

Public Law 101-429  
101st Congress

An Act

To amend the Federal securities laws in order to provide additional enforcement remedies for violations of those laws and to eliminate abuses in transactions in penny stocks, and for other purposes.

Oct. 15, 1990  
[S. 647]

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

Securities  
Enforcement  
Remedies and  
Penny Stock  
Reform Act of  
1990.  
Brokers.  
Investment  
companies.  
Fraud.  
15 USC 78a note.

SECTION 2. SHORT TITLE: TABLE OF CONTENTS; EFFECTIVE DATE.

(a) SHORT TITLE.-This Act may be cited as the "Securities Enforcement Remedies and Penny Stock Reform Act of 1990".

(b) TABLE OF CONTENTS.-

Sec. 1. Short title; table of contents; effective dates.

TITLE I-AMENDMENTS TO THE SECURITIES ACT OF 1933

Sec. 101. Authority of a court to impose money penalties and to prohibit persons from serving as officers and directors.

Sec. 102. Cease-and-desist authority.

TITLE II-AMENDMENTS TO THE SECURITIES EXCHANGE ACT OF 1934

Sec. 201. Enforcement of title.

Sec. 202. Civil remedies in administrative proceedings.

Sec. 203. Cease-and desist authority.

Sec. 204. Procedural rules for cease-and-desist proceedings.

Sec. 205. Conforming amendments to section 15B.

Sec. 206. Signature guarantees.

TITLE III-AMENDMENTS TO THE INVESTMENT COMPANY ACT OF 1940

Sec. 301. Civil remedies in administrative proceedings.

Sec. 302. Money penalties in civil actions.

TITLE IV-AMENDMENTS TO THE INVESTMENT ADVISERS ACT OF 1940

Sec. 401. Civil remedies in administrative proceedings.

Sec. 402. Money penalties in civil actions.

Sec. 403. Conforming amendment to section 214.

TITLE V-PENNY STOCK REFORM

Sec. 501. Short title.

Sec. 502. Findings.

Sec. 503. Definition of penny stock.

Sec. 504. Expansion of section 15(b) sanction authority with respect to penny stocks.

Sec. 505. Requirements for brokers and dealers of penny stocks.

Sec. 506. Development of automated quotation systems for penny stocks.

Sec. 507. Voidability of contracts in violation of section 15(c)(2).

Sec. 508. Restrictions on blank check offerings.

Sec. 509. Broker/dealer disciplinary history.

Sec. 510. Review of regulatory structures and procedures.

15 USC 77g note.

(c) EFFECTIVE DATES.-

(1) IN GENERAL.-Except as provided in paragraphs (2) and (3), the amendments made by this Act shall be effective upon enactment.

(2) CIVIL PENALTIES.-

(A) IN GENERAL.-No civil penalty may be imposed pursuant to the amendments made by this Act on the basis of conduct occurring before the date of enactment of this Act.

“(C) REMEDY NOT EXCLUSIVE.-The actions authorized by this subsection may be brought in addition to any other action that the Commission or the Attorney General is entitled to bring.

“(D) JURISDICTION AND VENUE.-For purposes of section 44 of this title, actions under this paragraph shall be actions to enforce a liability or a duty created by this title.

“(4) SPECIAL PROVISIONS RELATING TO A VIOLATION OF A CEASE-AND-DESIST ORDER.-In an action to enforce a cease-and-desist order entered by the Commission pursuant to section 9(f), each separate violation of such order shall be a separate offense, except that in the case of a violation through a continuing failure to comply with the order, each day of the failure to comply shall be deemed a separate offense.”.

#### **TITLE IV-AMENDMENTS TO THE INVESTMENT ADVISERS ACT OF 1940**

##### SEC. 401. CIVIL REMEDIES IN ADMINISTRATIVE PROCEEDINGS.

Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3) is amended by adding at the end thereof the following new subsections:

“(i) MONEY PENALTIES IN ADMINISTRATIVE PROCEEDINGS.-

“(1) AUTHORITY OF COMMISSION.- In any proceeding instituted pursuant to subsection (e) or (f) against any person, the Commission may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person-

“(A) has willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, or this title, or the rules or regulations thereunder;

“(B) has willfully aided, abetted, counseled, commanded, induced, or procured such a violation by any other person;

“(C) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under this title, or in any proceeding before the Commission with respect to registration, any statement which was, at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which was required to be stated therein; or

“(D) has failed reasonably to supervise, within the meaning of section 203(e)(5) of this title, with a view to preventing violations of the provisions of this title and the rules and regulations thereunder, another person who commits such a violation, if such other person is subject to this supervision;

and that such penalty is in the public interest.

“(2) MAXIMUM AMOUNT OF PENALTY.-

“(A) FIRST TIER.-The maximum amount of penalty for each act or omission described in paragraph (1) shall be \$5,000 for a natural person or \$50,000 for any other person.

“(B) SECOND TIER.-Notwithstanding subparagraph (A), the maximum amount of penalty for each such act or

omission shall be \$50,000 for a natural person or \$250,000 for any other person if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

“(C) THIRD TIER.-Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be \$100,000 for a natural person or \$500,000 for any other person if—

“(i) the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

“(ii) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act of omission.

“(3) DETERMINATION OF PUBLIC INTEREST.- In considering under this section whether a penalty is in the public interest, the Commission may consider—

“(A) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;

“(B) the harm to other persons resulting either directly or indirectly from such act or omission;

“(C) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior;

“(D) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in section 203(e)(2) of this title;

“(E) the need to deter such person and other persons from committing such acts or omissions; and

“(F) such other matters as justice may require.

