is a legitimate position that the agency is looking for, we would certainly like to be included on that.

And the second point is with regard to the funding issues and what have you. I just remind—the ranking member is not here on this—but I believe Chairman Schapiro asked for a funding level at $1.6 billion, but for some reason the Administration came in at $1.5 billion. So if the issue were, as the other side argues, one of funding, then you would think that they would be asking for the complete funding that Chairman Schapiro was asking for. I am mindful of the fact that the President's budget, of course, has come through both Houses now and apparently has not received a single vote in either House, so that may be part of the rejection from both, from the other side of the aisle, that they disavow anything to do with what the Administration is suggesting in their funding for this program and other programs as well.

And with that, I yield back to the gentlelady from New York.

Dr. HAYWORTH. Thank you, Mr. Chairman. And I thank our panel for the most informative perspective on challenges you face in cost-effectively and efficiently enforcing the law without unnecessarily disrupting the services that the American public needs.

With that, I think just summing up what we have been talking about, the American public needs assurance that your approach is working and that you are not missing out on appropriate deterrent measures, which is what punishment is supposed to be, in order to expedite processes.

If each of you could in about 30 seconds, and I apologize for the restriction, but just give the best argument that we can give to the American public for continuing to pursue enforcement under the methodology that you have now?

Mr. Alvarez?

Mr. ALVAREZ. It allows us to most quickly and efficiently require institutions to change their behavior and to provide resources to customers who have been harmed.

Dr. HAYWORTH. Mr. Khuzami?

Mr. KHUZAMI. I think if you look at the entire package of a settlement, which is a substantial financial penalty, a detailed complaint laying out the allegations, business reforms where appropriate, individuals charged, people barred, all of the legal costs, reputational damage, client concerns, shareholder concerns, everything that is packaged up in a settlement both as a result of the agency's action as well as simply the consequence of the wrongdoing, all told it really has a powerful deterrent message.

Mr. OSTERMAN. It allows us to accomplish the purposes of our statute and meet the public interest in an efficient and effective way and avoids protracted long-term litigation which may actually lead to less effective regulation.

Mr. STIPANO. We have taken a large number of enforcement actions in recent years. It is really only a small part of what we do when you consider the corrective action that is obtained through the examination process. And once we put an action in place, we are not done. Our examiners monitor for compliance through the exam process, and if those actions are violated, we can take progressively severe actions against the institutions.

Dr. HAYWORTH. Thank you. Mr. Chairman, could I possibly ask for 1 additional minute? I have one more question.

Mr. GARRETT. You still have time.

Dr. HAYWORTH. Would each of you tell us, is there some modification you might make, if possible, that would be even more productive in terms of the way in which you pursue your protective actions for the public?

We will start with Mr. Alvarez.

Mr. ALVAREZ. Our policy is to not require admission of guilt. In some cases more recently, we have also prohibited folks from denying guilt. That is a practice the SEC does regularly, and we are considering whether we should adopt that regularly.

Mr. KHUZAMI. For us, it is more about resources and the enhanced penalty authority.

Dr. HAYWORTH. Thank you.

Mr. Osterman?

Mr. OSTERMAN. We believe our practices are working quite efficiently.

Dr. HAYWORTH. Thank you.

Mr. STIPANO. We are comfortable with our present approach.

Dr. HAYWORTH. Thank you all. And thank you, Mr. Chairman.

Mr. GARRETT. And I thank the gentlelady very much.

Mr. Scott is recognized for 5 minutes.

Mr. SCOTT. Thank you very much. First, let me yield 10 seconds to the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Mr. Chairman, I just wanted to ask unanimous consent to put into the record a copy of the letter that was written by the SEC to Jack Reed, the chairman of the committee and in it, in the first paragraph, it does say why it is addressed only to the Senate as opposed to the House, because it was in response to a hearing that was being held there and was requested by the Senate.

Thank you.

Mr. GARRETT. Thank you. Without objection, it is so ordered.

Mr. SCOTT. Thank you, Mr. Chairman. Let me ask a question about the investors, when they can and cannot bring a lawsuit. Mr.

Khuzami, does an SEC settlement preclude or not preclude an investor from bringing action against a defendant?

Mr. KHUZAMI. It does not preclude.

Mr. SCOTT. And would you please describe how the SEC's settlement does not preclude that?

Mr. KHUZAMI. An injured investor or a shareholder is entitled to bring their own private cause of action irrespective of what the SEC does.

Mr. SCOTT. And what are the types of cases where the SEC can bring a case against a defendant?

Mr. KHUZAMI. All sorts of accounting violations, disclosure violations, registration violations, everything that is actionable under the securities laws, the Foreign Corrupt Practices Act violations, et cetera.

Mr. SCOTT. And in such cases, does the fact that an investor cannot bring an additional action change the decision-making process for determining whether it is appropriate or not to settle with the defendant?

Mr. KHUZAMI. No. In general, we are going to follow the same guidelines that I outlined previously.

Mr. SCOTT. Okay, and let me ask you about repeat offenders. Are they treated differently? How does the SEC identify and pursue repeat offenders?

Mr. KHUZAMI. With respect to individuals, if we see repeat offenders, that is more likely to result in a criminal referral and us working with criminal authorities to bring criminal sanctions to bear on the individual. Otherwise, we take past violations into account in setting our penalties. We have the same ceiling that I described earlier, but within that ceiling we have discretion, and it would be standard and appropriate for us to extract higher penalties for recidivists.

Mr. SCOTT. And does the SEC consider previous settlements by a defendant with either the SEC or another regulator when considering bringing an enforcement action against a defendant?

Mr. KHUZAMI. We would consider the previous violation, not necessarily the settlement. If we knew that somebody had violated the law, particularly in a similar way to what we are currently looking at, we would most assuredly take it into account.

Mr. SCOTT. Would an admission of guilt in a previous settlement or a trial change how the SEC considers future actions against defendants?

Mr. KHUZAMI. No, not necessarily. No, I don't think it would because when we conduct our investigations and arrive at a settlement, our view is that what we have found in that investigation is accurate and correct and true, as a result of months, if not years of investigations.

So we settled the prior violation. Even without an admission, we know what that person or that entity did previously, and we take that into account.

Mr. SCOTT. And do you believe that the infrastructure that you have in place now, the process, the procedures, is this sufficient moving forward to protect the markets, to protect investors, to protect everyone? In other words, do you feel you have all the necessary tools that you need or is there something else we need to do here in Congress to help you do a better job?

Mr. KHUZAMI. From the enforcement perspective, we did the largest restructuring in the history of the Division of Enforcement in 2009 and 2010, created specialized units, cut out a layer of management, created a COO, upgraded tips and complaints, did a lot of things, but still, we have a strong need for IT resources so that we can better collect all of the information we get and search it, better monitor our cases.

We need additional trial lawyers, and we need additional private sector experts to help us in very technical fields, so it is really those kinds of resources that would be most helpful to our effort.

Mr. GARRETT. I thank the gentleman. The gentleman's time has expired. The gentleman from Arizona is recognized for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman, and as you always worry sometimes when you see the empty chairs, understand you are never not in front of a television camera, so when we are running between offices, you are on all these screens around the building.

In the types of—let's just take a year's worth of different settlements for the last couple of years. Would I ever find a case where the decision was bifurcated, where the firm entered into a settlement agreement and said, we are going to change our practices, but an individual in the firm was referred to criminal action?

Are there any cases like that, where it has provided you flexibility to even sort of break up saying, I have an individual bad actor over here but the firm didn't have certain control mechanisms and that was their failure. That was more worthy of a settlement, this needed a criminal referral?

Mr. KHUZAMI. Yes. There are many cases where the entity may settle the matter. The individual employee may continue to litigate with us and may be referred to criminal authorities as well.

Mr. SCHWEIKERT. And do your settlements always cut off private rights of action?

Mr. KHUZAMI. No, they don't cut off private rights of action at all.

Mr. SCHWEIKERT. Okay, I am sorry, that was partially because I heard—I may have misheard. I thought I heard someone on my other side say that, so I wanted to come back to you.

Mr. KHUZAMI. There are some laws that we can proceed under that private plaintiffs can't, but our actions don't cut them off. In fact, our actions help them because when we file a 20- or 30-page complaint laying out all of our evidence and emails and meetings, plaintiffs can use that.

Mr. SCHWEIKERT. And, Mr. Chairman, this would be for whoever would have this expertise. Okay, you do a settlement. How much of the discovery work of that settlement is public?

Mr. OSTERMAN. When we do a settlement, all of our orders and settlements are public. They are required to be, under the law.

Mr. SCHWEIKERT. So in that case, you have actually done much of the research for—if there was some private right of action, you have actually done much of the work for it.

Mr. OSTERMAN. The work that has been done internally would be our work product. But in terms of the actual settlement itself, it is a public document. It has to be published.

Mr. SCHWEIKERT. I am just sort of curious, and this one I probably shouldn't go to, but how much of the work product goes immediately public and how much of it is discoverable, either through a Freedom of Information request or other court action?

Mr. STIPANO. I think one problem for us as bank supervisors is that our enforcement actions are really based on findings of our examinations, which by regulation are confidential.

Mr. SCHWEIKERT. And if you were to think about it, over the last 12 months, how many settlements have there been, and I won't hold you to an exact number.

Mr. KHUZAMI. In Fiscal year 2011, we filed 735 cases. About two-thirds eventually settled, some before litigation, some during litigation.

Mr. SCHWEIKERT. If you were to take a sort of a guess, how many of those, from both rumor to facts—and I am not going to hold you to a number—do you think also had other legal actions moving either after or in parallel? And I know that is a little ethereal.

Mr. KHUZAMI. That is speculation.

Mr. SCHWEIKERT. Okay, jump on to another one. How many of those did you have, my sort of earliest scenario, which is sort of a bifurcation, where a bad actor was referred to either criminal or other types of litigation where the firm was separated out with a settlement to clean up its practices?

Mr. KHUZAMI. Again, I would have to—I don't know off the top of my head.

Mr. SCHWEIKERT. Okay, but it is a scenario that does happen?

Mr. KHUZAMI. Yes, although candidly, most of the time, if, because, because corporations have liability because of the acts of their employees, if the company is under scrutiny and the individual is under scrutiny, it is likely to be both under criminal scrutiny and SEC scrutiny. It is not so often that one would go to one place and one would go to the other. Because if the individual engaged in something that might be criminal, the criminal authorities are also going to be interested in the entity.

Mr. SCHWEIKERT. Okay, and I note in my last 14 seconds, and you have already touched on this once before, okay, 700-some cases last year, if you were in an environment where you had to litigate everything, what happens to you? What happens to compliance, what happens to the mechanics out there?

Mr. KHUZAMI. I think you have to shift a substantial amount of your resources from your investigative staff to your trial staff, which means investigations are not getting done, which means there are a lot of people who did bad things who are running around out there who are not being caught, and a lot of investors lost money who are not being compensated.

Mr. SCHWEIKERT. Thank you. Thank you, Mr. Chairman.

Mr. GARRETT. Thank you. Mr. Ellison is recognized.

Mr. ELLISON. Thank you, Mr. Chairman. And let me thank the panel. There has been some questioning around what would happen if you had to try every case or what would happen if no settlement could include a nonadmission provision. Has there been such a proposal made as that?

Is there an existing proposal, are there agencies that offered a proposal which said you must try every case, or if you do settle a case, it can only be settled with an admission of responsibility or guilt?

So this discussion that we have had about not being able to settle cases, while interesting, doesn't really bear out any of the proposals that you all have made. Am I right about that?

Mr. KHUZAMI. Not in our proposal, and other than Judge Rakoff's opinion, which has now been questioned by the Second Circuit, there is no proposal that I am aware of.

Mr. ELLISON. Yes, okay, okay. Because I am an old trial lawyer myself, and I can't imagine a situation where you could make a prophylactic rule prohibiting nonadmission clauses. I think these things have to be done on a case-by-case basis.

But here is another question related to that, and this is a question that I know comes with some risk for anybody who answers it perfectly candidly, but I am just going to throw it out there anyway. Do you believe, based on resource issues or lack of resources, that you have had to settle cases that you would rather have gone forward and prosecuted, or do you believe you have settled cases that should have included some admissions but didn't simply because it would just cost too much and take too much time and energy and resources to demand that you would get results? Do you understand my question?

Mr. KHUZAMI. The resource issues don't dictate whether or not we require admissions. We have a policy that I have described, and we follow it regardless.

The lack of resources can affect cases in a more indirect way. There is some category of cases that you are going to pursue to the ends of the Earth, regardless. There are others where maybe you are going to narrow the theories, so you don't need an expert witness, or you are going to maybe charge only two defendants rather than four.

Mr. ELLISON. Yes.

Mr. KHUZAMI. And more, it manifests itself more in those kinds of decisions.

Mr. ELLISON. Mr. Stipano, do you want to address that?

Mr. STIPANO. The only thing I would add is that we don't initiate cases that we aren't prepared to litigate, and I think if we departed from that we would have a much harder time settling cases. I think one of the reasons why we are able to settle them so efficiently is that the respondents on the other side of the case know that we are prepared to litigate it all the way through the Court of Appeals if necessary.

Mr. ELLISON. Exactly, and it is those other cases that I am worried about. For example, there are numerous companies existing in America today who can drown you guys. They can just drop buckets of interrogatories, requests for admissions, depositions, et cetera. I know you can imagine that there are some corporations it would be tough to tangle with. Can you imagine a scenario where you wouldn't charge them because even though you think they are wrong, you just can't handle them?

Mr. KHUZAMI. We punch above our fighting weight.

Mr. ELLISON. Okay. I like to hear that. That is the right spirit, Mr. Khuzami. Thanks.

Mr. ALVAREZ. The other thing the banking agencies have that helps us quite a lot is we examine the institutions that we regulate on a very regular basis.

Mr. ELLISON. Okay, so you walk in there with a certain advantage?

Mr. ALVAREZ. Yes.

Mr. ELLISON. In terms of discovery?

Mr. ALVAREZ. And they know they have to deal with us on a regular basis.

Mr. ELLISON. Yes, right.

Let me ask you a few questions that kind of have something to do with the whole JPMorgan thing. I just want to get your views on it. I am asking you because I want you to know what I am getting at, as if it wouldn't be obvious, but I am not asking you specifically about that case. So I am not asking about that case, but my motivation for asking you is because of that full disclosure, okay?

And let's start with you, Mr. Stipano.

If a federally-insured bank was investing in credit default swaps that could result in them losing as much as 3 months of profit, would you expect that to be disclosed to investors?

Mr. STIPANO. I think that is really a question that involves interpretation of the Federal securities laws, and I am not in a position to answer that.

Mr. ELLISON. Okay. Does anybody want to answer that? No? Okay.

Mr. KHUZAMI. There are various rules that require disclosures of various kinds and various risks, so it would depend on the other variables as to whether or not that was the case.

Mr. ELLISON. So, if a federally-insured bank, again we are talking about federally-insured money, the public's money, would you expect that if such a bank was invested in CDS, that could result in the loss of 3 months of profit that regulators would be informed that these trades were going on, or do you think you are regulating to a degree that you would know that this was going on?

Again, I am not asking, I am not trying to pin anybody here with any wrongdoing. I am just asking theoretically, what kind of activity, when we are dealing with federally-insured money needs to be disclosed to either investors or regulators?

Mr. STIPANO. We should know about it. Under our exam authority we have access to all the books and records of the institution.

Mr. ELLISON. Okay. My time has expired. Let me say thank you to all of our witnesses and good luck on all your work.

Mr. SCHWEIKERT [presiding]. Mr. Ellison, I would never think of you as an old trial attorney. I recognize Mr. Carney for 5 minutes.

Mr. CARNEY. Thank you, Mr. Chairman. And thank you to the panelists. When you get to me, you know it is almost done, you have 5 minutes left. I want to thank you for all the information that you have provided us with today, your answers. You have obviously done a good job of explaining the rationale for your settlement practices.

And I think there is really kind of a fundamental disconnect. The reason, I suspect, that gave rise to this hearing today was the perception that people who have done wrong, who created a very serious financial crisis in our country is that there hasn't been adequate accountability. I think I heard my colleague from the other side of the aisle say that people didn't go to jail, and we have heard that from a number of Members.

And I agree with Mr. Watt that this isn't a Democrat concern, a Republican concern, whatever. I hear it from Democrats, Republicans, and Independents in the district I represent, which is in the State of Delaware.

You talk about your responsibility—and I am not a lawyer, so I have learned a lot today about legal processes—and you don't have the authority to put anybody in jail; is that correct?

Mr. KHUZAMI. That is correct.

Mr. CARNEY. So that really maybe we got the wrong panel this morning. Maybe we should have DOJ up here, because I think that is what people really are focused on and concerned about.

Is part of your consideration, prudential regulators, it is safety and soundness, Mr. Khuzami, it is investor protections or recovery, is deterrence or punishment part of your consideration in these actions and enforcement actions to take? If you would just go right down the line, starting with Mr. Alvarez.

Mr. ALVAREZ. Yes, certainly deterrence is and punishment is as well a concern for us. Most importantly, it is correcting the problem that we have observed, and that is our first priority. But we have a variety of ways of ensuring deterrence and getting the policies and procedures out to the world, informing the world of the kinds of judgments that we want to make.

Mr. CARNEY. But correcting the problems for the safety and soundness of the institution is primary?

Mr. ALVAREZ. It is the first priority.

Mr. CARNEY. Mr. Khuzami?

Mr. KHUZAMI. Yes, deterrence is a strong part of what we do. You are much better off preventing the wrong before the fact rather than trying to pick up the pieces afterwards.

Mr. OSTERMAN. Yes. Deterrence is certainly a big part of what we are doing in terms of the enforcement.

But as my colleague at the Fed said, we are really focused on safety and soundness of the banking industry. In terms of punishment, we do have powers through civil money penalties to seek penalties and we do that quite often when it is appropriate.

Mr. STIPANO. As my colleagues said, the primary focus of our enforcement action is remedial in nature. We are trying to address unsafe and unsound practices and violations of law that we find in the institutions. We do think there is a deterrent effect to our actions, both for the institution or the individual involved, as well as for others in the industry.

Mr. CARNEY. The perception that we are dealing with is that these perpetrators haven't been punished adequately. Do you believe that what you have done in these settlements—part of the problem is just the "no admit, no deny policy" just sounds pretty soft to me, and I know it sounds pretty soft to my constituents.

I understand your explanations completely and how you get to the settlements and it helps you achieve your objectives. But do you feel like what you have gotten in these settlements actually accomplishes what your considerations are for punishment and deterrence, again starting with Mr. Alvarez?

Mr. ALVAREZ. Yes, I do. I think we have been able to be more effective in improving the safety and soundness of institutions. But, remember, that also means that we are protecting depositors and taxpayers. We have had a number of actions that provide restitution to customers, so it is a broader array of folks that we are trying to deal with and punishment or retribution is not as high a priority.

Mr. CARNEY. Mr. Khuzami?

Mr. KHUZAMI. For the SEC, I think our record in financial crisis cases is strong, as I said earlier—over 100 entities and individuals, 55 CEOs and CFOs, I think sends a strong message.

Mr. CARNEY. By the way, I don't know in the context whether those numbers are impressive or not. It sounds pretty big, but I don't know relative to who might have committed these offenses.

You specifically, though, have asked for higher penalties, so that suggests that you are not completely satisfied with the punishment aspect of it.

Mr. KHUZAMI. What it means is there are some circumstances where more authority would be appropriate.

Mr. CARNEY. Fair enough. I only got a—

Mr. OSTERMAN. And I think we—the deterrent factor is definitely there. As we said before, we are there in the institution supervising it. We have cease-and-desist order authority, which we use quite often to address and remediate issues, and we do have civil money penalty authority to actually penalize.

And the ultimate penalty, frankly, is the removal and prohibition authority. We can remove an individual from banking for life, and we have done that.

Mr. CARNEY. It is a pretty big stick, I would say.

Mr. OSTERMAN. Yes.

Mr. STIPANO. Rich just made the point I wanted to make. But I think the broader point is that when we take enforcement actions, they are often part of a broader package. So civil money penalties, for example, may be coupled with restitution action, may be coupled with a removal and prohibition. There could be an action on an institution as well. And I think together, when it is viewed that way, it is very effective.

Mr. CARNEY. Again, thank you very much, and thank you for fighting above your weight class.

Mr. SCHWEIKERT. Thank you, Mr. Carney.

All right, I think we are out of questions.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

With that, this panel is dismissed. Thank you, gentlemen.

Will our second panel please be seated?

Welcome, gentlemen, and, actually as a courtesy, Mr. Frank would like to make an introduction.

Mr. FRANK. Thank you, Mr. Chairman. I want to introduce a man who has been before this committee before at my request, the Secretary of the Commonwealth of Massachusetts, William Galvin. By virtue of being elected Secretary of the Commonwealth of Massachusetts, he is our securities regulator and he has used that power—and it hasn't always been used by the incumbent in that office—in a very creative way and he is a good example of how you can use the prosecutorial authority, the civil prosecutorial authority, which he has, effectively. And, there are sometimes complaints that people who bring these charges, particularly those in an elected office, grandstand from time to time. Mr. Galvin has a long record of bringing enforcement cases, and I can't think of a time when he was repudiated by a higher authority, by judicial authority, or whether he—no accusation of overreach has come forward. So I am very pleased that he accepted our invitation to come here, because he is somebody who does this very well.

He also is a reminder that the administration of the securities laws and protection of the investors, protecting the stability of the economy is like other things in this country a shared Federal-State responsibility. And I have always tried to, as a member of the committee, be fully protective, frankly, of the role of the States when there have been some who wanted to make them go away.

And Mr. Galvin and others—and in a bipartisan way, because I think he is here—I don't know if he is here on behalf of the North American Securities Administrators, which is a very effective American-Canadian agency of State and provincial authorities who have been very helpful to us. So I thank you for that opportunity.

Mr. SCHWEIKERT. Thank you, Mr. Frank. Actually with that glowing introduction, how can it get any better. Mr. Galvin?

