13 Cooperation in the Securities Sector

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1. Protecting Securities Markets in the Face of Globalization

1.1. The ability to protect domestic securities markets turns on the ability to obtain and provide international cooperation. Capital markets today are increasingly global because transactions transcend national boundaries with greater frequency and speed; public companies raise capital beyond their geographic boundaries; and investors trade outside their countries. Fraudsters are equally unconstrained by borders; they engage in illegal conduct in a multitude of jurisdictions, often simultaneously, and they transfer illegal proceeds to numerous jurisdictions in an effort to evade detection and prosecution. This globalization of fraud is a critical issue for every securities regulator, because illegal conduct that goes without detection or prosecution affects each and every one of our markets. It affects the confidence of our investors and their willingness to invest, and it affects capital formation. And, if aspects of the illegal activity can occur within any of our borders, without fear of detection, we can be assured that those who are inclined to engage in fraud will migrate to these vulnerable markets.

1.2. Combating illegal cross-border securities activities requires that securities regulators have strong enforcement tools for their own investiga-

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tions, recognize that a threat to the integrity of a foreign market is a threat to their own, and are in a position to assist foreign authorities in investigating conduct that crosses borders.

2. Effective Domestic Powers to Combat Illegal Securities Activity: The U.S. Model

SEC's Authority to Conduct Investigations and Prosecute Violations

2.1. The Securities and Exchange Commission (SEC) has broad powers to investigate possible violations of U.S. federal securities laws. Facts are developed in many instances through informal inquiry, interviewing witnesses, examining brokerage records, reviewing trading data, and other methods. Once the commission issues a formal order of investigation, SEC staff also may compel regulated and nonregulated entities and individuals, by subpoena, to testify and produce books, records, and other relevant documents. SEC staff seek a range of documents in investigations, including bank and brokerage records, telephone records, corporate records, Internet service provider records, audit work papers, and client identification records.

2.2. In bringing an action against an entity or individual for violations of the U.S. federal securities laws, the commission can choose to initiate a proceeding either in federal district court or before an administrative law judge. The remedies that the SEC may ask the court or the administrative law judge to impose include disgorgement, cease and desist orders, officer and director bars, and civil monetary penalties. The SEC also may request interim relief from federal district courts to enjoin further fraud or destruction of records, and to impose asset freezes.

2.3. In the United States, the U.S. Department of Justice (DOJ) investigates and prosecutes criminal violations of the federal securities laws. SEC staff may refer a matter to the DOJ for investigation, and the DOJ may conduct its criminal investigations parallel to the SEC's civil investigations. Information shared between the DOJ and the SEC makes investigations and prosecution of these parallel matters more efficient and effective. This relationship does not, however, allow either the SEC or the DOJ to circumvent the protections afforded defendants. Each side must collect information in conformity with existing protections, such as a defendant's privilege against self-incrimination in connection with testimonial evidence. Cooperative relationships between securities regulators and criminal authorities are a feature common to virtually all jurisdictions.

SEC's Powers to Assist Foreign Counterparts

2.4. The U.S. Congress adopted two specific pieces of legislation to give the SEC the essential legal tools to cooperate internationally. First, the SEC is expressly authorized to assist a foreign counterpart (including use of the SEC's compulsory investigative powers) under Section 21(a)(2) of the Securities Exchange Act of 1934 (Exchange Act). This provision permits the SEC, at its discretion, to provide assistance "without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States." It reflects the fact that domestic securities enforcement should not be impeded because securities authorities, in varying stages of development, are subject to different legal frameworks. In deciding when to exercise its discretion, the SEC must consider whether (1) the foreign authority has agreed to provide reciprocal assistance, and (2) compliance with the request would prejudice the public interest of the United States.

2.5. In this regard, it is worth noting that foreign assistance requests to the SEC generally have been made by regulators with which the commission has a history of reciprocity. The SEC has recently encountered, and expects to continue encountering, however, information requests from regulators with which the SEC has little history of information sharing and which have varying degrees of ability to reciprocate. Sound policy reasons exist for providing assistance in these instances, provided, at a minimum, that the foreign regulator has the ability to protect the confidentiality of the information. Providing assistance in these circumstances furthers the long-term interests of the SEC by encouraging international information sharing. Affording assistance in these circumstances also gives the SEC the opportunity to take action to prevent U.S. markets from being used to further fraud, thereby protecting U.S. investors. Less fraud around the world means less fraud that could affect U.S. investors and markets. Additionally, to the extent that proceeds or evidence of fraud is located in the United States, the SEC has a strong interest in ensuring that the United States is not viewed as a safe haven for illegal conduct.

