

Securities and Exchange Commission Historical Society
Interview with Daniel M. Hawke
Conducted on June 2, 2021 by Kenneth Durr

KD:

This is an interview with Daniel Hawke for the SEC Historical Society's Virtual Museum and Archive on the History of Financial Regulation. Today is June 2nd, 2021. And I'm Kenneth Durr. Daniel, thank you for inviting me over to Arnold and Porter. It's an honor to be here. It's an honor to talk to you today.

DH:

My pleasure.

KD:

I want to start by going back to the early days, touch a little bit on your undergraduate experience and how you got interested in law.

DH:

Sure. I was born in Washington, DC at George Washington Hospital and grew up in the District of Columbia. My father was a lawyer in Washington. He's now retired, and he had a profound influence on my interest in law. I went to Tulane University in New Orleans and had a roommate who was a law student at Tulane Law School. And I saw what his training was like, and it appealed to me, so I applied to law school.

KD:

Did you ever think about securities law anytime in there?

DH:

I did not actually. When I graduated from law school, I became a litigator, for lack of any particular area that I wanted to concentrate in, and began my career as a litigator for roughly 10 years before I went to the SEC. Okay. So, BU for law school, I went to Boston University School of Law. I graduated in 1989.

KD:

Okay. And then you went to a local DC firm?

DH:

Yes. It was a Washington business firm. I would characterize it as a small to midsize firm called Tucker, Flyer, and Lewis. It was a wonderful training experience. I was frequently put into situations where I had to learn by the seat of my pants, and I did and prepared me well when I ultimately decided to go to the Commission.

KD:

Why did you decide to go to the Commission?

DH:

So, in my upbringing, I had known many Washington lawyers who had worked in the government and who espoused the virtues of public service. And in my family, public service was something that I would say was expected and encouraged. And by the time I had been out of law school for 10 years, I had a one-year-old baby. And thought that if I didn't go into the government now, I probably never would.

KD:

So, what did you bring to the SEC from your law practice? Most people go straight into the Commission, so what was the difference for you?

DH:

I think the difference was that I got the benefit of training from a law firm that was willing to give me the experience that I needed to grow. It was a very special law firm in the sense that everybody knew each other. There was a lot of comradery and there was an expectation that as a lawyer that public service was something to be encouraged.

KD:

So, at the Commission, did you go to work for Steve Cutler?

DH:

I did. Actually, it was Dick Walker who was the Director at the time. Steve was the Deputy Director. And I had become a partner in my law firm in 1996. And then decided after about a year of being a partner that I really wanted to go to the SEC. I applied, I got the job, and I became a staff attorney in the Division of Enforcement. This was about 1999.

KD:

What does a staff attorney do?

DH:

So, a staff attorney in the Division of Enforcement is an exalted position. It's really the highest calling, if I had to say. The staff attorney is responsible for organizing the investigation plan, executing on an investigation plan, learning the record, mastering the exhibits, mastering the law that's applicable to the conduct, and then ultimately, turning an investigation into an enforcement recommendation if it's warranted.

KD:

And then once you turn it into a recommendation, that goes to the Commission, right?

DH:

Well, it goes to the front office of enforcement who reviews it and decides, based on what they're seeing across the division, whether it merits consideration by the Commission. And then once it goes to the Commission, it's reviewed by various divisions, operating divisions, and individual Commissioners. And then, a meeting is held, a closed Commission meeting and the Commission acts on the recommendation.

KD:

And does it get to be your case?

DH:

As a staff attorney, it's your case, except to the extent that it's your supervisor's cases and the Commission's case and everybody else who has a piece of it.

KD:

Right. So, when the newspaper articles come out, the supervisor's name is usually on it I suppose?

DH:

That's correct. It's a well-worn tradition.

KD:

Okay. So, you became Branch Chief in 2002.

DH:

So, my first case was the Arthur Anderson case arising out of the Waste Management restatement. And at the time, that restatement was the largest restatement in the history of the United States. I arrived at the Commission in August of 1999. And Dick Walker and Steve Cutler set a deadline for when they assigned me the Arthur Anderson case and said, "We'd like to have a recommendation if any, from you by Memorial Day of 2000." So I proceeded to schedule testimony of the Arthur Anderson witnesses. And I think I took roughly 45 days of individual testimony over a six-month period to make the Memorial Day deadline.

KD:

At that time, a decision was made to extend the investigation through the summer. And I was given a Labor Day deadline to bring the case. So, by Labor Day of 2000, we issued Wells notices and began the process of wrapping up the case.

DH:

At that point, I had been through a full cycle of investigations as a senior counsel and staff attorney. I applied to become a branch chief. At the time I was in Jim Coffman's assistant director group. We were in Tom Newkirk's associate group, and I applied for Branch Chief in a different assistant director group with Scott Friestad, which I ultimately got, and then moved groups, which was somewhat unusual in the division at that time, to become a branch chief in a group that you were not a staff attorney,

KD:

Sounds like the performance on the Arthur Anderson case was pretty important for moving your career along. Is that the case it was?

DH:

Very much so. I had been out of law school for 10 years when I undertook the case. I think Steve Cutler had shown an interest in the work that I was doing and encouraged me to work hard and to get the case done quickly. And I did with the help of an accountant on the case and trial counsel. And that served as the foundation for my promotion to Branch Chief.

KD:

Okay. Another early case that showed up in my research was the Bank of America Securities case.

DH:

A very significant case under Section 17 a and b of the Exchange Act. Bank of America Securities was a broker-dealer. And during an investigation into its research, we ran into difficulty with the firm concerning its production of certain materials. And the order against Bank of America Securities was related to the firm's violations of Section 17(a) and 17(b) of the Exchange Act, which the firm would neither admit nor deny.

KD:

What do you call that? What is the technical term?

DH:

It would have been a cease-and-desist order on a neither admit nor deny basis. And the firm paid a \$10 million penalty for failure to comply with the provisions of Section 17 a and b of the Exchange Act.

KD:

Okay. So, you're pretty steeped into the enforcement group at this point. And the opportunity comes up to go to the region.