STATEMENT OF THE HONORABLE WILLIAM F. GALVIN, SECRETARY, COMMONWEALTH OF MASSACHUSETTS

Mr. GALVIN. Thank you, Chairman Schweikert. And Ranking Member Frank, thank you very much for those kind words.

Thank you for this opportunity to discuss regulatory settlements in the financial services industry. As you now know, I am Bill Galvin, Secretary of the Commonwealth and the chief securities regulator of Massachusetts.

Regulation without effect of enforcement makes such regulation little more than political rhetoric and, worse, leads to a false sense of financial security for our citizens.

We are not here today to compare bureaucracies or records of bureaucracies. I believe we all share a common goal of restoring confidence in the financial marketplace. For too many Americans, their recent experiences in the market have consisted of shattered retirement plans, broken promises, and broken dreams. They cannot understand and will not accept a regulatory system that holds none of the major actors accountable.

My Securities Division carries out an active program of civil enforcement in order to detect and stamp out securities fraud. These enforcement actions have returned over $400 million directly back to defrauded investors in Massachusetts. I have long spoken out against the established pattern in Federal settlements of allowing respondents to enter into settlements where they "neither admit nor deny" the allegations in the administrative complaint for the enforcement action.

In 2003, I had the opportunity to testify before a subcommittee of the United States Senate on Government Affairs. I said at that time, that too often the guilty "neither admit nor deny" any wrongdoing and routinely promise not to cheat again until they come up with a more clever method to do what they just said they would not do again.

I repeat those words today with an even greater sense of urgency as events of recent years and days have shown. One of the priorities of my Securities Division is the firms and persons who have violated the law should be required to acknowledge what they have done. Permitting a firm to enter into a settlement where it pays a fine but "neither admits nor denies" that it has done anything wrong permits that firm to avoid basic culpability for its actions.

In some instances, we have seen firms enter into regulatory settlements, pay large fines, and also issue press releases saying the firm settled the matter to avoid the distractions created by prolonged litigation. Permitting firms to take this kind of posture allows the firm to avoid acknowledging any misconduct and permits such firms to publicly take the stance that such settlements are part of business as usual.

If we intend to reform the worst practices in the financial industry, then the firms that have violated a law must acknowledge what they have done is wrong. In many cases there is a thin line between arriving at a satisfactory settlement and failing to reach any settlement at all.

I think it is very important that the most important aspect of a settlement, and in many cases the best resolution, is to require an issuer of securities or securities broker to repay defrauded investors and make them whole. One of the greatest satisfactions of my role is getting restitution for investors and preventing the operators of financial fraud from simply walking away from their victims with their ill-gotten profits.

Our enforcement actions also seek other sanctions. We have imposed significant fines, we have also served as a warning, we have secured agreements about future practices. For instance, in 2011 my Securities Division settled the Goldman Sachs "analyst huddles" case which involved the practice of Goldman Sachs giving its best research recommendations to preferred customers in order to attract more business from those customers, while denying it to others.

Goldman Sachs settled this case by agreeing to reform its practices and by paying a $10 million fine. In the settlement, Goldman Sachs admitted the factual allegations in the consent order, which we believe will deter Goldman and other firms from engaging in the same sort of conflicts in the future.

Between 2003 and 2012, total investor restitution of $404 million was paid directly to investors in Massachusetts securities cases, and this does not include auction rate security cases. We have also suspended the local licenses of many bad actors.

The Massachusetts Securities Division analyzed the 82 consent orders it has entered into since 2003, and based on that analysis, the respondents admitted to the facts alleged in the administrative complaints in more than 40 percent of the cases. The Securities Division has placed a high priority on getting restitution for the defrauded investors and sometimes that results in a variation. So when you do get restitution you may well not get an admission, but the goal should be to try to get an admission.

Much of the testimony I have heard here today suggests that these are opposite goals. They are not. If the system was working so well over the last 9 years, I don't think we would be seeing the repeat offenders we have seen over and over again. Much of the testimony I have heard today suggests that these are two unachievable goals. I disagree.

I believe that it is important that regulators ought to seek admissions if they can get them and certainly should not be required to get them if they can get a better result for investors, but at the same time the idea that somehow we should defer all results and avoid getting any admissions is a far too cosy relationship that has not protected the American people and has not led to a safer and better system for our country.

And so I hope that as a result of this hearing, and some of the changes I have heard discussed here this morning, there may well be a change of heart on this issue.

Thank you for this opportunity.

[The prepared statement of Secretary Galvin can be found on page 66 of the appendix.]

Dr. HAYWORTH [presiding]. Thank you, Mr. Secretary. Next, Mr. Richard Painter, professor of law at the University of Minnesota Law School.

STATEMENT OF RICHARD W. PAINTER, PROFESSOR OF LAW, UNIVERSITY OF MINNESOTA LAW SCHOOL

Mr. PAINTER. Thank you very much, Madam Chairwoman and Ranking Member. I have worked in securities law, I have taught securities regulation for almost 2 decades, and for 2½ years I was the chief ethics lawyer for the White House under President Bush.

I agree with the Second Circuit's view on the settlement in the Citigroup case, and that is for several reasons.

One, the SEC has very limited resources, as we all know, and, by the way, I would strongly urge Congress to seriously consider an increase in the budget of the SEC. I think it would be a good investment. But that being said, they have a very limited budget, and they need to be able to make the enforcement and investigation decisions.

And every time they investigate a case, they don't investigate another. Every time they litigate a case, they may have to spend resources there that could have been spent investigating other frauds, and they need the discretion to decide how to spend those resources.

Second, when you have a large settlement, such as you did with Citigroup, there is a clear message they did something wrong—$285 million is a lot of money. We all know they did something wrong. Exactly what they did wrong, which statute they violated, may not be so clear, but they clearly did something wrong.

Third, there often is legal ambiguity.

For example, Goldman Sachs—there was a settlement of a case with Goldman Sachs that involved securities that may not have been sold in the United States. And after the Supreme Court's decision in *Morrison* v. *National Australia Bank,* it might very well be the case that some of those transactions might not even be covered under the Federal securities laws.

There is ambiguity on that question. And the SEC settled that case with Goldman Sachs and then ran into that very ambiguity in litigation against an executive of Goldman Sachs, Fabrice Tourre, in the Southern District of New York. So there is often a reason to settle in order to not have to deal with legal ambiguity with respect to interpretation of statutes, even though there is clearly a situation of where the company did do something.

And the SEC sometimes will have a situation where if they take an ambiguous case into the courts and get a disfavorable decision and they lose, they not only lose that case, but bad facts make for bad case law, which could frustrate the SEC's enforcement agenda in other areas and a range of other cases.

Now, that being said, I do have two concerns that I want to express to this committee. One is that some of these settlements also involve waivers of specific regulatory—specific rules that provide that lenient regulatory treatment in a range of areas is not provided to entities that have entered into these types of settlements and SEC consent decrees. And what the SEC does is then goes and waives those provisions so that favorable regulatory treatment intended for companies that have been behaving themselves is still given to those companies that have not, and this is in a range of different areas that I have discussed in my written testimony.

I do not categorically disagree with those waivers, but I think that serious thought needs to be given to whether companies that have not complied with the law ought to be permitted, for example, to take advantage of favorable regulatory treatment given to so-called well-known seasoned issuers: Lehman Brothers; Bear Stearns; and Merrill Lynch; all well-known seasoned issuers—perhaps not as well-known and as seasoned as we thought.

And my last concern is that we need to focus on the individuals who are responsible for the conduct, not just the institutions. If $285 million, which might not mean a lot to Citigroup, but if that money were taken out of the bonuses of the individuals, not only who were responsible for the conduct but who supervised the entity, we might get a very different result with respect to repeat conduct.

And for this reason, I have suggested that we need to go back, in the investment banking area we need to go back to the system of personal liability of senior investment bankers for the debts of their firms, and that is the way it was when Salomon Brothers, Lehman Brothers, Goldman Sachs, Morgan Stanley—those were general partnerships and they were jointly and severally liable for the debts of their firms, and they did not take the types of risks that those firms take today.

My grandfather was an investment banker. He had a small shop, it folded, and he paid back the creditors. He paid back every single penny. And then when he was a partner of a larger firm, the same thing. They were jointly and severally liable, and they didn't behave the way they do today.

And that is why I proposed in some materials described in my written testimony that we need to take very seriously the need for personal responsibility, and that may mean personal liability for the people who are in charge.

[The prepared statement of Professor Painter can be found on page 95 of the appendix.]

Dr. HAYWORTH. Thank you, sir. And now Mr. Kenneth Rosen, professor of law at the University of Alabama School of Law.

STATEMENT OF KENNETH M. ROSEN, PROFESSOR OF LAW, UNIVERSITY OF ALABAMA SCHOOL OF LAW

Mr. ROSEN. Thank you, Madam Chairwoman, and Ranking Member Frank. I appreciate the opportunity to testify on the use of settlements by financial regulators.

Settlements constitute a crucial part of the enforcement process, especially as regulators seek to allocate limited resources in fulfilling their missions. Accordingly, it is critical that regulators retain flexibility to settle the cases that they pursue.

My testimony will focus on the practices of the United States Securities and Exchange Commission, where I previously served as a Special Counsel. However, the issues and concerns that I raise also might prove relevant to enforcement efforts of other regulators.

Settlements constitute a longstanding part of the enforcement process. Driving settlements are calculations by litigants about their potential to win and lose cases. For regulators, settlements may be especially attractive when the alleged violator of the law accepts conditions that give the agency comfort in ceasing litigation. When actions are settled, monetary and nonmonetary consequences may be significant. Of course, requisite for successful settlement negotiations is that notwithstanding such serious consequences, the alleged offenders also view it in their best interests to settle. Possible motivators for such action might be how exactly the language of settlements is phrased, especially as it relates to acknowledgment of legal violations.

Notwithstanding the tradition of settlements, settlements are not without controversy. Last November, in *SEC* v. *Citigroup Global Markets Inc.*, a United States District Judge rejected the Commission's efforts to settle a case and sought to proceed to trial. In granting the SEC's motion to stay the proceedings below, the Second Circuit rightly recognized multiple flaws with the District Court's opinion.

The Second Circuit warned, "the scope of a court's authority to second-guess an agency's discretionary and policy-based decision to settle is at best minimal."

The Court's observation is wise because government authorities pursuing supposed wrongdoers must harness limited resources to pursue an agenda that is fair to the parties involved and that secures both goals of punishment and deterrence of future violations. The calculation of how best to serve the public interest is a difficult one, and great deference to the agency seems merited as it pursues its mission.

Although a District Court might view individual settlements as "pocket change" to large financial institutions, others certainly can view payment of hundreds of millions of dollars as significant, and as a punishment for potential future violators to avoid.

It also seems useful to note that avoidance of an admission of guilt in a settlement does not necessarily equate to avoidance of reputational harm for the institution that settles.

Although frustration with the economic crisis might lead some to seek more restrictions on financial agencies' abilities to enter settlements, discretion to settle remains an important regulatory tool. Indeed at a time of rapidly shifting regulatory landscapes in light of the crisis, such discretion may be more important than ever.

Informing an agency's decision to consider settlement might be genuine concern about the understanding of what constitutes a violation as rules rapidly change. Settlement may permit agencies to ameliorate the consequences of confusion during regulatory transitions. While some might seek rigid outcomes or language in settlements related to new rule violations, efforts to impose such rigidity might incentivize odd results. Agencies might opt out of pursuing violations when results would be dictated in a settlement process related to such violations. This might further fray investor confidence.

The enforcement process certainly remains subject to possible improvements. However, if enforcement efforts seem inadequate, one should focus on the effectiveness of efforts to detect wrongdoing and the actions of officials actually charged with pursuing wrongdoers. Review of settlements in individual cases seems a second-best solution for changing how the enforcement process generally operates.

Moreover, enforcement is only one of a modern financial agency's many difficult tasks. As limited resources are taxed by other legislatively mandated actions, agencies may, by necessity, have to pull back on some enforcement efforts. Settlements likely will remain a vital tool for agencies to have some regulatory impact without expending the full resources involved with taking all enforcement actions to trial or administrative completion.

Thank you again for the opportunity to testify, and I welcome the chance to answer your questions.

[The prepared statement of Professor Rosen can be found on page 101 of the appendix.]

Dr. HAYWORTH. Thank you, sir. The Chair yields 5 minutes to herself.

Secretary Galvin, the recidivism rate that you would cite would be what, roughly?

Mr. GALVIN. I think in terms of the firms, many of the large firms are constantly coming in with different types of violations. I think more than the firms themselves, the fundamental problem that we keep seeing reappearing is treatment of customers unfairly in different ways. For instance, in my testimony I cited the settlement we just reached last year with Goldman Sachs on the so-called huddles, where, in effect, they were distinguishing between their preferred customers, giving them better information than their other customers.

Go back to 2003 when we had the market timing on mutual funds. It was really the same thing.

Dr. HAYWORTH. Okay, but—

Mr. GALVIN. So essentially, the firms are doing the same thing. They see no deterrent in having paid fines and being caught doing it before.

Dr. HAYWORTH. But would you say it is occurring at a rate of more than 50 percent?

Mr. GALVIN. I would say so, yes. We don't find, very rarely—I have a wide range of entities that are licensed, obviously many smaller ones who are less likely to return because the effect of this would be much more damaging to them if they have to pay damages. But the larger firms frequently are coming back with situations.

And the attitude doesn't change. That is the problem. That is my concern about the idea that they admit or deny is something that is acceptable.

Dr. HAYWORTH. Or perhaps the nature of the penalties could change or, as Mr. Painter says, joint and several liability mechanism might be appropriate.

Mr. GALVIN. I agree with him.

Dr. HAYWORTH. But another question, do you think in terms of the whole issue of admission—and this is for each of you, maybe we will start with you, Professor Rosen, since there is this question of secondary lawsuits or proceedings, civil liability that might be crippling, do you think that would act as a deterrent from admitting wrongdoing and thereby prolong a process that might lead to litigation instead of settlement?

Mr. ROSEN. Yes, I think that is really a concern. It is interesting if you look at the text of Judge Rakoff's opinion. One of the things that seems to give him great concern about the language is the fact that when one puts that language in, one doesn't essentially estop future use of that particular case from private litigations; but ultimately, that might make it attractive to the defendant in the SEC's case to engage in a settlement.

Once you take that away, you are starting to limit the upside. And, again, settlement has to be viewed as something that is mutually recognized by both parties to be in their interests.

Dr. HAYWORTH. Right, and it is essentially. It is a compromise, as we have said in the Second Circuit's opinion and that makes sense. Professor Painter?

Mr. PAINTER. Right. An admission of guilt is an admission to plaintiff lawsuits, and that is one of the biggest problems I have with requiring the SEC to insist on an admission of guilt. It drags the SEC into a battle between the large banks and other defendants and the plaintiffs' bar. And it is a battle that is extremely expensive and the SEC has very limited resources to deal with it. The defendants will dig their heels in, and they will burn up the SEC's resources fighting these cases.

Dr. HAYWORTH. And Professor Painter and Professor Rosen have both mentioned SEC resources in specific ways, if you will, Professor Painter, with regard to funding, you feel that the level of funding is not adequate to cover what the SEC needs to do in this world, and Professor Rosen, you have said we need better detection.

So do you think that if we could devote resources to detection, certainly it comes into play. And when we think about the eponymous law for our ranking member, many people have said if we had better detection and enforcement of antecedent law prior to Dodd-Frank, then we might have been able to deter some of the consequences that some of us fear from that law.

Your comments, Professor Rosen?

Mr. ROSEN. Yes, I think that detection is really such a critical thing in this particular instance. In fact, one of the things that was interesting in the prior panel of looking at the different types of regulators, is that the SEC versus the prudential-type regulators, the SEC actually has a compliance office as well, OCIE, which conducts examinations and thinking about those issues is important.

I would be worried that in some ways, our focus on the exact language of settlement becomes a distractor to try to better address those kinds of inspections issues and also the issues with enforcement at the Enforcement Division, which as Mr. Khuzami pointed out has really changed how it goes about enforcement quite drastically in the last year or so.

Dr. HAYWORTH. And our technology keeps changing so we have better tools. I yield to the ranking member.

Mr. FRANK. Thank you. Let me ask, obviously you have a decisionmaking any given day and then you have to look at the whole system. Sometimes you may decide to try to change the behavior—even if it would be a cost in the short term—basically what I have in mind is what would you guys all think about, in one egregious case where the SEC was pretty sure to respond—in the case of bankers you are exactly right, you don't want to bring a case that is going to set you a bad precedent, that is very clear—but what about in a very clear case if they are recalcitrant, go after them. Let them sue if you think you can win, and that might be setting a precedent for the future, that is, is there something to be said for picking a very strong case in where you can't get what you think you should get, including admissions, I think an admission—and I understand the points about reputation, but the admission can be very important. What about saying to the SEC, look, pick a strong case and make an example of somebody, not in a negative way, because you wouldn't do it unless you had a strong case and they had done things wrong and they were significant—what about that kind of approach? Say, yes, we know it is going to cost us something, but we think if we can bring this strong case and win, that can have a good impact on potential settlements going forward.

Mr. Galvin?

Mr. GALVIN. I definitely think so. One of the concerns I have, and this goes to the prior question from the lady from New York, I believe, I think the system is inverted when it doesn't put the investors first. In other words, I heard the testimony of Mr. Khuzami about how they used some of the results of the settlements. I think the SEC needs more authority to put money directly back in the hands of the investors. I don't think the experience with the so-called fair funds event have been that effective.

Secondly, as far as the financing of the agency, I would also suggest that the SEC should be able to retain some of the revenue that they get as a result of fines and employ—put costs on some of these they have to pursue. Why shouldn't the violators pay for some of the costs of enforcement? It seems to me—

Mr. FRANK. Let me respond to that. The SEC, of course, does levy fees and they make money for the Federal Government. I appreciate, Professor Painter, your point about raising the fee. But I would say to the Secretary, he will know, when I talk about New Bedford, that our problem with some of that is, if you give an enforcement agency the ability to levy fines and then spend some of them, I do worry about the incentive in that situation.

Mr. GALVIN. With scrutiny.

Mr. FRANK. Let me add—Professor Painter, I very much agree with—let me ask, what about the scenario of saying okay, this is a strong case, and we are going to take it and we understand it is going to spend some resources, but we think winning this case will be helpful in the future in terms of their attitude?

Mr. PAINTER. I think they should do that. When they have a strong case, they should fight that case and win when they are very confident they can do that. But there are a number of these cases where there are ambiguities.

Mr. FRANK. I agree with that. Mr. Rosen—

Mr. PAINTER. But the second point I want to make clear is that they need to hold the individuals responsible. For Citigroup shareholders to pay $285 million may not be what we need to do. We need to take it out—

Mr. FRANK. Let me ask you and then I will go to Professor Rosen, because on that point, I very much appreciate your testimony. The waiver point is a very strong point, and I intend to write to the SEC and say they ought to be very strict about the waivers. I appreciate that. That is one of those things where experts help us.

On the individual responsibility, I very much again appreciate that point. I note you say in the testimony—and I would ask you not to do anything right now—I would ask you to take a look at this, not off the top of your head.

We did include in the financial reform bill a provision that instructed every regulator of the financial institution to require that they have compensation practices that had good facts, that said that you would end the situation of a bonus in which heads, I win, and tails, I break even.

Is there some way to use that authority not to prescribe anything by the Federal Government but for the regulators to give a very strong incentive to the institutions to do the kind of individual responsibility. That is, is there some way to say under that authority you should say in the compensation package that an individual executive or a group who are responsible for that kind of a serious loss ought to bear some of the financial pain themselves?

Mr. PAINTER. I believe to some extent they could if it is a claw back of the bonus that is covered by the specific provision that you are talking about. My concern is that may not be enough and, as

I said, these investment banks in the old days were general partnerships.

Mr. FRANK. I appreciate that, and that might be a start on that and I think that might be—Professor Rosen, what about the scenario of saying, "Okay, this is one strong case, so we are going to fight you, we are going to spend a little money, but we think that may help for the future?"

Mr. ROSEN. Yes, I don't disagree with that. In fact, in talking today about the need for the discretion of the SEC and other regulators to settle, I think they also need the discretion to go forward with cases where they see they are relevant, and, in fact, I think that having served at the Commission, the folks who are there are very strategic in making those decisions and trying to get those proper precedents out there.

Mr. FRANK. I think we all agree that greater resources would give them the flexibility to make that kind of a decision.

Mr. SCHWEIKERT [presiding]. Thank you, Ranking Member Frank.

Mr. Rosen, can I come straight to where you just—doesn't the SEC still have that discretion to pursue a settlement or to say, this one is so egregious that we are going after them criminally?

Mr. ROSEN. Yes, absolutely. I guess the point—

Mr. SCHWEIKERT. It was just your tone, I just wanted to make sure I wasn't—not being burdened with a law school education.

Mr. ROSEN. Sure. I think that sometimes, like I said, the danger of this discussion of the settlements is it is almost a distractor from everything else that is out there and it is important to remember that discretion as well, to actually bring the cases when necessary.

Mr. SCHWEIKERT. Thank you. For anyone on the panel, have any of you engaged in a case over the last couple of years where there was settlement action at the SEC level but from a State level or an individual actor that the decision was we are going to go after them either civilly or criminally on a separate track?

Mr. Galvin?

Mr. GALVIN. We often work with the SEC. Usually, we try to coordinate our activities and we do, but sometimes we choose to go on cases that the SEC has passed on or perhaps has not gotten to yet. I can think of a number of instances where we initiated an issue and the SEC later joined in.

So I don't think it is always necessarily that—the range of possibilities is broad. As I said in my formal testimony, we try first and foremost to get restitution for our investors who have been defrauded. We do try to get an admission, and we succeed in many instances. We would sacrifice an admission if we thought it would help get restitution, so it is not a hard and fast rule.

My concern, and I voiced this earlier, was that to the extent that the discussion seemed to be with the earlier panel that there were alternatives that could not be mixed, I disagree with that. I think no one is suggesting, at least I am not suggesting, and I don't know of anyone who is suggesting, that in every case the SEC must get an admission; that is not the issue. The issue is, in my opinion, the that this has been too easy in denying admissions or seeking admissions.