2.6. The SEC recognized that foreign counterparts would be reluctant to share nonpublic information with the SEC without assurances that the information would remain confidential. They were concerned, in particular, about possible disclosures to third parties pursuant to a third-party subpoena or under the U.S. Freedom of Information Act (FOIA). As a result, a second legislative provision, Section 24(d) of the Exchange

Act, allows the SEC to keep confidential information it obtains from a foreign counterpart, even in the face of a third-party subpoena or an FOIA request. This confidentiality protection does not, however, prevent the SEC or criminal authorities from using the information necessary to take enforcement action.

3. Information-Sharing Arrangements

3.1. Following the adoption of information-sharing legislation in the United States, many jurisdictions adopted laws with similar aims. With these regulatory tools in place in other jurisdictions, the SEC began to formalize cooperative relationships with various foreign counterparts through international agreements generally known as memoranda of understanding (MoUs). The SEC has entered into approximately twenty bilateral enforcement MoUs with foreign counterparts. Although the existence of an MoU is not a predicate to the SEC's ability to engage in information sharing, the MoUs enhance the SEC's ability to gather the foreign-based information necessary to investigate and prosecute enforcement matters by setting forth a formal mechanism for the sharing of information. Each MoU is designed to fit the particular circumstances of the foreign market and the powers of the SEC's foreign counterpart.

3.2. Bilateral MoUs are largely used to share bank, brokerage, and beneficial ownership records. The MoUs generally do not circumscribe the type of information available, however, and do provide for the broadest possible assistance—as a result, the MoUs may also be used to share other information, such as testimony, audit work papers, and Internet service provider information. The MoUs set forth the permissible uses of information, including use for SEC investigations and proceedings and for assisting the DOJ. Apart from permissible uses, the SEC and foreign authorities commit to maintaining the confidentiality of nonpublic information shared pursuant to the MoU.

3.3. The SEC is also a signatory to the International Organization of Securities Commissions' (IOSCO) Multilateral MoU. This MoU specifies the particular types of information a signatory may be asked to provide (i.e., bank, brokerage, and beneficial ownership records); the permitted uses of the information (e.g., for civil and administrative investigations and proceedings, and onward sharing with criminal authorities); and the confidentiality of nonpublic information. The Multilateral MoU is open to IOSCO members who demonstrate their

legal authority to comply with the Multilateral MoU's key provisions. Currently (as of 2004), there are 26 signatories to the Multilateral MoU, including the SEC.

4. Necessary Legal Tools for International Cooperation

4.1. Over the past two decades, securities regulators have learned that there are certain legal tools essential to combating wrongdoing internationally. These are codified in the IOSCO Multilateral MoU, but these tools are critical, whether or not a securities regulator is an IOSCO member or a signatory to the IOSCO Multilateral MoU. Specifically, each securities regulator must be able to:

4.1.1. collect, under compulsion if necessary, key types of information essential to conducting an investigation, including bank and brokerage records and beneficial ownership information;

4.1.2. share nonpublic information in its files with a foreign counterpart relevant to the investigation the foreign counterpart is conducting;

4.1.3. conduct an investigation in its territory on behalf of a foreign counterpart, irrespective of whether the conduct in question violates, or would violate, the securities regulator's law;

4.1.4. allow information shared with a foreign counterpart to be used to facilitate the foreign counterpart's investigation and resulting proceedings, including assisting in a criminal prosecution; and

4.1.5. outside of the permissible uses, maintain the confidentiality of nonpublic information received from a foreign counterpart.

4.2. What this means in real terms is that a securities regulator should have the ability to use its enforcement powers on behalf of a foreign authority to the same extent it uses them to enforce compliance with domestic securities laws.

5. Ultimate Objective

5.1. Securities regulators agree that capital markets are essential to the well-being of the global economy and that investor confidence is critical to the success of capital markets. In order to promote investor confidence, we need to show that we are ready, willing, and able to take action against wrongdoers who commit illegal securities activity. This includes taking seriously the fraud and other illegal conduct that occur on mar-

kets outside our own, and giving priority to developing our ability to provide international assistance.

5.2. The international regulatory community is only as strong as its weakest link. The strength of the chain depends on each of us having the necessary legal tools to cooperate with foreign counterparts. Cooperation may be further enhanced by information-sharing arrangements, such as MoUs. Only with these pieces in place will we be able assure our investors that the securities markets are safer because securities regulators can act promptly and effectively to protect their interests and the integrity of the markets.