DH:

Correct. So, I had worked for Scott Friestad who was an Assistant Director at the time. And Scott was a terrific leader, supervisor, mentor. And obviously, I aspire to a higher level of involvement in the Division of Enforcement. But I knew that it would take many years if I wasn't creative and energetic in the way I approach my job.

DH:

And one day I was walking in the hallway after having come back from a lunch with Scott, where he had convinced me that I had another round of cases in me as a branch chief and that I shouldn't leave the agency. And I saw Steve Cutler in the hallway after that lunch. And he asked me, did I want to go to Philadelphia to run the enforcement program? And my mother-in-law at the time lived in Hoboken, New Jersey, my in-laws, and that was close enough to Philadelphia for me. And I went to Philadelphia after having been a Branch Chief in the Division of Enforcement. What's significant about that is that I skipped over the assistant director role and went directly into a senior officer position which was, I would say, highly unusual.

KD:

Now, there was a time when the regions were where it was at. A lot of action was out there, but probably not so much in the period we're talking about. Did you have any reservations leaving HQ and going out to the hinterlands?

DH:

I did. There were some people who thought that given my career path, the cases I had worked on, that my opportunities as a branch chief in the home office might be greater than going to Philadelphia as the head of enforcement.

What I learned when I got to Philadelphia was that it was an office that was on the move, that they had been doing several of the market timing and late trading cases and a number of the revenue sharing or what we called, shelf-space cases. And the office had tremendous energy and momentum under my predecessor, Ari Gabinet. Steve and Ari had been talking about the possibility of who they were going to hire as the head of enforcement. Merri Jo Gillette, who had been the head of enforcement, was promoted to become the Regional Director in the Chicago office. And I succeeded Merri Jo in her position as Associate Director in Philadelphia.

The Philadelphia office had a storied reputation. They had brought many significant cases over the years, and they had this momentum. Philadelphia was an important location for the SEC. The SEC had moved to Philadelphia during World War Two, where it became the home office of the Commission for many years in the Philadelphia Athletic Club. So, Philadelphia had a connection to the SEC that was unique.

And other aspects of it were, the SEC actually sits in the Philadelphia region. So, there was another opportunity to establish relationships between the home office and the regions that I thought was interesting. And the fact that I was coming out of the home office meant that I had an opportunity that few people do to really work both in the home office and in the regions and see if I could bring some harmony to some of those relationships.

KD:

So, you got to see both sides of things?

DH:

I did. And the operations in the region were very different than in the home office at the time.

KD:

Tell me about Ari Gabinet and how he ran things and how his personality influenced the region.

DH:

Ari is a larger-than-life personality. He was very energetic in the way that he ran the office. He was, I would say, an asset management attorney by training. I believe Ari was at the Dechert firm and did a lot of investment advisor and investment management work.

DH:

Ari had a tremendous amount of energy and enthusiasm. He was very creative in the way that he approached problem-solving. He was practical and efficient. He got the office moving in a way that historically it had not. And as a result, in part because of his personality and because of his energy level, it really infected the office with a sense of mission and an opportunity to do some pretty good things.

KD:

A lot of the regions develop this character based on the kind of work they do. Mutual funds in Boston and oil and gas in Fort Worth. Did Philadelphia have any of that? Was there some kind of economic underpinning to what it was about?

DH:

It did. In Philadelphia, there was a huge manufacturing base over the years and a lot of money. The mid-Atlantic region is home to trillions of dollars in assets under management with some very large market participants in our region. So necessarily, the Philadelphia office had to have a very strong examination and inspections program. And it did. It is one of the few regional offices whose exam program was larger than its enforcement program. And the result was that the office generated many high-quality exam referrals, both from the investment advisor program and from the broker-dealer program.

The result of that was that Philly, I think, had three areas that were the priority for me as regional director. The first was to enhance the exam program and the number and quality of referrals that came to enforcement from that program.

The second area was specialized in the sense that the office had developed expertise in municipal securities and had unique expertise because of the nature of the Commonwealth of Pennsylvania and the way that small towns and cities throughout Pennsylvania would raise money. Philadelphia developed expertise in the municipal bond market and that was an area of priority.

And then the third priority that I had was really to look for places where retail investors were most easily separated from their money and develop investigative plans to look for situations where people were the victim of hard-to-detect frauds or other serious misconduct that took advantage of them, or that sought to divest them from their hard-earned money.

KD:

Yes, I think when Chairman Cox appointed you as Director, there was a phrase in there about elderly fraud, which was going to be an important point of emphasis. Is this part of what you're telling me here?

DH:

Yes. There was a general view that as the baby boomer generation aged and as it had accumulated a great deal of wealth that there was concern at the Commission that seniors, who had traditionally been targets of opportunity for scammers and fraudsters, that with the aging population, there would be an increase in the number of actions or schemes targeted to seniors. And Chairman Cox was very concerned about making sure that we were focused on those types of issues.

KD:

Okay. Before we move you into director, there's one more thing I want to talk about, which I think took place before that, which is this electronic spider case. I just can't pass up something with a moniker like that, so lay that one out.

DH:

There's an interesting story behind what we called the Estonian spider case. This was a case that came in from an informant who had noticed a spike in the volume of a pharmaceutical company that was unexplained. There were no news events that were obvious. And there was a surge in volume that she didn't understand. And we looked at that concern and complaint and determined that she was correct, that there appeared to have been a surge in volume in this pharmaceutical company. And it happened to coincide with a news announcement that had been issued through a commercial newswire.

And that established an investigative lead that we then used to determine that the defendant was a young man named Oliver Peek in Tallinn, Estonia and he was roughly 24 years old, and he was a programmer. And he had figured out how to hack into the commercial newswire's database of impending news announcements. As I recall, we called the scheme a clever and pernicious fraud at the time, but what was significant about it was the way that it was discovered. And it was discovered using data analytics, a very crude, very rough form of data analytics that allowed us to track Mr. Peek's trading across many different types of securities. And then, we were able to match up that trading with corresponding news announcements that he had usually accessed a few seconds or minutes earlier through his spider program that he had launched on the newswire.