Mr. SCHWEIKERT. Mr. Painter, your observations of what you have experienced?

Mr. PAINTER. I have seen cases pursued by the State that are not pursued by the SEC. Often, they involve a smaller number of investors, and I believe that the State enforcement is critical, a critical supplement to what the SEC is doing. And in Minnesota we benefit from what Secretary Galvin is doing in Massachusetts. It is important to the whole country that there be effective State enforcement.

Mr. SCHWEIKERT. Mr. Rosen?

Mr. ROSEN. Yes, I will go a little bit into professorial mode here.

Mr. SCHWEIKERT. Uh-oh.

Mr. ROSEN. And one of the things that I stress in my course in securities regulation is not to forget the States. I think sometimes folks become so fixated on the Federal regulatory system that they forget that the States do have this authority, particularly as it relates to antifraud actions.

Mr. SCHWEIKERT. Your specialties and what you see happening from an academic standpoint and what is actually happening in the States, Mr. Galvin, I almost heard you sound as if sometimes you will do a triage decision, saying, look, the SEC is doing this, they are not pursuing this person, you are going to go after this bad actor. Was I reading more into what you were saying?

Mr. GALVIN. No, it may be the same, it could be multiple companies or multiple entities doing the same thing. They may choose to go after a large national company, we may choose to go after local actors. Obviously, the trigger for us is that in general our State, investors from our State have been affected. But in working with the other State regulators, we often trigger national efforts. For instance, I mentioned the auction rates securities matter, which is more a matter of liquidity than anything else, but it was the States that really led the way there in terms of taking action to get liquidity for its investors.

The SEC was very helpful because you do need a national regulator. I am a firm, I am very concerned about the SEC's ability to do what it needs to do. I think that is very important. States can't substitute themselves for the SEC. On the other hand, the States can be supplementary, and I think in many instances, we are.

Mr. SCHWEIKERT. Mr. Painter?

Mr. PAINTER. I strongly agree.

The work at the States is very important, particularly in light of the restricted budget of the SEC.

Mr. SCHWEIKERT. But my scenario, we know the SEC is going after these national players, you may have someone who has committed similar acts. Will you sort of triage who you pursue and say, look, they are going after them, I have other States and we have the same player. I am just sort of trying to understand the decisionmaking at the State level.

Mr. PAINTER. I think that is the approach, and it would make sense to have coordination. The problem is a lot of different factors may feed into whether a State decides to pursue actions or the SEC, so you may have both at the same time. You may have overkill in some cases and in other cases nothing happens.

Mr. SCHWEIKERT. With unanimous consent, I am going to give myself another 2 minutes.

No one argued.

I have two other questions. Forgive me for keeping you longer. How often will a decision to pursue at the State level be because you see coordinated action amongst a number of States or States within a certain region? Particularly for where you are, if your neighboring States are pursuing something, will that often be what draws you in?

Mr. GALVIN. Not necessarily. Usually, it is an investor from Massachusetts or a case we become aware of.

Mr. SCHWEIKERT. You beat me to the second half and that was how often will it be an investor or private action taking place that hits your radar that also draws you in?

Mr. GALVIN. It is primarily, sometimes it is our national practice we become aware of, like I mentioned, the auction rate securities situation. However, most often, it is an individual investor who comes to us with a specific issue or complaint.

We also do books and records examinations of companies. So we do some additional work where we discover things in the course of our books and records examinations as well that lead us to investigations.

Mr. SCHWEIKERT. Mr. Painter?

Mr. PAINTER. I do not know specifically what is being done in the States on that, but I believe that what Secretary Galvin is saying seems consistent with what I have heard is happening in other States.

Mr. SCHWEIKERT. Mr. Rosen, your perception from even some of the research and things that hit your desk, is it because they see motion in other States or there is a complainant or a filed complaint at the State level? What do you see draws much of the State regulators in?

Mr. ROSEN. Again, on some levels, it is sort of more speculation, not actually sitting in the offices with those regulators, but I think that what Mr. Galvin is saying makes sense and I think all of the above really can come into play. I think that as a typical matter, when regulators decide to pursue issues, some of those issues are ones that they generate through their own investigation, which is why I think that investigation is so important, but others are where they read the Wall Street Journal also and find it. And particularly now that we see a movement towards greater I think situations of universal settlements and so forth, once the bandwagon starts rolling along, there might be more prominence given to what is going on in particular litigation that might attract attention from other State regulators.

Mr. SCHWEIKERT. Gentlemen, I have to say "thank you" to you and to the previous panel. This actually has turned out to be a much more interesting day than I ever expected it to be. So I have learned some things.

Now, I have to read the script.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

And with that, this hearing is adjourned. Thank you gentlemen.

[Whereupon, at 1:05 p.m., the hearing was adjourned.]

A P P E N D I X

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Statement by

Scott G. Alvarez

General Counsel

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

May 17, 2012

Introduction

Chairman Bachus, Ranking Member Frank, and members of the Committee, thank you for the opportunity to discuss the Federal Reserve's enforcement program. Authority to take enforcement actions is one of the important tools Congress has provided the Federal Reserve to require financial institutions under its jurisdiction to address serious problems or risks that are found during the course of the supervisory process.

The Federal Reserve has supervisory authority over state member banks, bank holding companies, savings and loan holding companies, and subsidiaries of these holding companies, as well as foreign banks that operate branches, agencies, and certain other offices in the United States. The Federal Reserve's basic supervisory responsibility is to oversee the financial soundness of these institutions and their adherence to applicable banking laws. To this end, we monitor the largest of these institutions on a continuous basis and routinely conduct inspections and examinations of all of these firms to encourage their safe and sound operation. The vast majority of the Federal Reserve's supervisory actions address unsafe and unsound banking practices and are integrated into our supervision and examination process.

Over the past ten years, the Federal Reserve has taken nearly 1,000 formal, public enforcement actions, which includes the issuance of more than 600 written agreements and 100 cease-and-desist orders against the institutions and individuals subject to our jurisdiction. During this same period, in response to some of the more serious banking practices and suspected violations of law, the Federal Reserve has assessed more than 100 civil money penalties and restitution payments totaling more than $1.2 billion. Moreover, our investigations of insiders have led to the permanent ban of more than 80 individuals from the banking industry, including untrustworthy loan officers and traders, directors, and other banking officials.

Enforcement Tools

The statutory scheme established by Congress confers on the Federal Reserve and the other bank regulators a broad array of both informal and formal enforcement tools to be exercised at appropriate points throughout the course of the supervisory process. The primary means for addressing supervisory concerns at regulated financial institutions is informally during the ordinary course of the routine examination process.

The Federal Reserve examines, on a regular basis, institutions for which we have been granted supervisory authority by Congress and, through that authority, has complete and unfettered access to an institution's most sensitive financial information and processes, including information that would otherwise be privileged and not subject to public disclosure. Thus, many problems are identified and corrected during the examination process while examiners are still on site. These types of informal actions are well suited to address safety and soundness deficiencies or violations of law that bank supervisors believe can be readily corrected by the institution's management.

Enforcement measures may escalate depending on the severity or difficulty of the problem. Problems that cannot be corrected immediately will be formally reported to the institution in the examination report or in a supervisory letter as matters requiring management's attention and corrective action. These matters are presented to the institution's board of directors, which is charged with ensuring that management addresses and corrects them. Supervision staff will subsequently follow management's actions to ensure that the problem is corrected. If a problem requires a more detailed resolution or is more pervasive at an institution, the Federal Reserve may enter into a memorandum of understanding with the financial institution in which the board of directors commits to specific actions to correct potentially unsafe and unsound banking practices or possible violations of laws or regulations.

Unsafe and unsound practices and violations of banking laws found during the course of the supervisory process are usually resolved using the informal methods described above; however, an institution's failure to remedy an unsafe or unsound practice or comply with banking laws can subject the institution to the formal enforcement measures provided by Congress to the Federal Reserve and our fellow federal banking regulators. For example, in instances where a financial institution's management is recalcitrant in addressing a supervisory issue or the condition of the bank has become less than satisfactory, the Federal Reserve may enter into a formal written agreement, which is statutorily enforceable by assessing civil money penalties or imposing other sanctions.

On occasion, the Federal Reserve has also confronted situations where a financial institution's management either refuses to correct an unsafe or unsound practice or to comply with applicable laws or regulations, or where the practice or alleged violation is so widespread or so serious that normal recourse to informal supervisory methods is not appropriate or sufficient. In these cases, the Federal Reserve will commence more formal types of enforcement action against the regulated financial institution and its institution-affiliated parties.

These more formal remedies include, among other things, imposing orders directing the financial institution or its institution-affiliated parties to cease and desist from engaging in the improper or prohibited conduct, directing the firm to take certain actions to return to safe and sound banking practices, and, where appropriate, requiring the firm to make restitution or provide reimbursement, indemnification, or guaranty to third parties harmed by the wrongful conduct.[1] The Federal Reserve may also remove an institution-affiliated party from the banking institution and prohibit the party from participating in banking at other financial institutions.[2] Finally, we may determine that the assessment of civil money penalties is appropriate against either the offending institution or an institution-affiliated party.[3]

The Federal Reserve may commence a formal investigation to determine whether more stringent enforcement action is appropriate. This investigative authority, which complements our statutory examination authority, empowers designated Federal Reserve staff to issue subpoenas to take sworn witness testimony and compel the production of relevant documents necessary to establishing a factual basis for the alleged misconduct. These investigations usually involve circumstances where relevant information cannot readily be obtained through the normal supervisory process and that are more likely to result in a contested action.

Resolving Enforcement Actions

The vast majority of the Federal Reserve's formal enforcement actions are resolved upon consent, which is fully consistent with the goal of resolving supervisory concerns with bank management quickly and firmly. In crafting enforcement actions that are entered by consent, the Federal Reserve typically sets out summary recitations of the relevant facts in "Whereas" clause provisions; however, like our fellow banking regulators, it has not been our practice to require formal admissions to the misconduct addressed in our enforcement orders given the remedial nature of our enforcement program. Requiring admissions of fact and legal conclusions as a condition of entering into a consent action is likely to have a deleterious effect on our supervisory efforts by causing more institutions and individuals to challenge the requested relief

[1] 12 U.S.C. 1818(b)
[2] 12 U.S.C. 1818(e)
[3] See 12 U.S.C. 1818(i)

in contested administrative proceedings, which typically take years to reach final resolution, and which could delay implementation of necessary corrective action.

The enforcement authority of the Federal Reserve and the other banking agencies is different in significant respects from that of some other federal financial institution regulators. For example, in order to foster the soundness and stability of financial institutions and the nation's financial system, bank regulatory agencies must act quickly and effectively to address safety and soundness issues as well as potential violations of law. Moreover, safety and soundness concerns typically do not give rise to third-party claims and often require remedial action by banking institutions to address risks and conditions that are subjective in nature. Thus, the effectiveness of the regulatory framework established for financial institutions does not depend on actions brought by third parties to enforce their rights under the regulatory scheme.

Where an enforcement action cannot be resolved by consent, the Board may issue a formal notice of charges, which sets forth the factual basis for the remedy sought by the Board. The respondents named in the notice of charges in these cases are accorded the opportunity to answer the charges and request a formal hearing before an administrative law judge. Administrative hearings may be public and entitle the respondent to full and complete discovery of the information that forms the basis for the Federal Reserve's charges as well as the opportunity to present evidence at a formal trial-like hearing presided over by an administrative law judge. At the conclusion of the hearing, the administrative law judge will prepare a recommended decision including findings of fact and conclusions of law that is then presented to the Board for final adjudication and issuance of a final decision. Respondents may appeal the Board's decision to a federal court of appeals.

Only 11 of the nearly 1,000 enforcement actions taken by the Federal Reserve in the last decade were not resolved by consent. The Federal Reserve sought removal from banking of current or former institution-affiliated parties in eight of these contested cases, and sought compulsory cease-and-desist relief in the remaining three cases. Seven of the 11 cases went through the full administrative hearing process, while the remaining four were settled upon consent just prior to the scheduled administrative hearing. In the cases where a consent settlement was not reached, the contested action typically required an additional six months to two years to reach final resolution.

To the extent that there is noncompliance with one of our enforcement orders, we are statutorily authorized to apply to the appropriate federal district court for enforcement of the order.[4] The Federal Reserve also takes past conduct into account in determining both the level of enforcement action we will take and the type of corrective or punitive action we will require. Individuals who knowingly fail to comply with one of our final enforcement orders suspending them from office or prohibiting them from participation in the banking industry may be referred for criminal prosecution by the Department of Justice.[5]

Coordinating State and Federal Enforcement

In the exercise of our enforcement authority, the Federal Reserve works closely with other state and federal banking regulators, as well as other state and federal law enforcement agencies, on enforcement matters that raise issues within their respective jurisdiction. These efforts have led to many successful coordinated enforcement actions with these agency counterparts.

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[4] 12 U.S.C. 1818(i)
[5] 12 U.S.C. 1818(j)

The Federal Reserve refers matters that come to our attention during the supervisory process to other appropriate federal and state agencies, including law enforcement authorities.[6] We also provide technical assistance to other federal and state law enforcement authorities where violations of criminal or other laws may occur within their jurisdiction involving our regulated institutions.

Conclusion

The Federal Reserve's enforcement program serves the important purpose of addressing serious problems found in the normal course of our supervision and regulation of the financial institutions under our jurisdiction. It is a critical component of our authority to ensure safe and sound banking practices and enforce compliance with the banking laws.

Thank you for the opportunity to provide this information to the Committee. I would be happy to answer any questions you may have.

[6] Historically, fair lending matters have been referred to the Department of Justice and fair housing violations have been referred to the Department of Housing and Urban Development. Now, most consumer law matters will be referred to the Consumer Financial Protection Bureau as provided by statute.

Testimony of William F. Galvin
Secretary of the Commonwealth of Massachusetts

Before the Committee on Financial Services
U.S. House of Representatives
May 17, 2012

Examining Settlement Practices of U.S. Financial Regulators

Chairman Bachus, Ranking Member Frank, and other members of the Committee, thank you for this opportunity to discuss regulatory settlements in the financial services industry.

I am Bill Galvin, Secretary of the Commonwealth and Chief Securities Regulator of Massachusetts.

Regulation without effective enforcement makes such regulation little more than political rhetoric and, worse, leads to a false sense of financial security for our citizens.

My Securities Division carries out an active program of civil enforcement in order to detect and stamp out securities fraud. These enforcement actions have returned over 400 million dollars directly back to defrauded investors. As our reputation for effective securities enforcement has grown, we have deterred fraud from entering our state – promoters of many stock frauds do not want to risk dealing with our Enforcement Section, and they stay out of Massachusetts.

I have long spoken out against the established pattern in federal settlements of allowing respondents to enter into settlements where they neither admit nor deny the allegations in the administrative complaint for the enforcement action. In 2003, I had the opportunity to testify before a subcommittee of the U.S. Subcommittee on Government Affairs. I said at that time, "too often the guilty neither admit or deny any wrongdoing and routinely promise not to cheat again until they can come up with a more clever method to do what they just said they would not do again."

I repeat these words today with even a greater sense of urgency as events of recent days have shown.

One of the priorities of the Securities Division is that firms and persons that have violated laws should be required to acknowledge what they have done. Permitting a firm to enter into a settlement where it pays a fine, but neither admits nor denies that it has done anything wrong, permits that firm to avoid basic culpability for its actions. In some instances, we have seen firms enter into regulatory settlements, pay large fines, and also issue press releases stating that the firm settled the matter in order to "avoid the distractions" created by prolonged litigation. Permitting firms to take this kind of posture allows the firms to avoid acknowledging their misconduct and permits such firms to publicly take the stance that such settlements are part of business as usual.

If we intend to reform the worst practices in the financial industry, then the firms that have violated the law must acknowledge that what they have done is wrong.

The settlement of enforcement actions involves the evaluation and balancing of many factors. Settling a case is a dynamic process that requires considerable skill and persistence. In many cases, there is a thin line between arriving at a satisfactory settlement and failing to reach any settlement at all.

In determining the resolution of any case, the Massachusetts Securities Division gives the highest priority to the protection of investors. We do not pursue or resolve cases to enhance our prestige. Acting in the public interest and protecting retail investors are our paramount concerns.

Restitution and Other Remedies

However, in many cases, the best resolution we can achieve is to require an issuer of securities or securities broker to repay defrauded investors and make them whole.

One of the greatest satisfactions of my role is getting restitution for investors, and preventing the operators of financial frauds from simply walking away from their victims with their ill-gotten profits. Obtaining such restitution for investors means that they will be able to recoup their financial nest eggs: they will be able to cover college costs, they will be able to fund their retirements, or they will have the funds needed to pay the costs of long-term care. When we have obtained restitution for investors, in many cases we have saved them from financial ruin.

Our enforcement actions also seek other sanctions and remedies. We have imposed significant fines designed to deter future violations of the law and to serve as a warning to the industry that misconduct will not be tolerated.

In 2011, the Division settled the Goldman Sachs "analyst huddles" case, which involved the practice of Goldman Sachs giving its best research recommendations to preferred customers in order to attract more business from those customers. This practice gave some Goldman customers unfair advantages over other customers. Goldman settled the case by agreeing to reform its practices and by paying a 10 million dollar fine. In the settlement, Goldman admitted the factual allegations in the Consent Order, which we believe will deter Goldman and other firms from engaging in the same sorts of conflicts in the future.

Massachusetts participated in a national settlement of cases relating to improper sales of auction rate securities by three major brokerage firms. In that settlement we prioritized restitution: the firms neither admitted nor denied the facts that were alleged, but the firms agreed to repurchase those securities from investors, paying 19.6 billion dollars in restitution.

In the Securities Division's case against Fairfield Greenwich, a Madoff feeder fund, the respondents did not admit or deny the facts that were alleged. However, in that settlement, Fairfield Greenwich again agreed to make full restitution to Massachusetts investors. We gave high priority to getting restitution for investors in order to protect their interests in a situation that was rapidly deteriorating.

Between 2003 and 2012, total investor restitution of $404,037,375 was paid directly to investors in Securities Division cases. This does not include amounts paid in the multi-state settlement of the auction rate securities cases.

We have also suspended or revoked the licenses of bad actors in the securities industry. We have required firms to adopt remedial measures and special supervision procedures to address compliance problems.

Balancing Policy Factors in Settlements

The Securities Division must consider an array of factors in negotiating the settlement of an enforcement action.

The key factor is whether we can get restitution for investors and the amount of that restitution. We also give high priority to requiring that the respondent broker or firm admit the wrongdoing that led to the enforcement action.

We do consider other factors as well. Often, we can make a strong statement to the marketplace and deter others from violating the law if we can settle a case quickly and decisively. Collecting significant civil fines can affect the bottom lines of these firms and can deter other potential violators. Because our agency has limited resources, a good settlement will free those resources to pursue other complaints.

In settlement negotiations, we always seek to settle on strong terms and to make investors whole.

The Massachusetts Securities Division analyzed the 82 Consent Orders (settlements) it has entered into from 2003 to the present.

Based on this analysis, the respondents admitted to the facts that the Securities Division alleged in its administrative complaint in more than 40% of the cases.

The Securities Division places a high priority on getting restitution for defrauded investors. This results in a clear variation in the number of respondents who admit to facts in cases where restitution is paid, and in those cases where no restitution is paid. Restitution was paid in connection with 42 consent orders, a majority of settlements. In the cases where no restitution was paid, nearly half of respondents admitted to the alleged facts.

Judicial Review

While the courts play an important role in overseeing civil cases filed by the SEC and in approving settlements of those cases, the courts must not second guess SEC settlement policy. I have spoken out to urge the SEC to be more assertive in the area of requiring respondents to admit wrongdoing. I continue to believe this is a valuable tool to enforce the securities laws in a meaningful way.

This hearing addresses the recent rejection of a proposed settlement between the SEC and Citigroup by Judge Rakoff, of the Southern District Court in New York. Judge Rakoff's rejection of the settlement is being appealed by both parties, and the District Court proceeding is stayed. Judge Rakoff raised important and valuable questions about the settlement. The Judge particularly questioned why Citigroup should be able to settle very serious charges without any requirement that they admit what they had done. While many of the Judge's concerns were valid, by rejecting the settlement, he inappropriately substituted his own assessment of those issues for the assessment made by the SEC.

The SEC must maintain its independence on these issues. Those who in this case champion this Judge's view of this settlement should remember that once SEC independence is compromised, a different Judge in another case could weaken SEC settlement terms. As an executive agency, in the absence of obvious error, the SEC must be able to decide which matters to investigate, which cases to litigate, which charges to bring, and the terms of any settlements.

As the head of a securities regulatory agency, I understand the complex factors that go into the terms of a settlement. These include: limited agency resources, the anticipated testimony of witnesses, potentially uncertain issues of case law, the potential dissipation of funds available for restitution, and the activity of other regulators. Weighing these factors is the particular province of a regulatory agency –it will not serve the public interest or protect investors to permit courts to reject regulatory settlements based on a judge's sense that he would not have made the decisions that the regulatory agency made.

The Value of Requiring Admissions

Through my past public statements and through the way that the Massachusetts Securities Division handles its cases, my Office has taken a strong stand that persons and companies that have violated the law should admit what they have done. Dealing with other people's funds is a position of trust. Anyone who violates that trust should expect to be appropriately punished for violating the law – this includes a requirement to admit those violations. Requiring such admissions is a powerful tool to correct past bad conduct and to deter future violations. This requirement is absolutely in the public interest and promotes the protection of investors.

Thank you for this opportunity to testify. I will address any questions you have.

Testimony on "Examining the Settlement Practices of U.S. Financial Regulators"

by

Robert Khuzami
Director of the Division of Enforcement
U.S. Securities and Exchange Commission

before the

Committee on Financial Services
U.S. House of Representatives
May 17, 2012

Chairman Bachus, Ranking Member Frank, and Members of the Committee: I appreciate the opportunity to testify on behalf of the U.S. Securities and Exchange Commission regarding the Commission's practices concerning settled enforcement actions.

While numbers alone do not capture the breadth of the Commission's work, the SEC's enforcement program is achieving significant results. During FY 2011, the Commission filed 735 enforcement actions – more than the SEC has ever filed in a single year. In addition, the SEC obtained orders in FY 2011 for $2.8 billion in penalties and disgorgement. During the same period, the SEC filed 146 enforcement actions related to investment advisers and investment companies, a single-year record and a 30 percent increase over FY 2010. Also in FY 2011, the SEC filed 57 insider trading actions, a nearly eight percent increase over last year's total. And lastly, the SEC in FY 2011 brought 112 enforcement actions related to broker-dealers, a 60 percent increase over the prior fiscal year. Cases arising out of the financial crisis have been a particular priority of the Enforcement Division: to date, we have filed actions against 102 individuals and entities, naming 55 CEOs, CFOs, and other senior corporate officers, and obtaining orders for $2 billion.[1] Of course, statistics are just one consideration regarding the efficacy of an enforcement program, and one must also consider various qualitative factors as well. More significant than the number of cases filed is the fact that numerous cases filed by the Enforcement Division from FY 2009 through the present involve highly complex financial products, market practices, and transactions where the investor harm is great, the investigatory hurdles are significant, and the perpetrators most elusive.

As set forth more fully below, the SEC's settlement policies, like our Enforcement program more broadly, help protect investors. These policies, including the practice of

[1]Additional information concerning the SEC's financial crisis-related enforcement actions is available at http://www.sec.gov/spotlight/enf-actions-fc.shtml. Additional information concerning SEC enforcement actions filed in FY 2011 is available at http://www.sec.gov/news/press/2011/2011-234.htm ("SEC Enforcement Division Produces Record Results in Safeguarding Investors and Markets") and http://www.sec.gov/about/secpar2011.shtml ("SEC FY 2011 Performance and Accountability Report").

permitting defendants in appropriate circumstances to settle matters on a "neither-admit-nor-deny" basis, are common not just across federal financial agencies, but across federal agencies more generally, and they serve the critical enforcement goals of accountability, deterrence, investor protection, and compensation to harmed investors. It is for these reasons that federal courts across the country have repeatedly approved settlements including "neither-admit-nor-deny" provisions.

The SEC's Approach to Settlement

Under existing policy, the Division of Enforcement recommends that the Commission settle a case only when our informed judgment tells us that the settlement agreement is within the range of outcomes we reasonably can expect if we litigate through trial. In making that determination, we take into account many factors, including: (i) the strength of the evidence and the potential defenses, including the possibility that the Commission might not prevail at trial, or prevail but be awarded less than the proposed settlement achieves; (ii) the delay in returning funds to harmed investors caused by litigation; and (iii) the resources required for a trial, including, most importantly, the opportunity costs of litigating rather than devoting those resources to investigating other cases.

This approach to settlement serves the important goals of accountability, deterrence, investor protection, and compensation to harmed investors. With respect to accountability, before the Division recommends an enforcement action, Enforcement staff spends months or years building a case by gathering evidence, analyzing relevant documents, interviewing witnesses, and assessing possible defenses. In addition, potential defendants have the opportunity to present their defenses to the Commission in the form of a Wells Submission. Thus, the decision by the Commission to initiate an action – settled or litigated – is made with the benefit of a comprehensive evidentiary record and a full and fair opportunity to evaluate the risks of bringing the action. Moreover, SEC settlements are accompanied by a civil Complaint or an administrative Order Instituting Proceedings where the facts painstakingly gathered by the SEC staff – facts that reveal both the wrongdoing and the wrongdoers – are set forth in great detail. Through this process, we ensure that the decision to settle is an informed one; that wrongdoers are held accountable through the public dissemination of information about their misconduct; that, where appropriate, private litigants are able to utilize the SEC's detailed allegations to assist their own cases; and that the public sees that wrongdoers suffer penalties, bars, and other sanctions at a point in time when the misconduct is still fresh in their minds.

The immediacy of sanctions offered by a settlement also sends a strong message of deterrence. Quick action by law enforcement communicates to other potential wrongdoers that those who violate the law face swift and certain sanctions. Conversely, the longer the passage of time between misconduct and sanctions, the more diluted the deterrence message becomes.

Similarly, appropriate settlements provide investors with greater protection, since violators are more quickly sanctioned in a manner that decreases the likelihood that they will commit future violations. This minimizes the chance that other investors will be victimized. This is particularly true where the settlement includes associational bars prohibiting violators from continuing to work in the securities industry or from serving as an officer or director of a public company.

Lastly, settlements return funds to harmed investors with increased speed and certainty. Even the strongest case can suffer unexpected outcomes in litigation, creating risk and uncertainty. The risks include not just a potential negative outcome at trial, but also the possibility that the SEC obtains lesser remedies after a successful trial than those being offered in a negotiated settlement. Settlement avoids these risks, and allows for a more expeditious distribution of funds to harmed investors, since the delay inherent in litigation is avoided. Such delays can be quite substantial, given the huge backlog of civil cases awaiting trial in federal courts. Indeed, the most recently available statistics indicate that the median time interval for disposition of civil cases across all U.S. federal district courts ranges from 19 months to 44 months.[2]

We recognize that to achieve appropriate settlements satisfying all four of these goals, potential defendants need to know that we are prepared to litigate cases in the event an appropriate settlement cannot be obtained. For that reason, the Enforcement Division has improved its capacity to bring cases to trial, and stands ready and willing to file our cases unsettled where settlement terms are unsatisfactory. For example, 75 percent of the SEC's financial crisis-related cases filed against individuals, including CEOs, CFOs and other high-ranking executives of companies, were filed as litigated actions. The fact that such a high percentage of cases are in litigation strongly suggests that some number of settlements were available but rejected by the SEC as inadequate. And when the Commission does litigate, our trial teams are largely successful. Our record of litigation victories – we have prevailed against defendants in 84 percent of our trials since the beginning of fiscal year 2010 – sends a strong message to defendants and those who may contemplate securities law violations in the future. This approach seems to be working. A recent independent study by NERA Economic Consulting concluded that the median monetary value of the Commission's settlements in fiscal 2011 was at or near its highest levels since the enactment of the Sarbanes-Oxley Act in 2002.[3] All of the above metrics – more litigated cases, more trial victories and higher monetary settlements – support the conclusion that we settle a case when it makes sense to do so, and litigate when it does not.

Many other federal agencies also resolve cases through negotiated settlements and consent judgments.[4] For example, in recent years, the EEOC resolved 80 percent of its cases and

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[2] Statistics identifying median time intervals from filing to disposition of civil cases by district and method of disposition for the 12-month period ending March 31, 2011 *available at* http://www.uscourts.gov/Viewer.aspx?doc=/uscourts/Statistics/FederalJudicialCaseloadStatistics/2011/tables/C05Mar11.pdf

[3] Gulker, Buckberg and Overdahl, *SEC Settlement Trends: 2011 Update*, NERA Economic Consulting, January 23, 2012, *available at* http://www.securitieslitigationtrends.com/PUB_SEC_Trends_2H11_0112.pdf.

[4] Negotiated settlements submitted to a court for approval and entry of a judgment, such as those entered into by the SEC and other federal agencies, are called consent judgments or consent decrees. Consent judgments are unique forms of settlement because they possess "attributes both of contracts and of judicial decrees." *United States v. ITT Continental Baking Co.*, 420 U.S. 223, 236 n.10 (1975). Fundamentally, consent judgments "embod[y] a

the FTC resolved 80 percent of its antitrust actions by consent judgment.[5] The "vast majority" of civil antitrust cases brought by the Department of Justice are resolved in this fashion.[6]

The availability of settlements or consent judgments is crucial for agencies and courts. In 1973, at a time when the SEC brought far fewer enforcement actions than it currently does, the Second Circuit Court of Appeals recognized that the Commission "can bring the large number of enforcement actions it does *only* because in all but a few cases consent decrees are entered."[7] Courts also benefit because consent judgments conserve judicial resources, which is a primary reason for the "strong federal policy favoring the approval and enforcement of consent decrees."[8] By "lessening docket congestion," consent decrees "make[] it possible for the judicial system to operate more efficiently and more fairly while affording plaintiffs an opportunity to obtain relief at an earlier time."[9]

"Neither-Admit-Nor-Deny" Settlements are Both Common and Sound Public Policy

The SEC, like many other federal agencies without criminal prosecution authority, settles cases and obtains consent judgments on a "neither-admit-nor-deny" basis. This means that, while a defendant is not required to admit to the SEC's allegations of wrongdoing, it also is not permitted to deny the factual allegations in the SEC's Complaint or Order Instituting Proceedings as part of a negotiated settlement or consent judgment.

Consent judgments in which "none of the issues are actually litigated" – because the defendants do not admit, or outright deny, the factual allegations or liability – are the norm.[10] As one leading legal treatise states, the "central characteristic of a consent judgment is that the court has not actually resolved the substance of the issues presented."[11]

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compromise." *United States v. Armour & Co.*, 402 U.S. 673, 681 (1971) that, like any settlement, reflects a "balance of advantages and disadvantages." *SEC v. Clifton*, 700 F.2d 744, 748 (D.C. Cir. 1983).

[5] U.S. EEOC, *Office of the General Counsel Fiscal Year 2009 Annual Report*, at 62 (2009); U.S. FTC, *The FTC in 2010*, at 2 (2010).

[6] Acting Principal Deputy Assistant Attorney General John M. Nannes, *Termination, Modification, and Enforcement of Antitrust Consent Decrees*, 15 ANTITRUST 55, 55 (2000).

[7] *SEC v. Everest Mgmt. Corp.*, 475 F.2d 1236, 1240 (2d Cir. 1973) (emphasis added).

[8] *Wang*, 944 F.2d at 85; *Anita Foundations, Inc. v. ILGWU Nat'l Retirement Fund*, 902 F.2d 185, 190 (2d Cir. 1990) (settlements "represent compromise and conservation of judicial resources, two concepts highly regarded in American jurisprudence").

[9] *Evans v. Jeff D.*, 475 U.S. 717, 760 n.15 (1986).

[10] RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1982).

[11] 18A Wright and Miller, FEDERAL PRACTICE AND PROCEDURE § 4443, at 256–57 (2d ed. 2002).

The Supreme Court has recognized that defendants entering into injunctive consent judgments "often admit to no violation of the law."[12] In describing one consent decree, which stated that nothing in the decree was "intended to constitute an admission of fault," the Supreme Court stated that it was "customary" that "the consent decree did not purport to adjudicate" the plaintiff's claims.[13] Indeed, the Supreme Court has discussed consent judgments containing similar provisions without any suggestion that they are unfair, unreasonable, inadequate, or not in the public interest.[14]

Many federal agencies negotiate settlements in federal court and administrative proceedings containing "no admit" provisions. Several recent examples include:

- A settlement between the CFTC and Goldman Sachs Clearing & Execution, L.P. announced on March 13, 2012 where Goldman Sachs agreed to pay a $7 million fine for supervision failures and the settlement documents stated that *"[w]ithout admitting or denying any of the findings or conclusions herein,* Goldman Sachs Execution and Clearing, L.P. consents to the entry of this Order ..."[15]

- A settlement between the FDIC and certain directors and officers of Washington Mutual announced on December 15, 2011 where the settlement documents provided that it *"shall not be deemed to constitute an admission by Defendants of fault, liability, or wrongdoing ..."*[16]

- A consent order imposed by the Federal Reserve against Morgan Stanley announced on April 3, 2012 to address a pattern of misconduct and negligence in residential mortgage loan servicing and foreclosure practices at its subsidiary, Saxon Mortgages Services, Inc. where the consent order states that *"without this Order constituting an admission* by [Morgan Stanley], Saxon, or their subsidiaries of any allegation made or implied by the Board of Governors in connection with this matter ..."[17]

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[12] *ITT Continental Baking*, 420 U.S. at 236 n.10.

[13] *Maher v. Gagne*, 448 U.S. 122, 126 n.8 (1980).

[14] *See, e.g., Swift & Co. v. United States*, 276 U.S. 311 (1928) (refusing to vacate consent judgment in which defendant denied allegations of complaint); *United States v. Armour & Co.*, 402 U.S. 673 (1971) (addressing same consent judgment); *accord Arizona v. California*, 530 U.S. 392, 414 (2000); *Suter v. Artist M.*, 503 U.S. 347, 354 n.6 (1992); *Firefighters Local No. 1784 v. Stotts*, 467 U.S. 561, 565, 577 (1984); *United States v. Atlantic Refining Co.*, 360 U.S. 19, 23 & n.3 (1959); *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 141 n.3 (1948).

[15] *Available at* http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfgoldmanorder031312.pdf.

[16] *Available at* http://www.fdic.gov/news/news/press/2011/pr11192.html.

[17] *Available at* http://www.federalreserve.gov/newsevents/press/enforcement/20120403b.htm

In addition, while the SEC does not permit denials of wrongdoing by defendants in its settled enforcement actions, some federal agencies do permit such denials in the context of settlements. Recent examples include:

- A civil settlement with Bank of America announced by the Department of Justice on December 21, 2011 in which Bank of America agreed to pay $335 million in a fair-lending settlement concerning Countrywide's loan practices where the settlement documents provided that "the Defendants *deny all of the allegations and claims* of a pattern or practice of discrimination in violation of the FHA and ECOA as set forth in the United States' Complaint."[18]

- A settlement with Facebook announced by the FTC on November 29, 2011 in which Facebook agreed to settle charges that it "deceived consumers by failing to keep privacy promises" where the settlement documents provide that "Respondent *expressly denies the allegations* set forth in the complaint, except for the jurisdictional facts."[19]

Indeed, the SEC goes one step further and not only prohibits defendants from denying wrongdoing in a settlement, but has demanded a retraction or correction on those occasions when a defendant's post-settlement statements are tantamount to a denial.[20]

There is little dispute that if "neither-admit-nor-deny" settlements were eliminated, and cases could be resolved only if the defendant admitted the facts constituting the violation, or was found liable by a court or jury, there would be far fewer settlements, and much greater delay in resolving matters and bringing relief to harmed investors. The reality is that many companies likely would refuse to settle cases if they were required to affirmatively admit unlawful conduct or facts related to that conduct. This is because such admissions would not only expose them to additional lawsuits by private litigants seeking damages, but would also risk a "collateral estoppel" effect in such lawsuits. This means that a defendant could, as a result of the admission in the SEC settlement, be precluded from challenging liability in the private civil litigation. In addition, and most significantly, such an admission can help to establish elements of criminal liability, since many federal securities laws provide for both civil and criminal liability for the same violation. At a minimum, the risks of increased civil and criminal liability that flow from an admission in an SEC action are sufficiently real that defendants are highly unlikely to settle, if at all, until those risks have passed or are quantified and deemed acceptable.

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[18] *Available at* http://www.justice.gov/crt/about/hce/documents/countrywidesettle.pdf.

[19] *Available at* http://ftc.gov/opa/2011/11/privacysettlement.shtm.

[20] For example, in April 2003, after participating with several Wall Street firms in an global settlement with the Commission and state regulators, Morgan Stanley, through its CEO, Phillip Purcell, downplayed the seriousness of the charges against it and attempted to characterize itself as less culpable than other settling firms. In response, SEC Chairman Donaldson sharply rebuked Purcell, reminding him that "the [C]omission would regard a violation [of the duty not to deny the Commission's findings] as seriously as a failure to comply with any other term of the settlement." Purcell then issued a letter expressing regret and stating that the firm would not deny the allegations. *See* Floyd Norris, Morgan Stanley Draws SEC's Ire, THE NEW YORK TIMES, May 2, 203, Section A., Col. 1, Business/Financial Desk p. 1.

To be clear, the Commission has no sympathy for alleged securities law violators, or for the increased legal risks those companies or other defendants may face if required to admit wrongdoing as a condition of settlement. While some assert admissions may provide marginally increased accountability, the fact is that requiring admissions as a condition of settlement would likely result in longer delays before victims are compensated, dilution of the deterrent impact of sanctions imposed because of the passage of time, and the expenditure of significant SEC resources that could instead be spent stopping the next fraud. All of these are the very real costs of refusing to settle cases where we otherwise have obtained most or all of the sanctions and other remedies available to compensate and protect harmed members of the public.

The Commission discussed these costs, as well as the other factors that the Commission considers when deciding whether to settle any particular case, as part of its filings in the *Citigroup* case, which is currently on appeal before the United States Court of Appeals for the Second Circuit. The Commission charged Citigroup with violating the Securities Act of 1933 and simultaneously entered into a proposed consent judgment with Citigroup that resolved these charges. Through the consent judgment, which contained "neither admit nor deny" language, the Commission obtained most of what it could have obtained after a successful trial, including injunctive relief and $285 million in disgorgement, interest, and penalties. The district court rejected the consent judgment because, in the district court's words, it was not based on "facts, established by admissions or by trials."

The Commission appealed to the Second Circuit. To avoid wasting resources on a trial that would not occur if the district court's ruling were reversed, the Commission sought to stay the district court proceedings pending appeal. The Second Circuit granted the Commission's request on March 15, 2012. In its stay order, which is not dispositive, the Second Circuit held that the Commission had "made a strong showing of likelihood of success" on the merits, stating that it knew "of no precedent" supporting the proposition that admissions are a precondition for the approval of a consent judgment and finding it "doubtful" that the district court properly deferred to the Commission's judgment that the settlement was in the public interest.

The Second Circuit's preliminary decision also acknowledged the "numerous factors" that inform the Commission's exercise of this judgment, explaining that these factors "include the value of the particular proposed compromise, the perceived likelihood of obtaining a still better settlement, the prospects of coming out better, or worse, after a full trial, and the resources that would need to be expended in the attempt." The Commission's decision to settle also features "an assessment of how the public interest is best served," and the Second Circuit saw "no basis to doubt that the SEC's decision was in the public interest." Indeed, the Commission takes seriously its responsibility to assess whether a proposed settlement serves the public interest and in our view we exercise this authority with due consideration.

The reasons described above are among the factors weighed by the Commission when resolving cases though negotiated settlements and consent judgments on a "neither-admit-nor-deny" basis. And these reasons are among the reasons why federal courts across the country have time and again approved settlements by federal agencies containing "neither-admit-nor-deny" terms, or terms providing for the outright denial of allegations. In enforcing the securities,[21] antitrust,[22] environmental,[23] consumer protection,[24] public health,[25] and civil rights laws,[26] federal courts have entered consent judgments in actions resolved by federal agencies

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[21] Nearly all of the largest injunctive consent judgments proposed by the Commission and approved in federal court in 2010 and 2011 contain "neither-admit-nor-deny" clauses. *See, e.g.*, *SEC v. Alexander* (E.D.N.Y. Nov. 30, 2010) ($54 million) http://sec.gov/litigation/litreleases/2010/lr21753.htm; *SEC v. JP Morgan Secs. LLC*, (D.N.J. Jul. 7, 2011) ($51 million) http://sec.gov/litigation/litreleases/2011/lr22031.htm; *SEC v. Johnson & Johnson*, (D.D.C. Apr. 13, 2011) ($49 million) http://sec.gov/litigation/litreleases/2011/lr21922.htm; *SEC v. UBS Fin. Servs.*, (D.N.J. May 6, 2011) ($47 million) http://sec.gov/litigation/litreleases/2011/lr21956.htm; *SEC v. Alcatel-Lucent, SA*, (S.D. Fla. Dec. 30, 2010) ($45 million) http://sec.gov/litigation/litreleases/2010/lr21795.htm; *SEC v. ENI, S.p.A*, (S.D. Tex. Jul. 20, 2010) ($125 million) http://sec.gov/litigation/litreleases/2010/lr21588.htm; *SEC v. Technip*, (S.D. Tex. Jul. 9, 2010) ($98 million) http://sec.gov/litigation/litreleases/2010/lr21578.htm; *SEC v. Citigroup Inc.*, (D.D.C. Oct. 8, 2010) ($75 million) http://sec.gov/litigation/litreleases/2010/lr21605.htm; *SEC v. ABB Ltd.*, (D.D.C. Oct. 12, 2010) ($39 million) http://sec.gov/litigation/litreleases/2010/lr21673.htm; *SEC v. Diebold, Inc.*, (D.D.C. Jun. 14, 2010) ($25 million) http://sec.gov/litigation/litreleases/2010/lr21543.htm; *SEC v. General Elec. Co.*, No. (D.D.C. Jul. 30, 2010) ($23 million) http://sec.gov/litigation/litreleases/2010/lr21602.htm; *SEC v. Pequot Capital Mgmt.*, (D. Conn. Jun. 2, 2010) ($23 million) http://sec.gov/litigation/litreleases/2010/lr21540.htm.

[22] Antitrust consent decrees in which a defendant does not admit or outright denies liability or the allegations in the complaint have restructured entire industries, significantly affecting the economy. RICHARD A. EPSTEIN, ANTITRUST CONSENT DECREES IN THEORY AND PRACTICE 1 (2007). In *United States v. Microsoft*, the Department of Justice used the "not uncommon technique" of entering into a consent decree to resolve allegations that Microsoft unlawfully monopolized the market for operating systems for IBM-compatible PCs. 56 F.3d 1448, 1451–52 (D.C. Cir. 1995). The district court rejected the proposed consent decree and criticized the absence of an admission. The D.C. Circuit reversed, holding that the judge's "criticism of Microsoft for declining to admit that the practices charged in the complaint actually violated the antitrust laws" was "unjustified." *Id.* In addition, "no admit" clauses were central to consent decrees that fundamentally altered the meatpacking industry, *Swift*, 276 U.S. at 320; that dismantled AT&T, one of the world's largest corporations at the time, *United States v. AT&T*, 552 F. Supp. 131, 143 (D.D.C. 1982) (decree "would not constitute any evidence against, an admission by, or an estoppel against AT&T"), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983); that forced IBM to license its patents and spin off its service business, *United States v. IBM Corp.*, No. 72-344 (S.D.N.Y. Jan. 25, 1956) (consenting to judgment "without any admission by either party with respect to any such issue"); and that resolved charges of price fixing asserted against six American airlines, *United States v. Airline Tariff Publ'g Co.*, 1994 U.S. Dist. Lexis 11904 (D.D.C. Aug. 10, 1994) (consent judgment would "not be evidence against or an admission by any party with respect to any issue of fact or law").