The case was highly significant because it was the first indication that we had that trading activity was highly correlated to access to material non-public information. And although it looked like insider trading because it involved hacking, it involved new legal theories and new approaches to investigations that we had to undertake in order to be able to do these cases successfully.

KD:

Yes. And data analytics is going to become important.

DH:

The data analysts become very important because of what we learned in the Estonian case.

KD:

Okay. Did Chairman Cox sit you down and say, "I want you to run the regional office?" Or how did that work?

DH:

So, he invited me in for an interview. I had arrived at the office in March of 2005 as the Associate Director. About six months after I arrived, I had moved my family, I had bought a new house and Ari announced that he was going to be leaving. So, I had never really entertained the idea of becoming the Regional Director. I had just been promoted into the associate position. I had skipped a level of management to become an Associate Director. And I really put my hat in the ring just as a means of making it tougher on the other people who were interested in applying if they were going to become my boss. And I did that and ultimately, met with the chairman and Linda Thompson and Lori Richards, who was the head of OCIE at the time. And they selected me to become the next Director.

Chairman Cox had a very, what I would say, different and ambitious program with respect to involvement of the regional offices in the national enforcement program. And through a series of retreats and meetings that Chairman Cox conducted with the regional directors around the country, we would travel to different

cities and meet as a group with the chair and his general counsel, and a number of agency directors, to talk about how the regional offices could help the national enforcement program.

KD:

What was his vision, exactly?

DH:

Well, I think his vision was a more empowering view of the regional offices, in the sense that bringing them into the national program's enforcement priorities in a more concerted way than they historically had been in recent years. He did that by, in the first instance, making the district offices regional offices. So, when I went to Philadelphia, it was as the district administrator and within two or three years of Chairman Cox's arrival, he and the Commission had amended the code of federal regulations to change the designation of the district offices to regional offices. So, Philadelphia had been a district office under the New York regional office, and now under Chairman Cox became the Philadelphia regional office, as it had been prior to Chairman Levitt's creation of the district offices.

KD:

Right. Was there some sort of systematic implementation of information sharing, cases, things like that, that he was looking at as far as integrating the regions?

DH:

He was. I mean, I think he wanted to promote the idea that as a national enforcement program, the regional offices and the home office associate directors, were one united program, and he did this by convening these meetings and by instilling a sense within the regions that their enforcement efforts were integral to the national program.

KD:

So, your job is to go out and implement this.

DH:

It was, and my view was that Philadelphia sat halfway between Washington and New York and that it was important that, like most regional offices, it focuses on the things that it's really good at. And that meant taking advantage of the fact that we had a very prominent exam program that was in all the major regulated entities in our region at various times. That we had a strong enforcement group and that because of the revenue sharing and late trading cases that the office had done, Philadelphia was poised to do cases of national import. And my view was that that was how it could best contribute to the national program.

KD:

Let's go into a little bit of depth on the examination program, and tangentially with that, how you collaborated with OCIE.

DH:

So, the head of the exam program in Philadelphia is a woman named Joy Thompson, who is a very experienced lawyer and long-time SEC employee. She, I believe, has held the position of acting director of the Philadelphia regional office on multiple occasions, as directors came and went, Joy would step in. So, she had a very good sense of the office, and the exam program, as I said, is very large. It had a large broker dealer program, a large investment management inspection and examinations program, and a large investment adviser inspections and examinations program, and a range of cases came out of our exam program that formed the basis for actions that the enforcement group would then bring.

And there were a number of cases, including, for example, a case against an individual named Donald Anthony Walker Young, who was engaged in a Ponzi scheme that the examiners found and referred to

enforcement, some of the victims were heirs to the Strawbridge's fortune in Philadelphia. And so, the Donald Anthony Walker Young case was a very good example of the examiners working hand-in-hand with the enforcement staff to bring an enforcement action, to shut down a fraud as it was happening.

KD:

What percentage of cases would have worked that way? Was it 50/50?

DH:

It was not 50/50. Typically, the exam program will refer matters that involve willful misconduct, so matters that fall short of willful misconduct, where there's either negligence or other violations, often are resolved through the deficiency process. But a fair percentage of cases, maybe 10 to 20% of the cases that came out of the exam program, would yield an enforcement referral, sometimes more, sometimes less, that the enforcement staff would then investigate to determine whether or not there were violations. And over the years, the Philadelphia staff brought many of these types of exam referral cases that culminated in enforcement actions.

KD:

Sticking with exams and inspections a little bit, with the creation of OCIE there was always a little controversy. You've got this, in some respects, independent group within your group. Tell me how you work that. Did you sit down with Lori Richards and on repeated occasions and kind of divvy things up? How did the relationship work?

DH:

So, in Philadelphia, because the home office of the SEC headquarters was in the Philadelphia region, the Philadelphia office enjoyed a unique relationship with the home office. So, for example, our office would team with OCIE on certain examinations in the Mid-Atlantic region where OCIE wanted to better understand certain types of conduct that they were seeing nationwide. The ability to conduct joint exams with the Philadelphia office enabled OCIE leadership to get information about practices, products, and services that registrants in our area were engaged in. And so, a lot of the work that the Philadelphia office did was in tandem with examiners in OCIE, in the home office, and oftentimes around the country. Our examiners would be dispatched to other regional offices where we had expertise on matters that would benefit their offices.

KD:

Okay, so you had examiners, and they weren't necessarily part of OCIE. Is that right?

DH:

The examiners were part of OCIE. They existed in the regions within the broker dealer exam program and within the investment advisor exam program, and they were managed by Lori Richards out of Washington. In 2011 or '12, Carlo DiFlorio became the director of OCIE and, at the time, was looking to establish a national exam program very similar in concept to the national enforcement program that had previously been established. And that meant that the regional offices would have a more direct reporting role to the leadership in OCIE concerning the exam work that they were doing.

KD:

Anything else we should touch on with examinations and inspections?

DH:

I think that the restructuring that was done in OCIE that followed the enforcement program benefited from knowing what the benefits and what the positives and negatives were from the enforcement restructuring. So, I chaired the technology committee of the OCIE restructuring, I co-chaired it with a

woman named Kim Garber, and our role was to figure out what technology examiners needed to be able to conduct their examinations. And so, it was a comprehensive realignment of the exam program across all aspects, just like enforcement had done, but with unique focus on those things that examiners require to do their jobs. And my role was to look at the technology that the examiners were using, to look for ways to improve their surveillance and their examination work when they're inside registrants.