[23] *See, e.g.*, *United States v. American Electric Power Serv. Corp.*, No. 99-1250 (S.D. Ohio Dec. 10, 2007) (In this largest consent judgment in EPA history (measured by the cost of the injunctive relief), the defendant, which denied that it violated the Clean Air Act or was liable "for civil penalties or injunctive relief," agreed to spend approximately $4.6 billion to cut emissions and to pay a $15 million penalty); *United States v. BP Prods. North America Inc.*, No. 4:10-cv-3569 (S.D. Tex. Dec. 30, 2010) (BP resolved charges that it violated the Clear Air Act in connection with the Texas City refinery explosion, which killed 15 people and injured 170, by entering into a consent judgment that ordered it to undertake an array of remedial measures and pay one of the largest civil penalties ever assessed for Clean Air Act violations at an individual facility. BP consented "without the adjudication or admission of any issue of fact or law" and did "not admit any liability to the United States arising out of the allegations in the complaint."); *United States v. Massey Energy Co.*, No. 07-2999 (S.D. W.Va. Apr. 9, 2008) (defendants, who did "not admit any liability," agreed to undertake various remedial measures and pay a $20 million penalty, one of the largest ever penalties for wastewater discharge violations); *United States v. Caterpillar, Inc.*, No. 98-02544 (D.D.C. Jul. 1, 1999), cited by *United States v. Caterpillar, Inc.*, 2002 U.S. Dist. Lexis 468, at *7 (D.D.C. Jan. 17, 2002) (a group of defendants, which denied violating the Clean Air Act, agreed to spend nearly $1 billion dollars in remediation and pay a $83.4 million penalty); *United States v. Koch Indus.*, No. H-95-1118 (S.D. Tex. Mar. 7, 2000) (defendant, which did "not admit to any liability," resolved claims related to over 300 oil spills by agreeing to clean up the spills and pay a $30 million penalty, one of the largest penalties ever imposed upon a single company).

through negotiated settlements that may require the payment of significant penalties, imposition of substantial injunctive relief, and a prohibition against future violations of the law, among other things, but in which a defendant does not admit, or outright denies, factual allegations.

Recent Modifications to "Neither-Admit-Nor-Deny" Resolutions are Narrow in Scope

As noted, federal agencies commonly use, and federal courts commonly approve, settlements of civil enforcement actions on terms that do not require admissions, all to sound public policy effect. In light in the special situation where an SEC civil action may also involve a parallel criminal action, senior officials in the Division of Enforcement recently undertook a review of the "neither-admit-nor-deny" settlement policy. While reaffirming the policy more generally, as a result of this review, the Division, after consulting with the Commission, modified its policy to eliminate "neither-admit-nor-deny" language that could be construed as inconsistent with admissions or findings made in a parallel criminal proceeding.[27] In other words, it seemed unwarranted for there to be a "neither-admit-nor-deny" provision in those cases where a defendant had already admitted to, or been criminally convicted of, conduct that formed the basis of a parallel civil enforcement proceeding.

As a result of this change, the SEC will no longer include "neither-admit-nor-deny" language in those settlements where there is a parallel criminal conviction (by plea or verdict) involving factual or legal claims that overlap to some degree with the factual or legal claims set out in the Commission's Complaint or Order Instituting Proceedings. This change will only affect a minority of cases, and does not affect our traditional "neither-admit-nor-deny" approach

[24] *FTC v. Countrywide Home Loans*, No. 10-4193 (C.D. Cal. Jun. 15, 2010) (Countrywide Home Loans, "without admitting any of the allegations" that it overcharged 500,000 borrowers, entered into a consent judgment in which it agreed to be enjoined from engaging in certain conduct, to change its lending practices, and to pay $108 million); *United States v. Choicepoint, Inc.*, No. 1:06-cv-0198 (N.D. Ga. Feb. 15, 2006) (ChoicePoint, a data broker accused of unlawfully disclosing the records of nearly 200,000 consumers, agreed to injunctive relief and payment of the largest-ever civil penalty imposed by the FTC as part of a consent judgment that stated, "Defendant makes no admissions to, and denies, the allegations in the complaint.").

[25] Consent decrees between the FDA and biomedical firms accused of violating the Food, Drug, and Cosmetic Act contain similar disclaimers of admissions and liability. In one consent judgment, Abbott Laboratories agreed to pay a $100 million fine and to cease manufacturing over 50 diagnostic products "without admitting the allegations of the Complaint." *United States v. Abbott Laboratories*, No. 99 C 7135 (N.D. Ill. Nov. 2, 1999). Schering-Plough paid a $500 million fine—the largest at the time—and halted production of nearly 75 drugs "without admitting or denying the allegations of the Complaint and disclaiming any liability in connection herewith." *United States v. Schering-Plough Corp.*, No. C 02-2397 (JAP) (D.N.J. May 20, 2002).

[26] The approval of consent judgments that order significant injunctive relief without admissions by defendants—or with outright denials by defendants—also occurs with great frequency in the civil rights context. As just one example among many, state and municipal law enforcement agencies have altered their policing practices as a result of approved consent judgments in which the law enforcement agencies denied allegations of unconstitutional conduct by police officers. *E.g.*, *United States v. City of Los Angeles*, No. 00-11769 GF (C.D. Cal. Jun. 15, 2001) ("defendants deny the allegations in the complaint"); *United States v. New Jersey*, No. 99-5970 (D.N.J. Dec. 30, 1999) (the State "denies" the allegations).

[27] January 7, 2012 statement by Robert Khuzami on this policy change available at http://www.sec.gov/news/speech/2012/spch010712rsk.htm

in settlements that do not involve criminal convictions or admissions of criminal law violations.[28]

Conclusion

In sum, settling enforcement actions in appropriate circumstances allows the Commission to advance its investor protection mandate effectively and efficiently. We agree to settlements when the terms reflect what we reasonably believe we could obtain if we litigate through trial without the risk of delay and uncertainty that comes with litigation. Equally important, this settlement approach provides public accountability closer in time to securities laws violations with a detailed SEC Complaint or Order outlining the facts developed through a comprehensive investigation and identifying the wrongdoers by name. Settlements result in the prompt payment of disgorgement and penalties (which can be returned to injured investors), and the timely imposition of industry bars or other appropriate relief on wrongdoers, which protects investors and sends a strong deterrent message to the public. Our approach also preserves resources that we can use to stop other frauds and protect other victims. This approach, like the approach of other federal agencies, may require some measure of reasonable compromise, but is calibrated to redress wrongs committed by securities law violators, preclude wrongdoers from working with the investing public in the future, reform company practices, deter similar misconduct by others, and return funds directly to harmed investors in a timely manner.

Thank you for the opportunity to be here today. I am happy to answer any questions.

[28] A respondent in an SEC action recently admitted limited factual findings that were admitted for the purpose of a state civil enforcement consent order, while otherwise neither admitting nor denying the SEC's findings. *See* http://www.sec.gov/news/press/2012/2012-61.htm (press release describing SEC action against Goldman Sachs & Co charging that Goldman lacked adequate policies and procedures to address the risks posed by research "huddles" with a parallel action by the Massachusetts Securities Division).

EMBARGOED UNTIL DELIVERY

STATEMENT OF

RICHARD J. OSTERMAN, Jr.
DEPUTY GENERAL COUNSEL
FEDERAL DEPOSIT INSURANCE CORPORATION

on

EXAMINING THE SETTLEMENT PRACTICES
OF U.S. FINANCIAL REGULATORS

before the

COMMITTEE ON FINANCIAL SERVICES

May 17, 2012
2128 Rayburn House Office Building

Chairman Bachus, Ranking Member Frank, and members of the Committee, thank you for the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) about our settlement practices. In my testimony, I will discuss the FDIC's approach to enforcement and the tools we have available, as well as the public interest benefits derived from our enforcement policies and practices.

The core mission of the FDIC is to maintain stability and public confidence in the nation's banking system. As recent events have reminded us, the financial condition of banks influences the economy in direct, substantial and often immediate ways and, mindful of this, the FDIC is robust in its supervision of insured depository institutions and in correcting unsafe and unsound practices, violations of law, and breaches of fiduciary duty.

Among banking regulators, the combination of the FDIC's responsibilities as insurer, supervisor, and receiver is unique. As supervisor, the FDIC is the primary federal regulator for state banks that are not members of the Federal Reserve System, as well as state chartered savings associations. Presently, the FDIC directly supervises 4,115 insured state nonmember banks and 444 insured state-chartered savings associations, and by statute, in its role as insurer, has back-up enforcement authority for the rest of the over 7,000 FDIC-insured depository institutions. In addition, the FDIC acts as receiver for all failed insured depository institutions and, under the Dodd-Frank Act, has substantial responsibilities for large complex financial companies that may pose a systemic risk to the financial system.

The FDIC, like the other federal banking agencies has been given strong enforcement powers under section 8 of the Federal Deposit Insurance Act (FDI Act). These powers are used by the FDIC when corrective action is needed to protect consumers, the banking industry, and the financial institution itself from harm.

The FDIC's highly-trained examiner corps regularly examines FDIC-supervised depository institutions to ensure they are operated in a safe and sound manner in compliance with state and federal banking laws and regulations, including all consumer protection laws. When FDIC examiners find violations of law, breaches of fiduciary duty, or unsafe and unsound practices, including mismanagement and insider abuses, the FDIC requires corrective action, notably through removal and prohibition orders, the assessment of civil money penalties or cease-and-desist orders which may also include restitution.

From 2007 through 2011, the FDIC issued approximately 1,000 Cease-and-Desist Orders and 377 Removal and/or Prohibition Orders, as well as 753 Civil Money Penalties. These individual enforcement actions were based on a wide range of harm or risks caused to insured depository institutions and consumers.

Enforcement Process

Many of the FDIC's enforcement orders are issued based upon a stipulation between the FDIC and the respondent in which the respondent neither "admits nor denies" the allegations. Such consent orders are issued only after a thorough evaluation of the pertinent evidence to ensure that the FDIC's case against the respondent meets all of the statutory factors required to initiate an action and sustain a *prima facie* case. Consideration is given, among other things, to the particular facts and evidence in the case, the likelihood of success should the case proceed to litigation, the best way to meet our objectives and obtain the recommended relief, as well as how long it would take to get relief if the case did not settle.

The timeframe from obtaining the stipulation to issuance of an order is relatively quick, and the resulting final agency order is usually effective and enforceable immediately. Some stipulated orders, particularly cease-and-desist orders that seek quick correction of bank practices, are issued pursuant to delegated authority by appropriate managers in the FDIC's regional and area offices. Those involving restitution, civil money penalties, and removal and prohibition actions against individuals are carefully reviewed for both legal sufficiency and nationwide consistency, and then issued by the Washington office pursuant to delegated authority.

Should a respondent choose not to stipulate -- in other words, agree -- to an action, the FDIC prepares a Notice of Charges to initiate a case. While Notices of Charges seeking cease-and-desist orders are normally issued by the FDIC's Regional Offices under delegated authority, Notices to remove an individual from banking, require restitution, or impose civil money penalties are reviewed by the FDIC's Case Review Committee[1] before being issued. Once a case is filed, the procedures are governed by the

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[1] The Case Review Committee is a standing committee of the FDIC Board, and serves to review in advance and approve the initiation under delegated authority of certain

FDIC's formal Rules of Practice and Procedure. Specifically, a hearing is held before an administrative law judge (ALJ) and the ALJ's recommended decision is reviewed by the FDIC's Board of Directors which then issues a final decision and order. Stipulated final orders and those entered after a hearing are both published, which provides notice to the industry and to the public of a bank's practices and individuals' misconduct and its consequences.

Removal and Prohibition and Civil Money Penalty Orders

As noted earlier in the testimony, one of the corrective actions for which Congress granted the FDIC authority is the removal and prohibition from the business of banking, found in section 8(e) of the FDI Act. The FDIC has issued hundreds of removal and prohibition orders against institution-affiliated parties who were determined to have dishonestly or recklessly engaged in violations of law, unsafe or unsound practices or breaches of fiduciary duty and caused losses to the institution they were meant to serve or benefited themselves at the institution's expense. An 8(e) order prohibits the individual from participation in any manner in banking under a lifetime, industry-wide ban. This powerful tool serves to address past conduct while also protecting the industry as a whole.

Appropriately, the statutory requirements to bring a removal or prohibition action are quite stringent. The FDIC must determine that the respondent has engaged in violations of law, unsafe or unsound practices or breaches of fiduciary duty that resulted

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enforcement actions.

in a benefit to them or a loss to the institution or prejudice to depositors. In addition, the FDIC must determine that the conduct involved personal dishonesty or willful or continuing disregard for the safety and soundness of the institution.

Although most FDIC removal and prohibition action orders are issued on consent, the orders specifically state that a determination has been made by the agency that a respondent's actions meet each of the foregoing statutory elements. Thus, while a respondent who stipulates to an order does not technically admit the conduct, it is clear to the public and the industry that the FDIC has determined it can make a *prima facie* case that the respondent has engaged in egregious actions that the FDIC believes warrant the imposition of a very severe and immediate remedy—a lifetime bar from banking.

In the context of removal and prohibition, stipulated orders serve the public interest in several ways. Our experience has been that the time between initiation of the case and the final decision effecting a remedy is often two to three years, given the time frames for response, discovery and litigation of a contested case before an ALJ, including review of the ALJ's recommended decision by the FDIC's Board of Directors and issuance of a final decision and order. During this time, respondents still employed in the banking industry may remain in their positions with the possibility of committing more harm. In contrast, a person subject to a stipulated removal and prohibition order is precluded from participating in banking *immediately* upon the order's issuance.

The FDIC believes that requiring a respondent to specifically admit the alleged conduct in a settlement may have the unintended consequence of frustrating its goals. Many respondents would be hesitant to admit the conduct, and respondents' attorneys cannot reasonably support settlements that require admissions if their clients are potentially exposed to additional civil liability, or criminal action. Thus requiring admission of liability is likely to reduce the number of settlements, and to push the parties in remaining cases toward settling based on admission of the absolute minimum necessary to sustain a case. Furthermore, insisting on an admission of liability is likely to result in protracted negotiations regarding settlement, thus precluding a principal benefit of settlement—obtaining prompt relief. Additionally, given finite agency resources, if there are fewer settlements it would mean that, in total, we would be able to pursue fewer cases overall.

Stipulated civil money penalty orders often accompany removal and prohibition actions, as a means of further deterrence. The FDIC uses its enforcement authority to assess civil money penalties against institutions and institution-affiliated parties when we have found violations of law, unsafe or unsound practices or breaches of fiduciary duty, with a progressive increase in penalty amount as the egregiousness of the conduct increases. In considering the civil money penalty amount, the FDIC must take into account statutorily-mandated factors, including the size of the financial resources and good faith of the respondent, the gravity of the violation, and the history of previous violations. Civil money penalties collected are paid to the U.S. Treasury.

Cease-and-Desist Orders

Cease and desist orders are used by the FDIC as an enforcement tool for corrective action in several significant contexts. One of those contexts is when banks are in a troubled condition. As noted, since 2007, the FDIC has issued approximately 1,000 cease-and-desist orders to halt and correct violations of law and unsafe or unsound banking practices and to strengthen the capital position of the institutions it supervises, and thus to achieve better health of the industry overall. Most of these are orders against institutions that are in troubled condition, with many of them posing an elevated risk of failure if their problems are not corrected. Such orders set forth a detailed corrective plan, a virtual "road map" for the institution to follow to correct practices and to raise capital to return the institution to a safe and sound condition. While the institution neither admits nor denies the unsafe or unsound practices or violations that are the subject of the cease and desist order, the order does recite that the FDIC has reason to believe the requisite statutory elements[2] are present, and each corrective action that is ordered is based upon a specific examination finding.

Prompt action in such cases is essential to avoid the loss to the insurance fund, and the cost to communities and the economic system as a whole, that arise when a bank fails. Without the ability to settle a case quickly, the length of time to obtain relief in a contested case could, in many cases, render the relief ineffective. Additionally, the FDIC has the power through cease-and-desist actions to order affirmative relief, including ordering an insured depository institution or institution-affiliated party who was unjustly enriched to make restitution.

[2] Cease-and-desist actions require that the FDIC have a reason to believe that an institution or institution-affiliated party is engaging or has engaged, or is about to engage, in unsafe or unsound practices; or is violating, has violated or is about to violate law, rule or regulation, or any condition imposed in writing by the agency in connection with any action on an application, notice or other request, or any written agreement entered into with the agency. For restitution, the FDIC must prove the party was unjustly enriched in connection with such violation or practice or acted in reckless disregard of the law, applicable regulations or prior order of the agency.

The power to seek restitution can be particularly important when an institution or institution-affiliated party violates consumer protection laws and regulations, such as Section 5 of the Federal Trade Commission Act (prohibiting unfair or deceptive acts and practices), the Truth in Lending Act, the Truth in Savings Act, the Real Estate Settlement Procedures Act, among others. Where material violations of these consumer protection provisions are identified, FDIC seeks remedies that typically include cease-and-desist orders as well as restitution and civil money penalties. Depending on the severity of the violation and the extent of consumer harm, the amount of restitution sought for consumers can be substantial. In these consumer cases, orders for restitution are vehicles for consumer redress. Therefore, the FDIC has that additional interest in issuing such orders as quickly as possible.

Additionally, when violations involve fair lending laws, such as the Equal Credit Opportunity Act and the Fair Housing Act, the FDIC first determines whether the institution or institution-affiliated party engaged in a "pattern or practice" violation. If so, the FDIC will refer the case to the United States Department of Justice. If the violation is not a pattern or practice violation, or if the Department of Justice returns a case to the FDIC, the FDIC can pursue the enforcement remedies outlined above, assuming the statutory elements are met.

Professional Liability Cases

The FDIC also brings professional liability cases on behalf of the receiver of banks that have been closed by federal or state regulators. These cases serve a very different purpose than enforcement cases brought by the FDIC and the other banking agencies. Professional liability cases are civil tort and contract actions that seek recovery for damages caused to failed banks by their officers and directors, and by professionals working for the failed banks such as lawyers and accountants. Recoveries are used to pay claims against the receivership estate in accordance with statutory priorities set out by Congress, which provide first for payment of the receiver's administrative expenses, second for any deposit liability and third for general creditor claims.

The FDIC, consistent with its responsibilities as receiver, uses the most cost-effective approach available to obtain the maximum monetary relief in professional liability cases, whether this proves to be litigation or settlement. The FDIC has litigated certain cases for many years, including through appeal, when it has determined that it is cost-effective to do so. But most professional liability cases—like most civil litigation by other parties—settle, and the money is paid to the FDIC without a concession by the defendant regarding culpability.

SEC v. Citigroup Global Markets

The FDIC is aware of both the District Court and the Second Circuit decisions in the *U.S. Securities & Exchange Commission v. Citigroup Global Markets, Inc.* case. The FDIC is not a party to the case, does not have all of the facts, and thus is not in a position to express an opinion regarding the merits of the decisions. In response to the Committee's request for comment on the matter, we would note that the case is still before the Second Circuit, and that the Circuit has stayed the proceedings below, pending a decision on appeal regarding the order rejecting the settlement.

By statute, FDIC administrative enforcement actions, if not settled, proceed to hearing before an administrative law judge, and ultimately to final decision and order by the FDIC's Board of Directors, rather than trial in district court. As a consequence, we are very unlikely to be in the same position the SEC is in the *Citigroup* case. As indicated elsewhere in our testimony, it has been our experience that we are better able to accomplish the purposes of our statute by agreeing to 'neither admit nor deny' language in our settlements, which ultimately results in our imposing regulatory consequences on respondent's actions without the delays, resource costs, and litigation risks that would be involved if we insisted on admissions of liability as a condition to accepting a settlement.

Conclusion

In conclusion, we believe that the FDIC's process accomplishes its statutory responsibilities and purpose, while ensuring that the actions it takes serve the public interest and are prompt, effective and cost-efficient.

Testimony of Richard W. Painter

Before the United States House of Representatives Committee on Financial Services

10:00 AM Thursday May 17, 2012

Hearing on Examining the Settlement Practices of U.S. Financial Regulators

I have worked in private practice in New York and Connecticut for five years and taught securities law for seventeen years. For two and half years I served as the chief ethics lawyer for the White House under President Bush. I am familiar with the S.E.C. enforcement regime and private litigation that often grows out of S.E.C. enforcement actions. I have testified several times before the House and Senate on class action securities litigation and other aspects of federal securities law.

I agree with the Second Circuit's opinion in *SEC v. Citigroup Global Markets Inc.*[1] The S.E.C. needs discretion to decide how limited enforcement resources should be used in a way that maximizes investor protection. Federal courts should not define the way the S.E.C. litigates and settles cases. Congress also should resist the temptation to micromanage S.E.C. decision making in specific cases or even in broad categories of cases.[2]

Specific areas of concern include the following:

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[1] After investigating Citigroup's marketing of collateralized debt obligations, the S.E.C. sued Citigroup in the Southern District of New York for negligent misrepresentation. The S.E.C. and Citigroup then proposed a consent judgment under which Citigroup would pay $285 million to compensate investors, be enjoined from violating the securities laws, and establish procedures to prevent violations. Citigroup, however, did not admit any liability. The district court rejected this settlement as "neither reasonable, nor fair, nor adequate, nor in the public interest" and criticized the S.E.C.'s policy of "allowing defendants to enter into consent judgments without admitting or denying the underlying allegations." The district court ordered the case to go to trial. Upon appeal by both parties, the Second Circuit granted a stay of this order until a separate panel of the Second Circuit could decide the merits. The Second Circuit found that Citigroup and the S.E.C. were likely to prevail and observed that "the scope of a court's authority to second-guess an agency's discretionary and policy-based decision to settle is at best minimal."

[2] Congressional policy determinations, if too rigid, can prevent the S.E.C. from responding to rapidly changing, and even dangerous, market conditions. For example in 1999 Congress provided that security based swap agreements cannot be regulated as securities. See e.g. 1933 Act Section 2A (providing in part that "The Commission is prohibited from—A. promulgating, interpreting, or enforcing rules; or B. issuing orders of general applicability; under this title in a manner that imposes or specifies reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading with respect to any security-based swap agreement . . . ."). The debacle of 2008 showed that this policy decision may have been unwise, but regulators could do relatively little about it until Congress reversed course and regulated security based swaps in the Dodd-Frank Act of 2010.