KD:

I want to shift gears and talk about some cases, which are always fun. The Putnam pay to play case was one of the earlier ones under your leadership.

DH:

So, Putnam had begun as a revenue sharing case, I believe, before I arrived. And I had inherited a number of case cases like that, that had begun under Ari's tenure, and that my colleagues in the office continued to work on when I was there. I had a relatively light touch on those matters, but what was significant about them was that they were national cases in scale, in a number of late trading and market timing cases and revenue sharing cases, the penalties were in the tens, or in some cases, hundreds of millions of dollars. And those were really the catalysts that the Philadelphia office used to push from that really became the foundation for the work that it did over my tenure over the ensuing eight years.

So, I would look at a Putnam or a PIMCO, or one of those types of cases as really being... The market timing and late trading cases were really a regional phenomenon. Those cases had really been done out of the home office. So, when I came to the regions, they spoke in a vernacular relating to those types of cases that were very different from what I was used to. After those cases wound their way through the system, a lot of the lessons learned about working across offices, working in teams, coordinating across offices, those lessons learned began to inform the way that Philadelphia did business with other regional offices and the home office during my tenure.

KD:

Like Boston, for example, I think they had a lot of market timing cases. Did you work closely?

DH:

We did. David Bergers had become the director. Walter Ricciardi had been the director there and then David Bergers. Walter became the deputy director of enforcement when David became the director of the Boston office and David and I worked very closely. I was in Philadelphia, he was in Boston, and we had very similar dockets with the market timing, late trading, and revenue sharing cases.

KD:

There's another one called Joseph Forte. You worked with the CFTC on this one?

DH:

We did. This was a Ponzi scheme that arose shortly after the Madoff Ponzi scheme. What happened with Madoff was our office was fortunately unaffected by the Madoff issues, and as a result, we were tasked with following up on a number of the Ponzi schemes that sort of became apparent after the Madoff case. One of those cases was a Ponzi scheme involving Joseph Forte, who had used affinity type practices to secure roughly \$50 million in investor assets that were not actually invested in the things that he had indicated to investors he was investing in.

KD:

So, it was a classic Ponzi scheme?

DH:

Classic Ponzi scheme.

KD:

Okay. How did you end up breaking that?

DH:

We shut that down. There. We coordinated very closely with the CFTC and with the criminal authorities. There was a corresponding CFTC case on that matter, and we obtained the full range of injunctive and monetary relief that the Commission was entitled to obtain. There was some difficult claw back litigation, as I recall, from that case that sort of tested the proposition of when an innocent party receives the proceeds of a Ponzi type fraud from another investor, what the policy should be about clawing back those funds and the Forte case presented a number of those challenging type issues.

KD:

Did you resolve any of those?

DH:

We litigated a number of them with respect to claims against recipients of his proceeds. Mr. Forte had made a practice of donating certain proceeds that he received to certain institutions that were innocent recipients of those funds. And so, we had to proceed with claw back litigation in certain instances to recover those proceeds.

KD:

There is one more thing I want to talk about, just because it made national headlines, which is the Deepwater Horizon thing, and BP. Tell me how that came into your portfolio. How did you inherit that one?

DH:

I will talk about BP, with the caveat that my law firm is counsel to BP, and I am recused from matters involving BP. But at the Commission, the BP case arose out of the Deepwater Horizon matter, and the oil spill into the Gulf of Mexico. And the case came about by virtue of, obviously, the news reports. The question is why Philadelphia. I've gotten that question many times, and the reason is that we had cultivated an atmosphere and an environment where the staff was encouraged to look for new matters that suggested possible violations of the securities laws. And back when the Deepwater Horizon event occurred, it was difficult to tell how much oil was flowing into the Gulf of Mexico and from a reporting and disclosure standpoint that prompted a staff attorney in the Philadelphia office to question whether or not the company's disclosures about the rate of oil spilling into the Gulf were accurate.

KD:

Yes. So, you could just assume that, well, maybe they weren't, I guess.

DH:

We looked at it and there was an ephemeral aspect to... Everybody could see the oil gushing out of the pipeline, but nobody was quite sure how to measure it. And the question was, in fairness to BP, how do you require a disclosure where one might not be possible or a hundred percent accurate? Having said that there was evidence to suggest that there may have been violations of the securities laws, and as a result, these kinds of major events and catastrophes, the Commission felt strongly that companies have in place plans for dealing with these types of events and not to forget their disclosure obligations when it comes to how to report the impact of the event and that's what the BP case signified.

KD:

It's fascinating. There can be securities laws implications to almost anything if you look closely.

DH:

That's correct. And frequently when major news events happen to public companies, it can involve almost anything, but if it affects an investor's interests, then the Commission will have an interest in it, and the Division of Enforcement may have an interest in it. And so there's almost no conduct in the markets that you can look at and conclude that may not have some connection to a publicly traded company.

KD:

Okay. I want to start moving into the topic of the reinvention of the enforcement function at the SEC. Is there anything else from your Philadelphia period that we should talk about before we get into that?

DH:

I think that for me, my experience going into the regions helped give me a very balanced view. Having spent six years in the home office, doing big cases, and then coming into Philadelphia where it had such a terrific history and background of bringing meaningful cases, that when the opportunity to reinvent itself came up, for an office like the Philadelphia office, it was a critical moment in its history. It was a chance to do things and a chance to be involved in a way that it had never been before.

KD:

Okay. Of course, the precipitating event is the Madoff event.

DH:

That's correct.

KD:

Talk about the pressures that hit the SEC and hit enforcement, in particular.

DH:

There were intense pressures during this time period. We had just been through the financial crisis with a lot of volatility in the markets. The Madoff case came shortly after that, and it really rocked the foundations of the division. In my judgment, it called into question the culture of the division of enforcement and whether the division had lost its way in terms of how open minded it was to the possibility that there might be violations that it was missing. In part, this was a training issue, and in part, it was a cultural issue, but it was a moment at which the division of enforcement had to decide what its future was going to be. And if you look at the cases that were brought in 2008, prior to Madoff, there were substantial enforcement actions across the board. The division was performing at a very high level, and there was no general awareness that there were issues concerning how the division of enforcement would respond to a case like the Madoff case.