First, the S.E.C. has a limited budget and often must decide between competing priorities in both its investigations and enforcement actions. The S.E.C. cannot be everywhere all of the time. S.E.C. resources are sometimes better spent investigating potential wrongdoing than on litigating over wrongdoing that has already been investigated and exposed. At other times the S.E.C. should follow through with aggressive litigation, but only up to a point where alleged wrongdoers agree to compensate investors for losses and to take steps that prevent future wrongdoing. Making alleged wrongdoers "admit" they violated the law need not be part of such a settlement. If requiring such an admission discourages settlement, the S.E.C. will be forced to litigate cases it would rather not litigate, and often against defendants with far greater resources for litigation.

Second, large monetary settlements – such as the $285 million in the Citigroup case – make it clear to most observers that defendants did something wrong. The settling defendants at a minimum are guilty of careless business practices, most likely tainted with elements of "sharp dealing." The financial services industry is driven by business reputation, and monetary settlements, coupled with consent decrees prohibiting future violations, send a clear message that conduct was wrong. An admission to violating a specific law is not needed to get the point across to the public and to other industry participants.

Third, because of the way the securities laws are written and interpreted by the courts, legal liability may be an open question, even where defendants violated the spirit of the law. For example, it may not be clear whether a sale of securities took place inside or outside the United States, even if it is clear that the transaction was fraudulent. If the securities transaction took place outside the United States, the federal securities laws do not apply.[3] Rather than litigate over the location of the transaction, and thus over whether United States securities laws were violated or the laws of some other country were violated instead, both the S.E.C. and the alleged wrongdoer may prefer an injunction against future violations coupled with compensation of investors and/or a monetary penalty.

Another area of ambiguity is the difficulty in some cases of proving a defendant's intent or recklessness, as opposed to mere negligence, which is a critical issue in securities fraud claims under Section 10(b) of the Exchange Act.[4] Rather than litigate over whether the

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[3] See Morrison v. National Australia Bank, 130 S. Ct. 2869 (2010). Section 929P of the Dodd-Frank Act gives federal courts jurisdiction over S.E.C. and Department of Justice enforcement actions in connection with some securities transactions taking place outside the United States if the fraudulent conduct took place inside the United States.

[4] Misrepresentation claims under Section 17(a) of the 1933 Securities Act do not require a showing of the defendant's intent or recklessness, but claims under Section 10(b) of the 1934 Securities Exchange Act do require a showing of intent or recklessness. Section 17 is available to the S.E.C. in cases involving misrepresentation in the offer or sale of securities, but not for cases involving the defendant's misrepresentation in a purchase of securities, including insider trading. In these cases the S.E.C. often sues under Section 10(b) and must establish the defendant's scienter.

defendant was intentional, reckless or negligent in a Section 10(b) case, both the S.E.C. and the defendant may choose to settle on a consent decree, payment of a monetary penalty and no admission or denial of an actual violation.

Yes more areas of ambiguity include whether a particular financial instrument falls under the statutory definition of a "security" and whether fraudulent conduct was "in connection with" a securities transaction within the meaning of the statute. In each factually or legally ambiguous case, the S.E.C. and the defendant must weigh the risks of litigating and losing. For the S.E.C. the risks of losing a case include the loss of a monetary settlement for defrauded investors and the loss of an opportunity to enjoin future violations and to require specific steps that prevent violations. Another even greater risk is that a judicial opinion could respond to confusing facts with overly broad language that undermines the S.E.C.'s interpretation of the law in other cases. Confusing fact patterns often make for bad case law. The S.E.C. thus has good reason to settle such a case rather than litigate and lose not only that particular case but an entire category of related cases that could have been won later.

In sum, for the S.E.C. to litigate and lose a case with potential weaknesses can wreak havoc on the enforcement regime. The outcome may encourage wrongdoing by others who will see the S.E.C.'s loss as an opportunity to violate the same or related provisions of law with apparent impunity.

Finally, the expansive private plaintiffs' litigation regime in the United States, particularly the potential for class action lawsuits, makes it extremely unlikely that a defendant that has any decent legal defense will agree to settle a S.E.C. enforcement action when the settlement requires an admission of wrongdoing. Private plaintiffs' lawyers ride on the coattails of enforcement actions, seeking monetary damages that often exceed by many times the monetary payments specified in S.E.C. consent decrees. Admitting to a violation – particularly violation of a statutory provision for which courts have implied a private right of action – is an invitation to private suits.[5] Corporate defendants will instead take their chances litigating with the S.E.C., hoping that their enormous litigation resources will beat back the S.E.C. and also deter private plaintiffs. The S.E.C. rather than achieving a partial victory (including a monetary penalty and injunction) will thus be pulled into, and be forced to bear the brunt of, the defendant's battle with the plaintiffs' bar. In cases

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[5] Even an admission to violation of a provision for which there is no implied private right of action can be an invitation to lawsuits. For example, a defendant who admits to a violation of Section 17(a) of the Securities Act has for practical purposes admitted to most of the elements to a violation of Section 10(b) of the Exchange Act, with the exception of the requisite state of mind under Section 10(b). If a defendant has admitted to a violation of Section 17(a), a plaintiffs' lawyer thus is more likely to sue than if there is no such admission. The defendant knows this and will refuse to settle with the S.E.C. if admission of a Section 17 violation is required.

where the S.E.C. wins, plaintiffs' lawyers will take advantage of the S.E.C.'s expenditure of taxpayer funds for proving key elements of the violation. In cases where the S.E.C. loses, and cases which the S.E.C. may not bring at all because it knows there is no realistic chance of settlement, investors lose if defendants get away with conduct that still violates the securities laws.

In addition to these issues that arise in the Citigroup litigation I will point out two other issues to this Committee.

First, consent decrees – even if they do not involve admission of wrongdoing – often mean disqualification of the settling party from certain regulatory advantages for a period of time. These advantages include liberalized public offering rules for Well Known Seasoned Issuers and the Regulation A mini-registration regime that after the JOBS Act of 2012 will be made available for offerings up to $50 million. These regulations contain "bad boy" disqualifier provisions that make the exemption unavailable to issuers that have recently entered into consent decrees in SEC enforcement actions.

The S.E.C. sometimes agrees to waive these disqualification provisions when a defendant issuer settles an enforcement proceeding – in other words the issuer is permitted to continue to take advantage of one or more liberalized regulatory regimes intended only for issuers who have not recently been accused of violating the securities laws.

Waivers of these provisions should be evaluated carefully by the S.E.C. before they are granted as part of a settlement. They should not be routine. These waivers also should be explained carefully to the parties in the case and to the investing public. A common justification for such waivers is that the settling party committed the alleged violation in connection with securities other than its own, and that therefore its own investors were not harmed by the violation and do not need the added protection that is achieved by disqualifying the issuer from regulatory exemptions. This may be true in some cases, but in other cases, particularly if an issuer is in the business of buying and selling other issuers' securities, the issuer's conduct could have a direct effect upon its own investors. In retrospect after 2008 we know that some issuers such as Lehman Brothers, Bear Stearns and Merrill Lynch were not as well known or as seasoned as investors thought they were. Investors in many other investment banks lost a lot of money as well.

Second, I am concerned that we rely too much on regulation and enforcement to solve problems. The 1933 and 1934 Acts and SEC regulations apparently were not enough to prevent Enron and Worldcom, so we got the Sarbanes-Oxley Act in 2002. That did not prevent the disaster of 2008, so we got the lengthy Dodd-Frank Act in 2010 and dozens of new regulations from many federal agencies.

I am not opposed to regulation – sometimes we need it. But so far regulation has not compelled people who run financial institutions to make responsible decisions about risk.

Regulation alone probably cannot accomplish this. Bankers need a reason to make responsible decisions on their own – not because government tells them what to do.

One solution is for investment banks to return to a particular aspect of the successful business model that prevailed for decades until the 1980's: the personal liability of senior investment bankers for the debts of their firms.

My grandfather, Sidney Homer, Jr. was a bond market dealer with his own two-man firm from the 1930's through 1943 when he went to work for the Treasury Department's effort to impose an economic blockade on Germany. He left his partner in charge of the business. The partner took risky bets and the business failed. My grandfather, after he finished his government service, went back to New York and worked to pay his firm's creditors over five years. He did not ask the Treasury Department for a "bailout" and he did not hide behind the mantra of limited liability. He paid the money back.

In 1960 he joined Salomon Brothers as head of bond market research. That firm also was a partnership where each partner was liable for the debts of the firm. The same was true at Lehman Brothers, Morgan Stanley, Goldman Sachs and many other investment banks. These firms were capitalized with the partners' money, which they were paid gradually after they retired. If these firms failed the partners' other assets also would be at the creditors' disposal. It is no surprise that most investment banks were relatively conservative in the risks they took both with customers' money and their own.

Beginning in the 1980's many of these investment banks became corporations. For Salomon Brothers it happened in 1981, with a merger into Phibro Commodities. The era of Liar's Poker -- Michael Lewis's famous book about Salomon Brothers in the 1980's – had begun. The culture of even the most cautious investment banks changed quickly. Lewis told the story of how traders placed big bets and became instant heroes, boasting not only of their new riches but also the size of their male anatomy. Potential downsides from risk taking were an afterthought. There were Wall Street trading scandals throughout the 1990's and early 2000's, but each time investment bankers and regulators assumed that the industry as a whole was under control. Then came the debacle of 2008. And even now we still do not have the situation under control, as shown by the failure of MF Global and the $2 billion trading loss that J.P. Morgan announced last week.

If is for this reason that I have worked with Professor Claire Hill, also of the University of Minnesota law faculty, to propose in an article[6] and a forthcoming book that some measure

[6] See Claire A. Hill and Richard W. Painter, *Berle's Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability*, 33 SEATTLE LAW REVIEW 1 (June 2010) (symposium on Adolf Berle)

of personal liability for firm debts be imposed upon the most highly paid officers of investment banks and some other financial institutions. We do not insist upon the unlimited liability that characterized Salomon Brothers before 1981 or Lehman Brothers in the days when its prudence and solvency were beyond dispute. We do, however, suggest that creditors and shareholders of large financial institutions should demand personal accountability of high ranking executives that goes beyond loss of pay or even employment. People who make risk decisions for financial institutions, and are paid enormous amounts when those risks pay off, should be required to put a significant portion of their personal assets at the disposal of firm creditors in the event the firm fails.

I do not suggest that Congress take steps now to implement such a rule. The private sector has the means at its disposal. Personal guarantees of corporate indebtedness are a common phenomenon in the financial sector and indeed bankers often insist upon them before advancing loans to corporate customers. A financial institution should do the same for itself and identify who among its leaders is willing to stand personally behind the institution's solvency. Shareholders and creditors should insist that it do so.

Personal responsibility of financial services executives is a more general topic than the specific focus of today's hearing – settlement of S.E.C. enforcement actions. Nonetheless, we have learned in many contexts, including at this hearing, that there is only so much the S.E.C. can accomplish in enforcement actions and settlements, particularly on a limited budget. There is only so much that the S.E.C., or even Congress, can do to prevent financial failures by imposing new regulations. The financial services industry will become safer and sounder when the industry norm is once again that people, not just institutions, are held accountable.

Testimony before the
Committee on Financial Services
United States House of Representatives

"Examining the Role of Settlements in the Enforcement Process by Financial Regulators: The Example of the United States Securities and Exchange Commission"

Thursday, May 17, 2012

Kenneth M. Rosen[1]

Chairman Bachus, Ranking Member Frank, and Members of the Committee:

I appreciate the opportunity to testify on the important matter of the use of settlements by financial regulators as part of the process of enforcing the laws within their jurisdictions. Settlements constitute a crucial part of the enforcement process, especially as regulators seek to allocate limited resources in fulfilling their missions. Accordingly, it is critical that regulators retain flexibility to settle the cases that they pursue. My testimony will focus on the practices of the United States Securities and Exchange Commission ("SEC" or "Commission"), where I previously served as a Special Counsel. However, the issues and concerns that I raise also might prove relevant to the enforcement efforts of other regulators, even though the details of their enforcement processes may vary.

The Use of Settlements

Settlements constitute a longstanding part of the enforcement process. Their use by the SEC are neither novel nor without a place in the broader context of the agency's overall mission. While its focus is on the securities markets, the SEC's mission in addressing those markets is a multi-faceted one. Federal financial regulators like the Commission are charged with encouraging quality markets, informing the public on financial issues, helping to shape regulations, monitoring compliance with those rules, and enforcing those rules. Those enforcement efforts might be in administrative proceedings before the Commission or in federal court. And, SEC enforcement efforts might be taken in parallel or in conjunction with actions by other federal officials, such as the United States Department of Justice as it prosecutes criminal violations of the federal securities laws. SEC enforcement efforts also exist side by side with private rights of action. The key here is that SEC enforcement actions, and the settlement of some of them, should be viewed as part of a complex system of market regulation developed over many years.

As a general matter, settlements are seen in private and public actions. Driving settlements are calculations by litigants about their potential to win and lose cases, awards that

[1] Associate Professor of Law, The University of Alabama School of Law.

might be associated with particular outcomes, and the costs of continuing to pursue litigation rather than bringing it to a conclusion. Put another way, settlements are a form of risk management, where parties attempt to calculate the likelihood and ramifications of winning or losing a case. In this regard, settlements can be viewed as a mutual recognition by opposing parties that cessation of litigation with particular conditions may serve both of their interests. Thus, settlements enjoy a certain resonance as a reflection of the calculation of interests by the parties to the litigation themselves. That is not to say that settlements are perfect calculations. At times, they may reflect erroneous valuations of parties' interests. Nor are parties left entirely to their own devices in the settlement process as courts often must approve a settlement agreement reached by the parties.

The nature and value of settlements expressed above can apply both to private litigation and actions brought by public officials. Indeed, the value of a cessation of litigation even reaches the world of criminal law as reflected in the acceptance, for instance, of the legitimacy of plea bargaining. Not surprisingly, financial regulators like the SEC similarly have accepted the usefulness of settling litigation when such settlement includes an assessment that the costs of further litigation outweigh the benefits. Settlement in such instances may be especially attractive when the alleged violator of the law accepts conditions that give the agency comfort in ceasing litigation. Items providing such comfort, for example, might include acceptance by the alleged violator of monetary penalties or acquiescence to requirements related to future behavior. The SEC's decision to pursue settlements is particularly understandable given the nature of the securities laws. Although securities fraud and other important securities law violations find their foundations in statutes that date back to the 1930s—almost 80 years ago—parties continue to debate the exact meaning of those statutes. The United States Supreme Court's multi-decade securities law docket attests to the fact that law remains unsettled in this area and that litigants continue to face the real risk of not knowing exactly how courts will apply the relevant legal provisions.

Faced with the general uncertainty associated with all litigation, and the particular uncertainty of securities litigation, the Commission has utilized flexibility afforded to it in the enforcement process and actively has pursued settlement with alleged wrongdoers. When actions are settled, consequences are not necessarily insignificant. For instance, in its 2011 Performance and Accountability Report, the SEC emphasized multiple actions resulting in settlements that led to millions of dollars being paid by alleged violators.[2] In that same Report, the Commission also noted non-monetary consequences of settlements, such as consent to permanent injunction from violation of the federal securities laws' anti-fraud provisions and officer and director bars.[3] Of course, requisite for successful settlement negotiations is that notwithstanding such serious consequences, the alleged offenders also view it in their best

[2] *See, e.g.,* Securities and Exchange Commission, 2011 Performance and Accountability Report, at 14-15 (available at http://sec.gov/about/secpar2011.shtml).
[3] *See, e.g., id.* at 190-91.

interest to settle. Possible motivators for such action might be how exactly the language of settlements is phrased, especially as it relates to acknowledgement of legal violations, as well as calculations of the costs of continuation of an enforcement action and the possibility of more severe consequences were the alleged violator to lose in extended litigation.

Recent Controversy

Notwithstanding the tradition of settlements in securities law cases and settlements' potential attractiveness to both the Commission and alleged securities law violators, such settlements are not without controversy. Action in the federal courts of the Southern District of New York as well as the United States Court of Appeals for the Second Circuit recently has drawn attention to settlement practices.

Last November, in *SEC v. Citigroup Global Markets Inc.*,[4] United States District Judge Jed Rakoff of the Southern District of New York rejected the Commission's effort to settle a case arising out of a multi-year investigation of the defendant's alleged activities related to the market for collateralized debt obligations ("CDOs").[5] When the Commission filed its complaint claiming that Citigroup had engaged in negligent misrepresentation, it also submitted a proposed consent judgment with Citigroup; that "settlement provided in essence the following: Citigroup agreed (1) to pay $285 million into a fund, which the S.E.C. may distribute to investors in a pool of CDOs marketed by Citigroup in compensation of their losses, (2) to the entry of an order enjoining it from violating certain sections of the Securities Act of 1933, and (3) to undertake to establish procedures to prevent future violations and to make periodic demonstrations of compliance to the S.E.C."[6] Judge Rakoff refused to approve the consent judgment and instead ordered that the case move to trial.[7]

The SEC staff quickly disagreed with the District Court's apparent conclusions as to the proposed consent judgment's fairness, adequacy, reasonableness, and consistency with the public interest.[8] The SEC moved to stay the District Court proceedings pending determinations on the SEC and Citigroup's interlocutory appeals and a petition for a writ of mandamus; in considering that request, a panel of the Second Circuit usefully summarized what it perceived to be the

[4] No. 11 Civ. 07387 (JSR), __ F. Supp. 2d __, 2011 WL 5903733 (S.D.N.Y. Nov. 28, 2011) (available at http://www.nysd.uscourts.gov/cases/show.php?db=special&id=138) ("District Court Opinion").
[5] *See SEC v. Citigroup Global Markets Inc.*, 673 F.3d 158 (2d Cir. 2012) (available at http://www.ca2.uscourts.gov/decisions/isysquery/93261288-c6b0-40b6-a898-85cbe8c8b3f7/1/doc/11-5227_opn.pdf#xml=http://www.ca2.uscourts.gov/decisions/isysquery/93261288-c6b0-40b6-a898-85cbe8c8b3f7/1/hilite/).
[6] *See* 673 F.3d at 161.
[7] *See* District Court Opinion, *supra* note 4.
[8] *See* Robert Khuzami, *Public Statement by SEC Staff: Court's Refusal to Approve Settlement in Citigroup Case*, http://www.sec.gov/news/speech/2011/spch112811rk.htm (Nov. 28, 2011).

District Court's main objections to the consent judgment as the District Court found it to be unreasonable, inadequate, and not serving the public interest:

> First, the [district] court expressed strong disapproval of what it called "the S.E.C.'s long-standing policy—hallowed by history but not by reason—of allowing defendants to enter into Consent Judgments without admitting or denying the underlying allegations." Without the defendant's admission, such a judgment would have "no collateral estoppel effect" in another litigation brought against the defendant by victims of its alleged wrongdoing. "[It] ... leaves the defrauded investors substantially short-changed ... [as they] cannot derive any collateral estoppel assistance from Citigroup's non-admission/non-denial of the S.E.C.'s allegations." The court found it "hard [ ] to discern ... what the S.E.C. is getting from this settlement other than a quick headline." Because it "does not involve any admissions and ... results in only very modest penalties [described by the court as "pocket change to an entity as large as Citigroup,"], [such a consent judgment] is just as frequently viewed, particularly in the business community, as a cost of doing business." The court also found that the settlement "without any admissions [of liability by Citigroup] serves various narrow interests of the parties," but not the public interest.
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> The second reason given by the court for rejecting the consent judgment was its perceived unfairness to the defendant, Citigroup.
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>> [The settlement] is not reasonable, because how can it ever be reasonable to impose substantial relief [on Citigroup] on the basis of mere allegations? It is not fair, because, despite Citigroup's nominal consent, the potential for abuse in imposing penalties on the basis of facts that are neither proven nor acknowledged is patent.
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> The court's third reason for concluding that the consent judgment was not in the public interest was that, without admission of liability, a consent judgment involving only modest penalties gives no "indication of where the real truth lies."
>
>> [The settlement] is not adequate, because, in the absence of any facts, the Court lacks a framework for determining adequacy. And, most obviously, the proposed Consent Judgment does not serve the

> public interest, because it asks the Court to employ its power and assert its authority when it does not know the facts.
>
> An application of judicial power that does not rest on facts is worse than mindless, it is inherently dangerous. The injunctive power of the judiciary is not a free-roving remedy to be invoked at the whim of a regulatory agency, even with the consent of the regulated. If its deployment does not rest on facts—cold, hard, solid facts, established either by admissions or by trials—it serves no lawful or moral purpose and is simply an engine of oppression.[9]

Judge Rakoff's opinion at least raises questions about whether the District Court went beyond reviewing the consent judgment in the more traditional fashion to perhaps substituting some of its own judgments for that of the parties in assessing the relevant interests. While leaving the underlying legal issues of the appeal open to determination by the merits panel, in granting the SEC's motion for stay, the Second Circuit panel made some important observations. First, the panel recognized the significance of the issues raised by the District Court's order. Those issues "include[d] the division of responsibilities as between the executive and the judicial branches and the deference a federal court must give to policy decisions of an executive administrative agency as to whether its actions serve the public interest (and as to the agency's expenditure of its resources) [as well as] a court's authority to reject a private party's decision to compromise its case on the ground that the court is not persuaded that the party has incurred any liability by its conduct."[10]

Second, the Circuit Court rightly recognized that the District Court appeared to reach too hasty a judgment that the defendant misled investors and that the Commission could prove the defendant's liability at trial. The panel took notice of litigation risks seemingly overlooked by the District Court, including the chance that maybe the defendant did not mislead investors, that the SEC might lose at trial, and that the defendant might not consent to settlement if forced to admit liability.[11] The panel seems directly aligned with the realities that often drive settlements. Parties often settle when they see uncertain results in continuing litigation and the ability to secure important concessions in ceasing litigation early.