DH:

I think there was some division among the senior leadership, within the career leadership, about which direction the agency ought to go in, following Madoff. I think there was a general recognition, especially when Chairman Shapiro came in, that the system for determining tips, complaints, and referrals, TCRs, and whistleblower complaints needed to be reformed. So, when the restructuring of the Division of Enforcement began, one of the areas that Rob Khuzami was focused on was how to improve the handling of incoming tips, complaints, and referrals.

KD:

Let's back up a little bit. You talked about the culture and was it a sense of, "I don't want to be too harsh," or was it a sense of arrogance, like "oh, we've got this covered." Or was it a sense that existing procedures worked well and there really was nothing to change? What was this cultural problem?

DH:

I think there was difficulty in the way in which whistleblowers came in, and the kinds of information that they shared, and the staff's willingness to receive that information with an open mind. I think one of the problems that the Madoff case illustrated was that sometimes somebody might come across in a way that suggests they're not credible, but that, in fact, they're telling a very true and very concerning story. And so, it really was as much a training issue as a cultural issue in terms of being open to the possibility that what somebody is telling you could actually be true, and that you need to follow up on those situations very carefully or they can turn into bigger situations that become problematic.

KD:

Okay. So, an assumption is made given the perceived quality of the whistleblower, I guess.

DH:

I think there were assumptions made about the credibility of certain whistleblowers and about how valuable their information was, and I think those were very regrettable. In our office, I worked hard to restructure the way we did incoming TCRs. Before the rest of the agency had really gone to this route, we had assigned people, dedicated people, to do nothing but review incoming TCRs. The Office of Internet Enforcement had done some of that work, and each regional office had various people that would manage that. What we did was we formalized it and began tracking our incoming TCRs, and really began to learn about how to handle TCRs in a way that ensured that they would not fall through the cracks.

KD:

Okay. So, you started doing that right away in Philadelphia.

DH:

We did.

KD:

Rob Khuzami, of course, has got a look at the entire Commission, and is he starting a similar program with all the other regions?

DH:

So when he comes in after the Madoff case gets filed, a few months after the Madoff case gets filed, Rob began a restructuring program, where he convened a meeting down in Solomons Island in Southern Maryland of the leadership of the division: the branch chiefs, the assistant directors, associate directors, and regional directors, and home office associates. And the leadership got together, and it was a very intense weekend of caucusing, debating, deliberating, hand-wringing, and other consultations among and between colleagues about where we wanted the Division of Enforcement to go in the wake of these events.

I think that pretty much everybody accepted that as storied and as reputable as the division had become over many, many years, that there was some maintenance that was due, and that rethinking some of the ways that the division did its work made sense. So, Rob came in and he shined a spotlight on every corner of the division and assigned different senior officers to run different task forces or working groups, depending on the topic. And my topic was to create the Office of Market Intelligence.

KD:

Okay. Yeah. So TCRs is an obvious one. Was that part of the six? There were six groups.

DH:

So, there were a number of groups. One was a committee that focused on the elimination of the branch chiefs and the streamlining of the leadership structure of the division. Another group focused on the establishment of the five specialized units and the Office of Market Intelligence. I ran the task force that headed the Office of Market Intelligence, but when the transition was done to the five specialized units, the Office of Market Intelligence was integrated into that transition plan. And for me, what that meant was negotiating the consolidation of the Office of Market Surveillance, the Office of Internet Enforcement, with the union to create a new office within the Division of Enforcement.

KD:

Okay. And there's also a national exam program that emerged from all of this.

DH:

Correct. And that national... Well, national enforcement or national exam?

KD:

I've got national exam.

DH:

Yes. The national exam program was the program I referred to earlier that Carlo di Florio started, where he modeled it loosely on several of the things that Rob Khuzami had done in enforcement.

KD:

Okay. So, let's talk about your little piece of the general reorganization and how you approached that.

DH:

So, my piece was really twofold. I was an unofficial member of the group that was debating the establishment of the units. So, I met frequently with the folks who were conceiving the units to give them my input on the kinds of issues that I thought this specialization should focus on. And because of Philly's role in detecting insider trading and in approaching insider trading cases with a trader-based approach, the group forming the specialized units was very interested in trying to bring some of that work into the specialized areas.

The other area was municipal securities. Because of our focus on munis, it was an area that was ripe for specialization. And then on top of that, I sat on an executive committee that Chair Schapiro had established to develop a blueprint for restructuring the way that TCRs came into the agency. And part of my work in the task force for OMI was coordinating with the chair's executive committee to ensure that the TCR review policies that the Division of Enforcement implemented were consistent with the chair's objectives in fixing the problems that had led to the Madoff situation. So, I was integrally involved in working with Steve Cohen, of the chairman's office at the time, and attending regular weekly meetings to reform and restructure the way complaints came in through all channels within the agency.

KD:

Okay. So that was really it as far as TCRs, just more listening?

DH:

In establishing the Office of Market Intelligence, there was a lot of maneuvering within the Division of Enforcement, because all the specialized units were being established at the same time. So, we had to negotiate with the union, and protocols for how you reassign people from multiple different offices within the division into a new office that didn't previously exist. And those entailed negotiations, that entailed working out agreements, and it entailed developing policies and procedures that would apply to every regional office and every staff attorney in the Division of Enforcement. It wasn't just the structure of the office, it was the purpose of the office, it was its goals, it was how to measure its success. It was the full

range of considerations that you would have to navigate in establishing any new office within a long-standing federal agency.

KD:

And the union was a challenge here.

DH:

Ironically, the union became very much a partner in the negotiations for how to set up the Office of Market Intelligence. There were people who had a lot of concerns about how their jobs would change. And the union, I think, was rightly concerned that as the agency revamped its internal policies and procedures for handling TCRs, that the staff was adequately protected and that the policies that were adopted were workable and that people had appropriate supervision and training to get their work done. I had a very constructive and positive relationship with the NTEU. And Carolyn Welshhans, who was the negotiator for the NTEU on the OMI agreement, I ultimately hired into the Market Abuse Unit as a staff attorney, and she is now an associate director of enforcement. She was integrally involved in some of the restructuring and has some of that history as well.

KD:

So, this project that you worked on, this is what emerged into the Market Abuse Unit, is that right?

DH:

Well, the Market Abuse Unit was somewhat separate from OMI. It had similarities to it, but it was separate. It was part of this informal consultation that I was having with the committee, one of the six committees that was forming the specialized units. And in that committee, people like David Bergers, Merri Jo Gillette, Andrew Calamari, were very involved in trying to decide which specialized unit should be established, what areas of the enforcement program needed specialization, which areas didn't, how those units would be staffed, how they would operate within the regional offices.

There were a host of issues regarding reporting lines, regarding who would make decisions on charging decisions and enforcement recommendations, how trial councils would be assigned. I mean, a range of personnel and process issues that had to be thought through by this group of people. And so, I wasn't a member of that committee, but I was very involved in the discussions at the associate director level concerning how the restructuring would take place.

KD:

Emerging technology is behind this, right?

DH:

Correct. So, one of the goals that the agency had in restructuring the division was how to make better use of technology in its investigations, not just to identify new investigations, but to use the technology during investigations. And part of the genesis of the Market Abuse Unit was to begin to incorporate technology into the way in which the unit did its investigations. I articulated a vision for how the Market Abuse Unit could do that, and ultimately, I was selected to be the first chief of that unit.

KD:

All the while remaining director of...

DH:

Director of the Philadelphia regional office, that's correct.

Just to digress for a moment, I had a wonderful relationship with all the directors that I worked under. Rob Khuzami was a terrific director. Our deal was that once he selected me to be the chief of the Market

Abuse Unit, that I would, at some point, step down from the regional office. I thought there were many advantages to being in the regional office position while the unit was stood up, because I could call upon resources from the office to help. And ultimately, I did not end up stepping down until months after Rob left, much to his, I think, chagrin. But we've hugged it out and it's better now.

KD:

That's what you get for having a good idea.

DH:

That's right.

KD:

Well, let's talk about how that unit worked, and particularly through some cases. And I've got a list. I've got the Fair Financial case, for example, shows up early.

DH:

So, we're in a position where there was no pipeline of cases. Fair Finance was a case that was an offering fraud case out of Indiana that had started under the Philadelphia regional office. But when the Market Abuse Unit got started in January of 2010, there were a number of issues emerging in the markets concerning high-frequency trading, dark pools, co-location of servers at the exchange level, the role of ATSS, a range of market structure issues. But at the time, we weren't calling them market structure, we were calling them system issues or other types of issues.

On May 6th of, I guess it would be 2010, the flash crash happened. The Market Abuse Unit, this process of staffing up the unit that had begun under Rob, by April of 2010, had been completed. And on May 6th, we were new with a brand new staff, and we had a mandate to look at these system-type issues. So, the flash crash became a template for us to learn current market structure. And over the course of a weekend in May, beginning May 8th, Sanjay Wadhwa, who was deputy director of the Market Abuse Unit, Rob Cohen, and a number of others and I rallied to the chairman's all-hands call to figure out whether an enforcement response to the flash crash was appropriate.

What we found was that although there was no conduct that warranted an enforcement response at the time, it was an education for us that enabled us to establish and open dozens and dozens of market structure cases relating to the exchanges, the ATSS, broker-dealers, and other market structure-related participants whose conduct was implicated by various aspects of issues we encountered on the flash crash.

KD:

So, this is almost a trial by fire on the issues that you were instituted to learn about.

DH:

The term that we used internally was training by subpoena, which I'm not sure the industry would appreciate, but the units were conceived as part investigative operations and part think tanks. And the goal was taking the lessons learned from the Madoff situation and translating them into new investigative approaches that involved rethinking the way that investigations are done, that involve incorporating technology into investigations, and that basically was a wholesale reframing of the way that at least the Market Abuse Unit would approach its investigative work.

KD:

Okay. Year after the flash crash, you've got the Kluger case, which has an interesting phrase, "organized insider trading."

DH:

Organized insider trading was a phrase that we developed in connection with very deliberate, very willful, very intentional insider trading. Then there are some insider trading cases where somebody receives information serendipitously and then they use poor judgment, and they trade on it. That would be a case where it's not organized, it's just happenstance, it's fortuitous. Organized insider trading, sometimes referred to as hard-to-detect insider trading, is trading that is done intentionally and deliberately to take advantage of material non-public information in breach of a legal duty.

And what we were seeing, back to the Estonian spider case that I had first encountered in Philadelphia, was a proliferation of trading frauds that sought to take advantage of information but weren't necessarily always insider trading. And through technology and developing new investigative approaches, including the trader-based approach, we began to develop technology within the division in the 2008-2009 timeframe that ultimately became the mandate for the Market Abuse Unit to develop a new approach to how insider trading enforcement is done.

KD:

So, in a case like this—for example, do you remember where that one originated, the Kluger case?

DH:

So, the Kluger case was very interesting, because this was a case involving a middleman. And the SEC had identified trading by the trader in the case many years earlier but could never prove who his source of information was. And that was because there was a middleman between the trader and Mr. Kluger, who was an attorney at various different law firms throughout the scheme. Mr. Kluger, as an associate in the law firms, was an M&A associate, he had access to material non-public information about pending transactions that his law firms were working on. He passed that information to a middleman, who then passed it to a trader.

We did not know who Mr. Kluger was, all we knew was that there was suspicious trading. And we picked up on a trading pattern by the middleman in innocuous stocks, innocent stocks, where the trading pattern was similar to the trading pattern that the trader used. And once we were able to establish that they both were trading in the same innocent stocks, that pattern established that they likely knew each other, and opened up the lead that we needed to figure out where the middleman was getting his information from. And through matters that are non-public, we are able to establish that Mr. Kluger was the source of the information. Ultimately the SEC brought an enforcement action against Mr. Kluger -- a criminal case against him and his co-conspirators. I think Mr. Kluger received 12 years' incarceration, which remains the longest jail term for insider trading.