Third, the panel properly warns that the District Court seemed to encroach on the realm of policy judgments traditionally reserved to administrative agencies. The Circuit Court notes

[9] 673 F.3d 161-62 (citations omitted).
[10] *Id.* at 160.
[11] *See id.* at 163-65.

that "[w]hile we are not certain we would go so far as to hold that under no circumstances may courts review an agency decision to settle, the scope of a court's authority to second-guess an agency's discretionary and policy-based decision to settle is at best minimal."[12] The Circuit Court's concern that the District Court may have failed to exercise proper deference to the SEC seems consistent with broader notions of prosecutorial discretion often seen, for instance, in the criminal law context. Government authorities pursuing supposed wrongdoers must harness limited resources to pursue an agenda that is fair to the parties involved and that secures both goals of punishment and deterrence of future violations by the alleged violator and others who might violate the law.[13] The calculation of how best to serve the public interest is a difficult one, and great deference to the agency seems merited as it pursues its mission.

That is not to say that courts must rubber stamp all settlements without reflection on their contents. Courts can, and as this case illustrates do, ask tough questions about settlements. However, courts also must remember the importance of deference and be mindful of other branches of government's role in the policy-making process. If such deference is not given on settlements, one wonders whether officials with discretion on whether or not to pursue violators in the first instance will simply refuse such pursuit given lack of control at the settlement stage of litigation.

In the wake of the financial crisis, one can understand frustrations of members of the public, including those who might happen to serve in the judiciary. However, great difficulties may attach to regulating within what might be termed the crucible of scandal.[14] Ultimately, "regulation" involves those who make laws and rules, those who administer them, and those who judge their application. All must be careful to respect their particular roles. The enforcement process certainly remains subject to possible improvements. However, the more transparent and ultimately more effective way to improve that process is by addressing its components in a direct way. If enforcement efforts seem inadequate at times, then one should focus on the effectiveness of efforts to detect wrongdoing[15] and the actions of officials actually charged with pursuing

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[12] *See id.*

[13] Although a District Court might view settlements as "pocket change" to large financial institutions, others certainly could view payment of hundreds of millions of dollars as significant, and as a punishment for potential future violators to avoid. It also seems useful to note that avoidance of an admission of guilt in a settlement does not necessarily equate to avoidance of reputational harm for the institution that settles. Indeed that type of reputational harm may be significant to entities seeking to convince others to allow them to handle their money and investments.

[14] *See* Kenneth M. Rosen, *Mickey, Can You Spare a Dime? DisneyWar, Executive Compensation, Corporate Governance, and Business Law Pedagogy*, 105 MICHIGAN LAW REVIEW 1151, 1166-68 (2007).

[15] For the SEC, this might, for instance involve operations of the Office of Compliance Inspections and Examinations.

wrongdoers. Review of settlements in individual cases seems a second-best solution[16] that is a less likely vehicle for change in how the enforcement processes generally operates.

The Continued Need for Agency Discretion

Although frustration with the economic crisis might lead some to seek more restrictions on financial agencies' ability to enter settlements, discretion to settle remains an important regulatory tool. Indeed, at a time of rapidly shifting regulatory landscapes in light of the crisis, such discretion might be more important than ever.

Informing an agency's decision to consider settlement might be genuine concern about the general level of understanding of what constitutes a violation as rules rapidly change. Settlement may permit agencies to ameliorate the consequences of confusion during regulatory transitions. This may be especially significant as agencies under modern financial legislation increasingly must implement new regulatory rule requirements with specific content under tight time frames, leaving them with little discretion in the rulemaking context.[17] Discretion in the enforcement context may help agencies at the margins to avoid some unintended consequences of new rules as the agencies may work on their own and with Congress to adjust such regulations. While some might seek rigid outcomes on issues, like imposition of particular language in settlements related to new rule violations, efforts to impose such rigidity might incentivize odd results. Agencies might opt out of pursuing violations in the first instance when results would be dictated in the settlement process related to such violations. This might further fray investor confidence.

As previously mentioned, enforcement is only one of a modern financial agency's many difficult tasks. As limited resources are taxed by those same schedules of rulemakings and other legislatively mandated actions, agencies may by necessity have to pull back on some enforcement efforts. Settlements likely will remain a vital tool for agencies to have some regulatory impact without expending the full resources involved with taking all enforcement actions to trial or administrative completion. That is not to say that less enforcement is a good result, but rather that it might be the only practical option under the circumstances. To the extent that is disturbing, all branches of the government will need to work together to revisit the issue of how to prioritize the use of limited regulatory resources.

In considering the case for continued agency discretion, one should not neglect the fact that such discretion, as long has been the case, will not be absolute. One way to interpret the events of the *Citigroup* situation is that the system on some level works. Federal judges actually do examine settlements. But as the Second Circuit implied, they must do so with great care. Moreover, agencies themselves can and do engage in self-reflection of their settlement practices.

[16] *Cf.* Jill E. Fisch & Kenneth M. Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 VILLANOVA LAW REVIEW 1097 (2003).
[17] *See* Kenneth M. Rosen, *"Who Killed Katie Couric?" and Other Tales from the World of Executive Compensation Reform*, 76 FORDHAM LAW REVIEW 2907 (2008); *see also* http://sec.gov/spotlight/dodd-frank.shtml .

Of note, the Commission actually has initiated its own analysis of how it goes about settlements in some circumstances.[18] In its oversight role, Congress should monitor these efforts. More generally, it should continue to seek more data, like the Commission provides in its annual reports, to help evaluate objectively to what extent tools like settlement are used and more generally the effectiveness of financial regulators' enforcement programs.

The challenges are great for such programs, and the success of these programs are critical to the investor confidence that helps drive capital formation and economic growth. While it might be attractive to promulgate many new rules, actual enforcement of existing rules may drive public confidence as well. Now is a time for a comprehensive and vigorous dialogue on issues like limited resource allocation prioritization as it relates to enforcement. And, as financial instruments and markets become more complex—and frauds and other problems associated with those instruments and markets become more difficult to address—more regulators at all levels of government, local, state, and federal, likely will be drawn into the battle against financial irregularities. Coordinating those efforts will be critical.[19] Task forces and joint efforts already are underway, but potentially significant legal issues will continue.[20] These important issues also deserve attention.

Conclusion

Thank you again for the opportunity to share my insights on the use of settlements. I welcome the chance to answer your questions.

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[18] *See* Robert Khuzami, *Public Statement by SEC Staff: Recent Policy Change*, http://sec.gov/news/speech/2012/spch010712rsk.htm (Jan. 7, 2012) (noting adjustment to policy on "'neither admit nor deny' language" in cases involving certain parallel criminal matters). Moreover, agency operations may be monitored by an inspector general.

[19] This likely will lead to the revisiting of settlement issues as well in a world of additional universal settlements involving multiple regulators.

[20] For example, access to information and documents produced by a government agency in one investigation may raise issues about access to those materials in other matters.

For Release Upon Delivery
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TESTIMONY

OF

DANIEL P. STIPANO

DEPUTY CHIEF COUNSEL

OFFICE OF THE COMPTROLLER OF THE CURRENCY

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

May 17, 2012

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent those of the President.

INTRODUCTION

Chairman Bachus, Ranking Member Frank, and members of the Committee, I welcome this opportunity to discuss the OCC's supervisory and enforcement authorities and process. In the letter of invitation, the Committee expressed interest in how the OCC has used its enforcement powers to initiate and settle actions against financial institutions and individuals.

The OCC uses its supervisory and enforcement authorities to ensure that national banks and federal savings associations ("banks") operate in a safe and sound manner and in compliance with the law. As described below, the OCC and the other federal banking agencies ("FBAs") have a broad range of supervisory and enforcement tools to achieve this purpose. However, the FBAs are not law enforcement agencies, and do not have authority to conduct criminal investigations or to prosecute criminal cases. Rather, the FBAs ensure that suspected criminal activity is referred to the appropriate criminal authorities for prosecution.

The Committee's interest spans a broad range of topics, involving different types of financial firms and different regulatory regimes. My testimony covers the OCC's activities and perspectives on enforcement in three key areas: 1) our approach to enforcement and how we use different types of enforcement actions; 2) the process we employ to initiate, settle, or litigate enforcement actions; and 3) how we coordinate with other state and federal regulatory agencies and law enforcement agencies. In the course of describing the OCC's settlement practices, I also will address the OCC's practice of allowing a party to settle an enforcement action without admitting or denying wrongdoing.

I. THE OCC'S ENFORCEMENT PHILOSOPHY, AUTHORITY, AND APPROACH

The OCC's enforcement process is integrally related to our supervision of banks. The OCC addresses operating deficiencies, violations of laws and regulations, and unsafe or unsound practices at banks through the use of supervisory actions and civil enforcement powers and tools. The heart of our enforcement policy[1] is to address problems or weaknesses before they develop into more serious issues that adversely affect the bank's financial condition or its responsibilities to its customers. Once problems or weaknesses are identified and communicated to the bank, the bank's management and board of directors are expected to correct them promptly.

In addition to the nature and severity of the conduct at issue, the cooperation and capability of bank management in addressing problems is an important factor in determining if the OCC will take enforcement action and, if so, the severity of that action. Banks are subject to comprehensive, ongoing supervision that, when it works best, enables examiners to identify problems early and obtain corrective action quickly. Because of our regular, and in some cases, continuous, on-site presence at banks, we have the power and ability to promptly halt unsafe or unsound practices or violations of law, in many cases without having to take an enforcement action. This approach permits most bank problems to be resolved through the supervisory process of continual comment by the OCC and response by the bank. Relevant written supervisory actions include the issuance of comprehensive Reports of Examination, supervisory letters, and Matters Requiring Attention ("MRAs") tailored to the specific problems existing at the bank.

When the normal supervisory process is insufficient or inappropriate to effect bank compliance with the law and the correction of unsafe or unsound practices, or circumstances otherwise warrant a heightened enforcement response, the OCC has a broad range of potent enforcement tools. For less serious problems, the OCC begins at one end of this enforcement spectrum with informal enforcement actions. Informal actions typically take the form of a

[1] OCC's Enforcement Action Policy, which was publicly released as OCC Bulletin 2011-37, provides for consistent and equitable enforcement standards for national banks and federal savings associations and describes the OCC's procedures for taking appropriate administrative enforcement actions in response to violations of laws, rules, regulations, final agency orders, and unsafe or unsound practices or conditions.

memorandum of understanding ("MOU") or a safety and soundness compliance plan.[2] In situations where the OCC determines that significant risks are present that could adversely affect the adequacy of the bank's capital, the OCC may establish an Individual Minimum Capital Ratio ("IMCR") requiring the bank to achieve and maintain capital levels higher than regulatory minimums and to submit a capital plan when the bank's capital levels are below the levels required by the IMCR.

These informal actions frequently involve specific and detailed steps the bank must take before the action is terminated. Informal enforcement actions deal with all aspects of bank operations, ranging from asset quality and credit administration to loan review, underwriting, and consumer compliance. Specific areas that affect a bank's safety and soundness are often addressed through informal actions including articles relating to: loan documentation, credit underwriting, interest rate exposure, capital adequacy, asset quality, earnings, managerial competence, internal controls and management information systems, audit systems, and employee training and staffing. Informal enforcement actions also often address issues relating to compliance with laws in all areas of bank operations, such as disclosure of loan terms and protection of consumer financial information. Informal actions also can provide for restitution and other relief for bank customers affected by the practices at issue. In the OCC's experience, banks usually go to great lengths to take the corrective steps necessary to achieve compliance with informal enforcement actions.

In some circumstances, however, informal action is not appropriate, such as when the bank has serious problems coupled with less than satisfactory management; there is uncertainty about the ability or willingness of management and the board of directors to take corrective measures; or the underlying problem is severe and there is a strong agency interest in formalizing the remedial actions required. In such cases, the OCC can and will take formal enforcement action. Unlike informal actions, formal actions are both public and directly enforceable. Section 8 of the Federal Deposit

[2] Upon determination and notification of a bank's failure to meet safety and soundness standards, a bank is required to submit a safety and soundness compliance plan to correct the deficiencies. *See* 12 U.S.C. § 1831p-1, 12 CFR 30 and 12 CFR 170.

Insurance Act ("FDI Act"), 12 U.S.C. § 1818, gives the FBAs power to take formal enforcement actions to require correction of unsafe or unsound practices and compliance with any law, rule, or regulation applicable to banks.

For example, in the safety and soundness context, the OCC may issue a Formal Written Agreement or a Cease and Desist Order ("C&D") requiring the bank to take appropriate corrective actions. These may include raising capital, increasing liquidity, improving internal controls, divesting troubled assets, or restricting the payment of dividends or bonuses. Similarly, in the consumer protection context, the OCC may issue a Formal Written Agreement or a C&D requiring a bank to cease engaging in the activities at issue, and to provide restitution to affected consumers. When the bank does not consent to these actions, the OCC will file a Notice of Charges seeking issuance of a C&D. Where a bank's capital is impaired, the OCC also may issue a Capital Directive or a Prompt Corrective Action ("PCA") Directive,[3] when authorized by law.

OCC also may impose civil money penalties ("CMPs") on banks and institution-affiliated parties ("IAPs").[4] CMPs may be imposed independent of, or in conjunction with, other supervisory or enforcement actions. In addition, we have the powerful tool of removing and prohibiting individuals from serving as directors, officers, or employees of federally insured depository institutions. Removal and prohibition ("R&P") authority is our most effective tool in dealing with serious cases of insider abuse and self-dealing because an R&P order is effectively a lifetime ban on the individual working in the banking industry.

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[3] Under 12 U.S.C. § 1831o, 12 CFR 6, and 12 CFR 165 (Prompt Corrective Action or PCA), insured banks are subject to various mandatory and discretionary restrictions and actions depending upon the bank's PCA capital category. Mandatory restrictions and actions are effective upon the bank being noticed that it is in a particular PCA category. Discretionary restrictions and actions are imposed on the bank through the issuance of a PCA Directive.

[4] Pursuant to 12 U.S.C. § 1813(u), an IAP includes directors, officers, employees, or controlling shareholders of, or agents for, an insured depository institution; any other person who has filed or is required to file a change in bank control notice; any shareholder, consultant, joint venture partner, or any other person who participates in the conduct of the affairs of an insured depository institution; and any independent contractor who knowingly or recklessly participates in any violation of law or regulation, breach of fiduciary duty, or unsafe or unsound practice, which caused or is likely to cause more than a minimal financial loss to, or significant adverse effect on, the insured depository institution.

Most bank supervisory issues are resolved informally so the number of formal enforcement actions reported on the OCC's Web site reflects a minority of all types of corrective actions we take.[5] The following chart reflects the number of formal and informal enforcement actions brought by the OCC against institutions and individuals during the past several years:

OCC Enforcement Actions

Type of Enforcement Action	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**
Bank:				
Cease and Desist Orders	20	41	61	45
Bank Civil Money Penalties	10	11	9	8
Formal Agreements	58	93	118	59
Prompt Corrective Action Directives	1	5	2	3
Capital Directives	0	2	5	3
Bank Individual Minimum Capital Ratio Letters	15	132	130	50
Memoranda of Understanding	17	53	38	16
Commitment Letters	10	15	7	3
Safety and Soundness Plans	6	10	10	3
Personal:				
Personal Cease and Desist Orders	16	15	6	16
Personal Civil Money Penalties	27	17	43	32
Removal/Prohibition/Suspension Orders	33	27	26	36
Notifications of Prohibition, Following Conviction for Crimes of Dishonesty	211	254	152	142
Letters of Reprimand	19	20	23	23
Totals	**443**	**695**	**630**	**439**

The list of OCC enforcement actions in recent years illustrates the OCC's ability and willingness to take formal actions when warranted to require correction of unsafe or unsound banking practices and violations of law. As the above chart indicates, during the past four years, the OCC has taken over 2200 enforcement actions against banks and their IAPs. These actions address a wide range of issues relating to unsafe or unsound practices or conditions, including capital adequacy, liquidity, asset quality, earnings, loan portfolio management, information technology, audit procedures, internal controls, managerial competence, books and records adequacy, as well as violations of law. During the last several years, the OCC has taken a large number of formal actions

[5] Formal enforcement actions taken by the OCC are published on a monthly basis pursuant to 12 U.S.C. § 1818(u).

to specifically address the deteriorating financial condition at some banks; to remedy weaknesses to bank programs, operations and performance; to require qualified management; to ensure that bank management follows safe and sound banking practices; and to address unfair treatment of bank customers.

II. ENFORCEMENT ACTION PROCESS

When circumstances warrant enforcement action, the OCC follows a well-established process for initiating and resolving such actions through either settlement or litigation. Through this process, the OCC ensures that its bank supervision and enforcement authorities are applied efficiently, effectively, and consistently, and respect the due process interests of respondents. Our process, in particular our practice of resolving enforcement actions with the consent of the bank or individual, promotes the OCC's supervisory goals. The OCC is best able to address bank operating deficiencies, noncompliance with laws and regulations, unsafe or unsound practices, and unfair treatment of bank customers, at an early stage before those weaknesses or problems become unmanageable and potentially adversely affect the bank's depositors and customers or the deposit insurance fund.

In the initial stages of the enforcement decision-making process, examiners work with legal staff to determine whether there is a legal basis for an enforcement action to address supervisory concerns, unsafe or unsound practices, noncompliance with laws or regulations, or breaches of fiduciary duty. In cases where CMPs are being considered, the appropriate supervisory office issues a "15-day letter" to the bank or individual notifying them that the OCC is considering assessing CMPs and is providing them an opportunity to respond with information pertinent to the OCC's evaluation of the appropriateness of the penalty. In each case, the supervisory office and legal staff prepare a case presentation memorandum with staff recommendations for enforcement action for consideration by an appropriate Supervision Review Committee ("SRC").[6] The appropriate SRC

[6] The OCC has several Supervision Review Committees. The Washington Supervision Review Committee ("WSRC") is responsible for reviewing all proposed enforcement actions against non-delegated banks and their

reviews the supervisory and legal support for all proposed enforcement actions and makes a recommendation to the appropriate decision maker.

Once the appropriate decision maker has authorized the enforcement action, it is important that the OCC take enforcement actions as soon as practical. For example, in a case where a bank is engaging in unsafe or unsound practices, or bank customers have suffered harm as a result of the practices at issue, a C&D can require the bank to immediately cease engaging in these practices and take affirmative action to correct the conditions resulting from such practices. To the extent that it is appropriate to assess CMPs against a bank, members of the board of directors, or senior management, assessment of CMPs also encourages the immediate correction of these practices. CMPs serve as an important deterrent to future violations of law, regulation, orders, and conditions imposed in writing, unsafe or unsound practices, and breaches of fiduciary duty, both by the person or bank against which the CMP is assessed and by other bankers and banks.

Recognizing the need for prompt and effective action to ensure that banks take corrective and remedial measures to ensure safety and soundness and protect depositors and consumers, Congress granted the FBAs broad authority to pursue administrative enforcement remedies. In effectuating the intent of Congress, the OCC has an established practice of attempting to resolve enforcement actions with the respondent's consent, usually before the need to serve a Notice of Charges. Formal enforcement actions are ultimately resolved by either the consent of the bank or individual to the enforcement action, or through litigation. The vast majority of OCC enforcement actions are resolved by consent.

IAPs and all non-delegated enforcement actions, and making recommendations to the appropriate agency decision maker. WSRC also considers and makes recommendations on all proposed referrals to other federal agencies, including the Department of Justice ("DoJ"), the Department of Housing and Urban Development ("HUD") , and the Securities and Exchange Commission ("SEC"). The Midsize Supervision Review Committee and the District Supervision Review Committees review and make recommendations on delegated and non-delegated enforcement actions against delegated banks and their IAPs to the appropriate decision maker.

In the process of resolving C&D, R&P, and CMP actions, the OCC communicates each approved enforcement action to the respondent bank or IAP and affords a period for settlement negotiations. The OCC's practice is to present the proposed formal action in the form of a draft order and, in the case of C&Ds, a draft order and a stipulation and consent to the issuance of an order, for consideration by the bank or individual. The OCC's standard form of enforcement order typically contains a plain statement of the Comptroller's factual contentions supporting the action and provides that the bank or IAP does not admit or deny wrongdoing. Once the document has been presented to the respondent, the OCC is willing to consider proposed changes, for example, in the wording of the document or the time frames for compliance, in order to obtain a negotiated settlement.

In those relatively few cases where a negotiated settlement cannot be reached, the OCC initiates an administrative hearing process by filing a Notice of Charges with the Office of Financial Institution Adjudication notifying banks or individuals of charges for issuance of a C&D, issuance of a R&P order, or assessment of CMPs. Litigants are then afforded an adjudicatory hearing on the merits. The FBAs have an established procedure for conducting adjudicatory proceedings pursuant to Uniform Rules of Practice and Procedure.[7] This procedure affords the bank or individual with extensive due process, including an opportunity to respond to the notice, conduct pre-hearing discovery, and present evidence at the hearing before an administrative law judge ("ALJ"). Following the issuance of a recommended decision by the ALJ, the Comptroller issues his final decision and order based on the entire record of proceeding, which is subject to limited review by an appropriate court of appeals. This entire process typically can take anywhere from two years to five years to complete.[8]

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[7] *See, e.g.*, 12 CFR Part 19, Subpart A.
[8] The OCC also is authorized to issue interim orders (Temporary Cease and Desist Orders and Suspension Orders) to impose measures that are necessary to protect the bank against ongoing or expected harm during the pendency of an administrative proceeding. An interim order is immediately effective and remains in place until a final order is issued or an appropriate U.S. district court decides to set aside, limit, or suspend the order pending completion of the administrative proceeding. Interim orders require satisfaction of a heightened legal standard and, because they are

The longstanding practice of permitting the bank or individual to neither admit nor deny wrongdoing allows the OCC to get an enforceable order in place at an early stage of the proceeding, and encourages compliance with the enforcement action and immediate correction of any deficiencies that need to be addressed. Because consent orders are made available to the public, requiring an admission of wrongdoing would prolong settlement negotiations and increase the number of respondents who choose to litigate the merits of the action. Given the corrective action and relief that the OCC obtains through the settlement, the OCC has viewed such a statement as a useful factor in obtaining prompt remedial action, and as essentially extraneous to the supervisory objectives that the OCC is able to promptly achieve.