KD:

The interesting thing here is though how you did this. I mean, do you just have a big room full of guys working on computers and following... I mean, did they have a spreadsheet that says, do X, Y, Z, or were they just flying by the seat of their pants and figuring out how to do this?

DH:

Yes. They were not flying by the seat of their pants, but they were figuring out how to do this in a systematized, concerted way. And there were two aspects to their approach, or our approach. The first was how to engineer an investigative approach that preserved the element of surprise, the government's ability to investigate covertly. And the second was the technology that we use to be able to sort through billions of rows of trading data, trading that is occurring in fractions of a second, and be able to organize and surveil that data in a meaningful way.

And it was not a room full of guys. Although I appreciate the visual, it was actually a room and a couple guys, separated by thousands of miles distance. I think one was in Denver and one was in Philadelphia. They conceived and developed investigative approaches using different technological tools to be able to identify who the traders were who were trading the same securities.

And so, the first approach was developing the investigative approach, a trader-based approach. That was a change because, historically... The SEC is a disclosure-based agency that really begins its inquiries by asking what security is at issue. And its historic approach to insider trading was to look at a security and ask who traded that security? The approach that we developed was really a trader-based security, where instead of looking at the trader and asking who traded, we looked at the... Instead of looking at the security and asking who traded that security, we looked at who traded the securities and what securities were common to them. And by switching this orientation, we were able to see that multiple traders had multiple securities in common to them.

And all this did was establish an investigative lead. All it did was establish the possibility that different traders might know each other and might have a common source of information.

KD:

Yes. That's fascinating. I think you might've mentioned it, but when did that shift happen? It's a really important shift, from looking at the individual security to just surveying trading and looking at trading.

DH:

It happened under Linda Thompson in the 2007 to 2008 timeframe. There was a group of people within the division that had developed tools called the Single Securities Analysis Tool and the Multiple Securities Analysis Tool that were very crude and sort of staff-developed programs that enabled them to sort large amounts of what we call blue sheet data or cleared equity, clear trading data, by trader. And it was those initial discussions that resulted in the establishment of what was called the Automated Blue Sheet Analysis Project, or ABAP. The SEC staff determined that there were different ways to organize trading data to identify relationships and patterns of trading among traders who potentially knew each other. And that ability to surveil trading for those kinds of connections and relationships is what unlocked the ability of the Market Abuse Unit to do its work.

KD:

Gotcha. And that was really the precondition for creating the—

DH:

That was the precondition. And it has its traces its roots back to the Estonian case where we had luck sorting large amounts of data.

KD:

Okay. Another case, Bristol Myers Squibb. And here we have the Obama Financial Fraud Enforcement Task Force. So, you're working with a much larger group here.

DH:

Correct. So, the Department of Justice had a tablet had established the Financial Fraud Task Force. And the SEC was asked to contribute cases to that effort and through a series of meetings in New York and through consultations with different us attorney's offices, the Market Abuse Unit developed a series of cases. The Bristol Myers Squibb case was one of them was actually against an individual, an officer there who had traded on material non-public information.

KD:

What was it like working with this larger group?

DH:

The SEC enjoys a very close working relationship with its counterparts at the Department of Justice. And in a case like the Ramnarine case or any of the insider trading cases that we did that had a parallel criminal component, there are rules that govern parallel proceedings. Meaning that the SEC as an

independent agency is obligated to bring its own cases for its own reasons based on its own evidence. There are times where it gathers evidence that it thinks might be of interest to criminal authorities, and in conjunction with sharing that evidence or making it accessible to the criminal authorities, there are well-established procedures to work closely with them throughout all aspects of their investigations. And over time it's become an area... Parallel proceedings are very complicated. They are very procedurally challenging. They have a lot of risk. And we really developed an expertise in how to manage parallel proceedings during insider trading cases.

KD:

Okay. But this Obama Fraud Enforcement Task Force, did that change this relationship in any way?

DH:

It accentuated and enhanced the DOJ's interest in the work that we were doing. And there were meetings that I recall attending in New York where the task force talked about their objectives and the agencies that attended these discussions were tasked with figuring out how their programs would feed into the DOJ program. So, it was coordination that was already occurring in the ordinary course, but that was enhanced and amplified under the Obama years.

KD:

Okay. And coming closer to the current day, there is another topic that the Market Abuse Unit took on, was something called market structure violations.

DH:

Correct.

KD:

Market structure is constantly evolving. So, talk about how you kept up with that constant evolution.

DH:

So, the market structure enforcement... it's very rare for the division of enforcement to develop a whole new type of violation or a whole new program area. And market structure was one of those areas that, in the wake of the flash crash and with the congressional scrutiny that had come with it, that the Division of Enforcement developed a much deeper understanding of how the markets operated.

And Chairman Shapiro gave a speech or testimony before Congress, I believe it was December 8th of 2010, in which she talked about the Division of Enforcement's efforts to police market structure. And that was really the genesis of what we know as the current Market Structure Enforcement Program, where the division now pursues cases against broker dealers, against automated trading systems, against exchanges against other market participants that seek to leverage the structure of the market improperly to their advantage.

So, for example, in a case that we brought against the New York Stock Exchange, it involved the release, the dissemination, of data to its proprietary subscribers before it released data to the public SIP feed, the Securities Information Processor Feed. And that disparity in releasing data created a perception in the market that... Or there was a perception in the markets that the markets were unfair to retail investors.

KD:

Right.

DH:

And the notion that an exchange, a major exchange, was releasing market data to its paying customers before it was being released to the public created concerns that market structure needed to be policed in a more systematic and concerted way.

KD:

And you got involved in the Facebook IPO thing, too. Is that just because it was so high profile?

DH:

No. Each one of the market structure cases, the cases against the exchanges and in the case against NASDAQ for its Facebook IPO, it involved crossing trades at the open of its auction for the IPO shares. And there were issues concerning how the opening trading went down and the timing of it, and when individual trades were actually reported. We felt that was a situation where an exchange in the position of NASDAQ ought to have policies and procedures in place for dealing with those kinds of events and brought charges on those grounds.

KD:

Where do you see the Market Abuse Unit going in the future?

DH:

Well, over the last four years, the unit was reoriented a little bit. Half of the folks in the unit were reassigned or brought into the cyber unit to police some of the digital asset and cryptocurrency space. But as I understand it, because many of the people in the cyber unit came from market abuse, the two units maintain a relationship and they share the same industry specialists in the analysis and detection center. They were able to do many of their cases in a coordinated and cohesive fashion.

I don't know that you necessarily need two units like that going forward, but I would be in favor of... I think the Market Abuse Unit was a great success. I think it brought a lot of important novel and programmatically significant cases. I watched Andrew Ceresney's Oral History before I came here, and he speaks a lot about the market structure enforcement work that the Market Abuse Unit did. I worked very closely with Andrew and believe that his tenure as director really established the Market Abuse Unit as a force to be reckoned with. I think it remains a very strong, incredible unit.

I think the units as a whole need some attention and some TLC, I think, to reinvigorate them. But I see the Market Abuse Unit continuing, and at least I hope it continues. And I believe that the cases that it has brought have been incredibly behavior-changing and have had a positive impact on the markets.

KD:

Now, you put this thing together and this raises a new twist on an old question, which is the kinds of skillsets, the kinds of people who can do this work could make a lot of money somewhere else. How did you get them to come and work for the SEC?

DH:

We did it by, I think, articulating a vision of approaching investigations in novel and creative ways. And in ways that harken back to what I think is the golden age of the Division of Enforcement, where doctrinal ingenuity, investigative techniques, cooperation, basic concepts have always existed in the Division of Enforcement's program. And I like to think of myself as a student of history and as somebody who's invested in the Division's history, and that has learned both from its successes and its mistakes. And in fashioning the unit, my vision and under Rob Khuzami's mandate was to reinvent the ways that the Division of Enforcement does certain things.

I was among a group of senior officers with a foot in both camps. There was a camp of senior officers who did not agree with the elimination of the branch chiefs or the creation of the specialized units. I was a branch chief, and I was very invested in what branch chiefs do and believe strongly in their utility and in

their role. And I had concerns about the elimination of branch chiefs. I did not have concerns about the establishment of specialized units. And the reason was because I felt like there were at least indications from the Madoff case that suggested that the division needed to rethink the way that it had done things.

Not to suggest that the way that it had done things needed to be changed, but I thought it could be improved upon. And I thought that borrowing from some of the lessons learned in the early days of the division made a lot of sense. And it was that approach to articulating a vision that I think attracted high caliber top performing people within the division.

And the unit gained a reputation for being a desirable place to work. I think the current leadership of the division, Melissa Hodgman and Kelly Gibson, who are both in acting roles at the moment, both worked in the Market Abuse Unit, a number of senior officers, Rob Cohen, Joe Sansone, and others have matriculated and been promoted by virtue of the work that they've done in the unit. And so, people began to see the Market Abuse Unit as a stepping ground, a stepping stone for further advancement in the division. And I think that's one of the things I'm most proud of.

KD:

Where is the future for the regions, then? You're talking about having two feet in two different places. I want to return to that because that was your first look at things. Where's that going, given the level of specification that we're seeing, specialization? What's left for the regions?

DH:

Well, I think that it's incumbent upon every regional office to know what their strengths are, to be honest about where they have weaknesses, and to harness their energy and strengths in the areas that they are best at. And at the same time, to look for ways to contribute to the national program both on the exam side and the enforcement side.

I think the future of the regional offices is bright. I think that they have benefited from strong leadership over the last four years, in particular, and certainly in the years before that. We've not talked about Jim Clarkson, who was the head of regional office operations for many years and was a major figure in my ascendancy to the job in Philadelphia. The regional offices for years maintained a very close, cohesive relationship among regional directors.

The regional directors are unique in the agency because they are, I believe, one of the only jobs, senior level jobs, which have two major program areas report to them. So, both on the exam side and enforcement side, they have interests in common that really nobody else in the agency has. So, the cohesiveness among the regional directors, the coordination between them and the home office associates, and then of course the relationship to the front office, to Joe Brenner, to chief counsel, to the deputy director, and to the director themselves, it, to me... The future of the regions is dependent a lot on the ability of the leadership in Washington to tap into the energy, creativity, and resourcefulness that exists in the regions.

And I think from my vantage point as somebody who grew up in the home office, but then got promoted into senior positions in the regions, I am very optimistic that the program is as strong as it's ever been today.

KD:

Let's talk about Jim Clarkson.

DH:

Sure.

KD:

He's important.

DH:

He is very important.

KD:

And it sounds like you had a pretty good relationship.

DH:

I did.

KD:

Describe him a little bit to me and tell me how he worked with the regions and kept them on the same page.

DH:

Jim was somebody who viewed himself, I think, as safeguarding the core values of the Division of Enforcement and ensuring continuity in the senior leadership roles in the regions. I think when Jim learned that a branch chief from the home office was going to be the head of enforcement in Philadelphia, and then subsequently a year later, the regional director, I think it took some getting used to by him. But I think I was able to demonstrate that his confidence in me was well-placed.

I worked very closely with him over the years that he was in that role to forge relationships with other regional directors. He had a unifying effect on the regional offices. And he was the regional office presence in DC, so that when somebody needed to be in the room, as slots were being handed out, or as decisions were being made about resources or about priorities, the regions had a voice when those decisions were being made, and Jim was that voice. And in my experience with him, he was warm, supportive, and mentoring. And I don't think he gets enough credit overall for how important his stewardship was to maintaining the culture and the values in the division of enforcement, and the overall quality.

KD:

I'm glad we brought that one up. Anything else that we've missed that we should talk about?

DH:

I don't think so. I've been gone from the agency for almost six years now. And when I reflect back on my time in Philadelphia and in my time in the Market Abuse Unit, I think back to a level of energy and commitment that was very exciting to be a part of, and that had a profound impact on the history of the agency and on the division. And I'm very proud to have been there when I was.

KD:

Terrific place to stop, Dan. And thank you so much.

DH:

My pleasure. Thank you.