The effectiveness of the OCC's approach can best be illustrated in the context of achieving the agency's primary supervisory goals in dealing with problem banks. In these situations, our primary supervisory goal, which is achieved for most problem banks, is rehabilitation and return to non-problem status. Obtaining an institution's consent to an immediately effective order helps ensure that its problems are addressed at a stage when rehabilitation is still possible, thus helping the bank avoid failure. Where a bank's problems have proved insurmountable, as when the bank has been unable to attract additional capital from private investors, our enforcement actions are designed to prepare the bank for resolution through receivership at the least possible cost to the deposit insurance fund. In these cases, obtaining the bank's consent can be critical to minimizing further losses. Requiring an admission of wrongdoing from an institution will significantly delay the imposition of an order and jeopardize the achievement of these goals.

During the recent economic downturn, the OCC used a combination of enforcement tools to correct problems that resulted in deteriorating financial conditions at banks. Our actions are designed to remedy various unsafe or unsound practices including inadequate capital and liquidity,

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almost immediately subject to judicial review, it can also take an extended period of time to resolve these types of enforcement actions.

inappropriate growth, inadequate loan underwriting, a lack of appropriate internal policies and controls, and ineffective management. The various corrective measures incorporated into our enforcement actions have included requiring the bank to raise additional capital, restrict borrowings, eliminate certain activities and even entire business lines, adopt appropriate underwriting standards and policies to govern lending activities, remove senior officers and members of the board of directors, limit the transfers of assets, and eliminate payments of bonuses or dividends.

We have used a variety of enforcement tools, including Formal Agreements, MOUs, IMCRs, and C&Ds to achieve these remedies. Each action has been crafted to deal with the specific problems existing at each bank. In some cases, we have issued multiple enforcement actions to a single bank.

In some problem bank cases, we have used PCA authority in addition to other enforcement tools. PCA capital categories and the restrictions associated with those categories, including the use of PCA Directives, are driven primarily by a bank's capital levels. Because depletion of capital usually occurs as a result of other deficiencies, capital is often a lagging indicator of problems. Consequently, the OCC generally places a problem bank under an enforcement action well in advance of a decline in capital that could trigger either the issuance of a Notice of Intent to Issue a PCA Directive, or a PCA Directive itself. In addition, Formal Written Agreements and C&Ds often contain more restrictions and affirmative obligations than would be prescribed in a PCA Directive.

In many cases, a bank's compliance with a Formal Written Agreement or C&D negates the need for additional enforcement actions while addressing the underlying concerns. In an effort to comply with the enforcement action, banks frequently adopt, fully implement and adhere to all of the required corrective actions set forth in the agreement or order within assigned time frames. In such cases, once sufficient time has passed and the OCC examiners have verified through the examination process that the corrective actions are effective in addressing the bank's problems, the enforcement action may be terminated. The decision to terminate is subject to the same review and approval process as is applicable to new enforcement actions.

III. OCC COORDINATION WITH OTHER REGULATORY AND LAW ENFORCEMENT AGENCIES

The FBAs regularly share supervisory information and undertake coordinated enforcement actions. As an example, when the OCC issues a remedial enforcement action against a bank, the Federal Reserve Board often will take a complementary action with respect to the bank's holding company. Pursuant to an interagency agreement, the FBAs regularly exchange documents and information concerning unsafe or unsound practices or violations of law and notify each other of significant enforcement actions against banks and individuals.

We also coordinate extensively with other regulatory agencies and with law enforcement authorities. OCC has entered into information sharing agreements with virtually all of the state banking agencies and all 50 state insurance departments, and we regularly share information with the SEC and other Federal agencies. We make enforcement referrals to all of these regulators, as well as to state licensing boards and state professional ethics and responsibility boards, with respect to misconduct by attorneys, accountants, real estate agents, appraisers, and other professionals. We also make enforcement referrals and cooperate in investigations conducted by other Federal agencies, including, for example, the Financial Crimes Enforcement Network ("FinCEN"),[9] the Department of Labor, the Internal Revenue Service, HUD, the Federal Election Commission, the Federal Trade Commission, and the Consumer Financial Protection Bureau, with whom OCC recently entered into an information-sharing agreement.

When we find suspected criminal violations, including evidence of fraud, we ensure that such matters are referred to the DoJ. We often coordinate with and assist the DoJ, the Federal Bureau of

[9] Pursuant to an interagency agreement, OCC provides information to FinCEN concerning all significant violations of the Bank Secrecy Act ("BSA") detected during our examinations. In addition, the two agencies coordinate enforcement efforts, and often take simultaneous actions against a bank to impose appropriate CMPs for BSA violations.

Investigation, and the Secret Service in their investigations and prosecutions of fraud and other financial crimes, as appropriate, by providing documents and information to those agencies and, in some cases, by making OCC examiners available to serve as special agents to the grand jury and as expert banking witnesses for the prosecution at trial.

OCC is a member of the Financial Fraud Enforcement Task Force and several of its subgroups. We are an original member of the National Interagency Bank Fraud Working Group ("BFWG"), which is chaired by DoJ, and we participate in various BFWG subgroups such as those covering Mortgage Fraud and Payment Processor Fraud. Additionally, the OCC is a member of the Bank Secrecy Act Advisory Group chaired by the Department of the Treasury.

CONCLUSION

The OCC's enforcement authority is an integral part of our comprehensive bank supervision process. The primary goal of our enforcement actions is to ensure that national banks and Federal thrifts under our supervision operate safely and soundly, and in compliance with all applicable laws. The OCC has broad and comprehensive enforcement authority to achieve these goals. We also have a well-established process for taking administrative enforcement actions that provides for swift and forceful corrective action at an early stage, while taking into account the due process rights of respondent banks and individuals.

Response to questions from the Honorable Bill Posey by the Federal Deposit Insurance Corporation

Please provide the following data on your agency's settlement practices. Should your agency lack the authority to pursue criminal prosecutions, please tell me what referrals related to the questions posed your agency has given to the Department of Justice and the outcome of those referrals.

Q1: Number of criminal prosecutions pursued
Q2: Number of convictions arising from those prosecutions

A1&2: As you are aware, banks and their institution-affiliated parties who violate federal or state criminal statutes can be prosecuted by the United States Department of Justice (DOJ) or criminal prosecutors in the various states. The FDIC has no authority to pursue criminal prosecutions against banks and bankers, but it does play an important role in ensuring that information about suspected crimes is brought to the attention of criminal prosecutors, as do other federal and state regulators.

The FDIC has promulgated a regulation, 12 C.F.R. Part 353, that requires an insured state nonmember bank to file a Suspicious Activity Report (SAR) when the bank detects a known or suspected criminal violation of federal law or a suspicious transaction related to a money laundering activity or a violation of the Bank Secrecy Act. SARs are filed with the Financial Crimes Enforcement Network (FinCEN) of the United States Department of Treasury. When FDIC examiners discover suspicious activity and the bank has not filed a SAR, the FDIC will file a SAR with FinCEN. The FDIC 2011 Annual Report indicates that for the years 2009, 2010, and 2011, a total of 128,973, 126,098, and 125,460 SARs, respectively, were filed regarding open and closed FDIC supervised insured depository institutions. Of this total of 380,531 SARs filed, 301 were filed by the FDIC and the rest by banks the FDIC supervises. Law enforcement SAR review teams, made up of DOJ attorneys and agents from the Federal Bureau of Investigation, access and analyze the data collected by FinCEN for purposes of pursuing criminal investigations and possible criminal prosecutions and refer cases for prosecution to the appropriate United States Attorney.

While SARs are a critical tool in detecting and prosecuting crimes against financial institutions, they are only reports of suspected criminal activity, not evidence of a crime. Prosecutors at DOJ must decide whether to prosecute based on the facts, seriousness of the alleged crime, and available resources. Thus, while many SARs result in criminal prosecutions and convictions, many do not. While prosecutors may communicate informally with the FDIC in individual cases, any comprehensive statistics regarding prosecutions and convictions would have to come directly from DOJ.

The Office of Investigations of the FDIC's Office of Inspector General (OIG) works closely with the supervisory side of the FDIC to identify and investigate financial institution crime, especially various types of fraud. The OIG works cooperatively with U.S. Attorneys throughout the country and those efforts have resulted in the prosecution of numerous individuals for financial institution fraud and mortgage fraud schemes. Highlights of the cases pursued by the OIG are detailed in its semiannual reports to Congress, which can be found on its website www.fdicig.gov under the "Publications" tab. In addition, the following is a summary of the volume and outcome of Office of Investigations' cases during and following the most recent banking crisis.

Office of Investigations Open/Closed Cases Statistics

Fiscal Year ending 9/30

	2008	2009	2010	2011	2012*
Total Cases Opened	79	83	79	75	36
Open Banks	41	33	23	36	25
Closed Banks	26	36	43	30	10
Total Cases Closed	53	48	38	52	34
Judicial Actions					
Indictments/Informations	123	137	169	184	53
Bank Officers/Directors	*11*	*17*	*17*	*23*	*5*
Convictions	103	100	109	168	46
Bank Officers/Directors	*14*	*14*	*8*	*25*	*5*
Arrests	44	84	98	112	27

*First half of FY 2012, ending 3/31/12

Additional information regarding these investigative activities can be obtained from the FDIC Inspector General at (703) 562-2166.

Q3: Number and amount of stipulated settlements (and the total amount of damages to which the settlement pertains

A3: As FDIC witness, Richard Osterman noted in his May 17 testimony, with regard to open banks, most enforcement orders are issued based upon a stipulation with the respondent. From 2007 through 2011, the FDIC issued approximately 1,000 Cease-and-Desist Orders, 377 Prohibition Orders and 753 Civil Money Penalties (CMPs). To provide more detail on the CMPs assessed following the banking crisis of 2008, we reviewed all CMPs issued from 2009 through 2011. Excluding the CMPs assessed for inaccurate Home Mortgage Disclosure Act reporting and for Flood Disaster Protection Act violations, in 2009 the FDIC issued 33 CMPs with assessments totaling $1,371,500. In 2010, the FDIC issued 59 CMPs with assessments totaling $3,970,900. Finally, in 2011 the FDIC issued 49 CMPs with assessments totaling $14,566,500. With respect to consumer enforcement cases where there is evidence of significant consumer harm, the FDIC typically seeks restitution for the benefit of aggrieved consumers. During the period 2009 through 2011, the FDIC issued 14 restitution orders against banks. Collectively, those orders resulted in $65 million of restitution for consumers.

Q4: Number of compensation committees examined for impropriety

A4: While the FDIC incorporates review of executive compensation as a matter of course in every safety and soundness examination, most of the financial institutions supervised by the FDIC are smaller community banks that do not have dedicated compensation committees. For these smaller institutions, executive compensation generally is addressed by the bank's board of directors or perhaps by an executive committee of the board. In examining for executive compensation, where the level of compensation does not match the duties and responsibilities of the office or is inconsistent with peer group comparison, FDIC examiners will further investigate the situation. In most cases where compensation irregularities are discovered, the institution will voluntarily address and correct the situation. In rare cases, the FDIC has been forced to pursue formal enforcement actions such as Cease-and-Desist Orders requiring correction and reimbursement of excessive compensation previously paid.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

July 27, 2012

The Honorable Bill Posey
Committee on Financial Services
United State House of Representatives
Washington, DC 20515

Dear Congressman Posey:

This responds to your letters dated July 10 and June 14, and to the questions that you asked at the May 17, 2012, hearing before the House Committee on Financial Services regarding enforcement actions taken by the Federal banking agencies and the Securities and Exchange Commission. You requested information concerning the number of criminal prosecutions pursued and the number of criminal convictions resulting from those prosecutions, and number and amount of stipulated settlements reached as a result of wrongdoing related to the 2008 financial crisis. In addition, you requested information concerning our examinations of the compensation committees of the financial institutions that we supervise.

As I mentioned in my written statement, the Federal banking agencies are not law enforcement agencies, and do not have statutory authority to conduct criminal investigations or to prosecute criminal cases. Rather, the Office of the Comptroller of the Currency (OCC) and the other Federal banking regulators ensure that suspected criminal activity is referred to the appropriate law enforcement authorities for investigation and possible prosecution. The OCC examines financial institutions within our jurisdiction to ensure that they have appropriate processes in place to detect and file suspicious activity reports (SARs) with the government identifying transactions involving possible violations of law or regulation.[1] State and Federal criminal investigative agencies and prosecutors have direct electronic access to the SAR database in order to assist in their investigations and criminal prosecutions.

The OCC supervises more than 2,000 national banks and federal savings associations. Since the financial crisis of 2008, these institutions have filed more than 1,800,000 SARs involving suspected criminal wrongdoing. In addition, the OCC has contacted the Department of Justice and other federal law enforcement authorities to draw their attention to specific SARs or particular circumstances involving potential, serious wrongdoing. When requested, we also provide assistance to criminal investigative authorities by providing requested documents, making exam staff available for interviews and, on occasion, assigning examiners to serve as agents for grand juries or to testify at trial on behalf of the United States. However, the decision

[1] See 12 C.F.R.§ 21.11 (2012).

to file criminal charges is entirely within the discretion of the Department of Justice or other federal agencies with authority to pursue criminal prosecutions.

I also noted in my written testimony that the OCC has issued more than 2,200 administrative enforcement actions against financial institutions and associated individuals since fiscal year 2008. The chart on page 5 of my written testimony lists the different types of enforcement actions taken by the OCC during the past four years, which address a wide range of issues relating to unsafe or unsound conditions and violations of law, including actions to address wrongdoing by employees, officers and directors of financial institutions. The total amount of restitution ordered by the OCC to be paid to harmed customers and depositors in these enforcement actions exceeds $300 million. In addition, during this same period of time, the OCC has assessed more than $225 million in civil money penalties, payable to the U.S. Treasury, against financial institutions and individuals related to various wrongdoing and unsafe or unsound practices.

On June 30, 2010, the OCC and the other Federal banking regulators issued Interagency Guidance on Sound Incentive Compensation Practices.[2] This guidance, which OCC proposed in October 2009, sets clear expectations for banking organizations concerning their incentive compensation arrangements and related risk-management, control, and governance processes. For example, we expect financial institutions will establish and implement incentive compensation arrangements that do not encourage employees to expose their organizations to imprudent risks. In addition, incentive compensation policies must be compatible with effective controls and risk management. Each institution's board of directors or, in appropriate circumstances, its compensation committee, must actively oversee and approve the firm's incentive compensation policies and understand and evaluate the internal controls and risk management processes related to compensation. Review of a financial institution's compensation practices, and the control and oversight exercised by a compensation committee of the board of directors, is a regular part of OCC periodic examinations to review an institution's safety and soundness and compliance with laws and regulations.

I hope this information is helpful. If you have any questions concerning this matter, please do not hesitate to contact me or Carrie Moore, Director, Office of Congressional Liaison, at 202-874-4844.

Sincerely,

Daniel P. Stipano
Deputy Chief Counsel

[2] 25 Fed. Reg. 122 (June 25, 2010).

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

November 28, 2011

The Honorable Jack Reed
Chairman
Subcommittee on Securities, Insurance and Investment
Committee on Banking, Housing and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510-3903

Dear Chairman Reed:

Thank you for the recent opportunity for senior staff of the Securities and Exchange Commission to appear before the Subcommittee on Securities Insurance and Investment to discuss our progress regarding management and structural reforms at the agency. During the hearing, our Director of Enforcement identified statutory limitations on our ability to pursue penalties and factors that influence the structure of our settlements. This letter provides additional information regarding these issues, and some suggested legislative solutions.[1]

As you know, the Commission has worked to streamline and strengthen its enforcement program and in so doing has achieved outstanding results. The agency filed a record 735 enforcement actions in fiscal year 2011, including many cases involving highly complex products, transactions, and market practices. More than $2.8 billion in penalties and disgorgement was ordered in Commission enforcement actions in fiscal year 2011. In the area of financial crisis related actions, the Commission has charged more than 80 individuals and entities, including approximately 40 CEOs, CFOs and senior officers.

Notwithstanding these impressive results, the Commission's statutory authority to obtain civil monetary penalties with appropriate deterrent effect is limited in many circumstances. As described below, certain statutory changes would further enhance the effectiveness of the Commission's enforcement program by expanding the Commission's authority to seek monetary penalties for the most serious securities law violations. The changes would increase the statutory limits on civil monetary penalties, more closely link the size of monetary penalties to the scope of harm to investors and associated investor losses, and substantially raise the financial stakes for securities law recidivists.

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[1] The views expressed in this letter are mine and do not necessarily represent the views of the full Commission.

Imposing Appropriate Monetary Penalties for Serious Violations

The federal securities laws authorize the Commission to obtain monetary penalties in both federal court actions and administrative proceedings. These laws generally set forth two alternative methods for calculating the maximum amount of penalties. The first method, applicable in both civil cases and administrative actions, permits a per "violation" calculation, the amount of which increases by tier based on the seriousness of the misconduct. Currently, the highest tier (tier three) – available for violations with the most substantial consequences to investors – is capped by statute at $150,000 per violation for individuals and $725,000 per violation for entities. The second calculation method provided by statute permits imposition of a penalty equal to "the gross amount of pecuniary gain" to the defendant "as a result of the violation." *See* Securities Act of 1933 § 20(d)(2); Securities Exchange Act of 1934 § 21(d)(3)(B); Investment Company Act of 1940 § 42(e)(2); Investment Advisers Act of 1940 § 209(e)(2). This second calculation method can only be used to determine the maximum penalty amount in a federal court action and is not available in administrative proceedings.

In many cases, these provisions impose substantial constraints on the penalties that a court or the Commission can assess because the gross amount of the pecuniary gain to a defendant may be small relative to the seriousness of the violation and the resulting harm to investors. For example, many frauds involving misrepresentation of a public company's financial condition may result in a relatively small pecuniary gain to the company itself or the corporate managers who committed the fraud. Yet such frauds often result in enormous losses to innocent investors. In those cases, the maximum penalty available to the Commission may not adequately reflect the seriousness of the violation or the impact on victims of the fraud.

Three targeted changes would increase the size of the civil penalties available under both existing calculation methods, provide a new calculation method intended to tie the size of a penalty to the amount of associated investor losses, and make the same calculation methods available in both civil and administrative actions.

1. The first proposed statutory change would increase the per violation cap applicable to the most serious violations (*i.e.*, tier three) to $1 million per violation for individuals and $10 million per violation for entities. That would help to ensure that a third tier penalty has an appropriate deterrent effect on both individual and corporate violators, and is not viewed as just a cost of doing business.

2. The second proposed statutory change would amend the maximum tier three penalty to authorize penalties equal to *three times* the "gross amount of pecuniary gain" to the defendant and make a calculation method based on "gross amount of pecuniary gain" available in administrative proceedings for all violations. That would allow the Commission to address situations where the actual pecuniary gain to the violator is relatively small compared to the nature or magnitude of the wrongdoing, and would eliminate the current disparity between the penalty relief available in district court and administrative proceedings.

3. The third proposed statutory change would authorize a calculation method for tier three penalties based on the amount of "investor losses" incurred as a result of a defendant's violation that would be available in both civil and administrative actions. That would allow the Commission to take into account more directly the harm inflicted on investors in seeking appropriate penalties.[2]

Together, these changes would provide the Commission with greater flexibility with regard to monetary penalties in cases where the misconduct is very serious, repeated, or involves substantial investor losses, but the current statutes do not allow for an appropriately significant penalty.

Authorizing Greater Penalties for Recidivists

As the Committee is aware, the Commission sometimes is confronted with individuals or entities that have violated the securities laws repeatedly. In some instances, such defendants' subsequent misconduct violates the federal securities laws and/or a federal court injunction or a bar previously obtained or imposed by the Commission. Current law does not provide the Commission with adequate tools to deter this category of violators. Two statutory changes would provide new sources of penalty authority that would explicitly increase the cost of repeat offenses.

1. The Commission should be authorized to seek a penalty enhancement in the current action equal to three times the otherwise applicable penalty cap if within the preceding five years a defendant has been criminally convicted for securities fraud or become subject to a judgment or order imposing monetary, equitable, or administrative relief in any SEC action alleging fraud. That would enable the Commission to seek monetary penalties against recidivists that are over-and-above the limitations described previously, regardless of the calculation method used.

2. The Commission should be authorized to seek a civil penalty if an individual or entity has violated an existing federal court injunction or a bar obtained or imposed by the Commission. That would include officer and director bars (imposed under Sections 8A(f) or 20(e) of the Securities Act or Sections 21(d)(2) or 21C(f) of the Exchange Act), penny stock bars (imposed under Section 20(g) of the Securities Act or Sections 15(b)(6) or 21(d)(6) of the Exchange Act), and other equitable disqualifications ordered by a court (under Section 21(d)(5) of the Exchange Act). This approach would be more efficient, effective, and flexible than the limited and cumbersome civil contempt remedy. Such authority also would be comparable to the Commission's existing ability to obtain civil penalties for violations of its administrative Cease and Desist orders. *See* Securities Act of 1933 § 20(d)(1); Securities Exchange Act of 1934 § 21(d)(3)(A); Investment Company Act of 1940 § 42(e)(1); Investment Advisers Act of 1940 § 209(e)(1).

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[2] Implementing the change may require the Commission to expend significant additional resources to determine and prove the amount of investor losses in particular cases – for example, to conduct event studies or to retain expert witnesses to evaluate and opine on such losses.

The Honorable Jack Reed
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Conclusion

The statutory changes proposed above would substantially enhance the effectiveness of the Commission's enforcement program by addressing existing limitations that have resulted in criticism regarding the adequacy of Commission actions against those who violate the securities laws. I have asked my staff to prepare draft legislative language for these five proposals that we will provide shortly under separate cover. We would welcome the opportunity to work with the Subcommittee and its staff to address these limitations on penalty authority by further developing the proposals discussed above.

Sincerely,

Mary L. Schapiro

Mary L. Schapiro
Chairman

cc: Ranking Member Mike Crapo

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