“(4) EVIDENCE CONCERNING ABILITY TO PAY.- In any proceeding in which the Commission may impose a penalty under this section, a respondent may present evidence of the respondent’s ability to pay such penalty. The Commission may impose a penalty under this section, a respondent may present evidence of the respondent’s ability to pay such penalty. The Commission may, in its discretion, consider such evidence in determining whether such penalty is in the public interest. Such evidence may relate to the extent of such person’s ability to continue in business and the collectability of a penalty, taking into account any other claims of the United States or third parties upon such person’s assets and the amount of such person’s assets.

“(j) AUTHORITY TO ENTER AN ORDER REQUIRING AN ACCOUNTING AND DISGORGEMENT.-In any proceeding in which the Commission may impose a penalty under this section, the Commission may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

“(k) CEASE-AND DESIST PROCEEDINGS.-

“(1) AUTHORITY OF THE COMMISSION.- If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this title, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation. Such order may, in addition to requiring a person to cease and desist from committing or causing a violation, require such person to comply, or to take steps to effect compliance, with such provision, rule, or regulation, upon such terms and conditions and within such time as the Commission may specify in such order. Any such order may, as the Commission deems appropriate, require future compliance or steps to effect future compliance, either permanently or for such period of time as the Commission may specify, with such provision, rule, or regulation with respect to any security, and issuer, or any other person.

“(2) HEARING.-The notice instituting proceedings pursuant to paragraph (1) shall fix a hearing date not earlier than 30 days nor later than 60 days after service of the notice unless an earlier or a later date is set by the Commission with the consent of any respondent so served.

“(3) TEMPORARY ORDER.-

“(A) IN GENERAL.-Whenever determines that the alleged violation or threatened violation specified in the notice instituting proceedings pursuant to paragraph (1), or the continuation thereof, is likely to result in significant dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest, including, but not limited to, losses to the Securities Investor Protection Corporation, prior to the completion of the proceedings, the Commission may enter a temporary order requiring the respondent to cease and desist from the violation or threatened violation and to take such action to prevent the violation or threatened violation and to prevent dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest as the Commission deems appropriate pending completion of such proceedings. Such an order shall be entered only after notice and opportunity for a hearing, unless the Commission, notwithstanding section 211(c) of this title, determines that notice and hearing prior to entry would be impracticable or contrary to the public interest. A temporary order shall become effective upon service upon the respondent, unless set aside, limited, or suspended by the Commission or a court of competent jurisdiction, shall remain effective and enforceable pending the completion of the proceedings.

“(B) APPLICABILITY.-This paragraph shall apply only to a respondent that acts, or, at the time of the alleged misconduct acted, as a broker, dealer, investment adviser, investment company, municipal securities dealer, government securities broker, government securities dealer, or

transfer agent, or is, or was at the time of the alleged misconduct, an associated person of, or a person seeking to become associated with, any of the foregoing.

“(4) REVIEW OF TEMPORARY ORDERS.-

“(A) COMMISSION REVIEW.-At any time after the respondent has been served with a temporary cease-and-desist order pursuant to paragraph (3), the respondent may apply to the Commission to have the order set aside, limited, or suspended. If the respondent has been served with a temporary cease-and-desist order entered without a prior Commission hearing, the respondent may, within 10 days after the date on which the order was served, request a hearing on such application and the Commission shall hold a hearing and render a decision on such application at the earliest possible time.

“(B) JUDICIAL REVIEW.-Within-

“(i) 10 days after the date the respondent was served with a temporary cease-and-desist order entered with a prior Commission hearing, or

“(ii) 10 days after the date the Commission renders a decision on an application and hearing under subparagraph (A), with respect to any temporary cease-and-desist order entered without a prior Commission hearing, the respondent may apply to the United States district court for the district in which the respondent resides or has its principal place of business, or for the District of Columbia, for an order setting aside, limiting, or suspending the effectiveness or enforcement of the order, and the court shall have jurisdiction to enter such an order. A respondent served with a temporary cease-and-desist order entered without a prior Commission hearing may not apply to the court except after hearing and decision by the Commission on the respondent’s application under subparagraph (A) of this paragraph.

“(C) NO AUTOMATIC STAY OF TEMPORARY ORDER.-The commencement of proceedings under subparagraph (B) of this paragraph shall not, unless specifically ordered by the court, operate as a stay of the Commission’s order.

“(D) EXCLUSIVE REVIEW.-Section 213 of this title shall not apply to a temporary order entered pursuant to this section.

“(5) AUTHORITY TO ENTER AN ORDER REQUIRING AN ACCOUNTING AND DISGORGEMENT.-In any cease-and-desist proceeding under paragraph (1), the Commission may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.”.

SEC. 402. MONEY PENALTIES IN CIVIL ACTIONS.

Section 209- of the Investment Advisers Act of 1940 (15 U.S.C. 80b-9) is amended by adding at the end thereof the following new subsection:

“(e) MONEY PENALTIES IN CIVIL ACTIONS.-

“(1) AUTHORITY OF COMMISSION.-Whenever it shall appear to the Commission that any person has violated any provision of

this title, the rules or regulations thereunder, or a cease-and-desist order entered by the Commission pursuant to section 203(k) of this title, the Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, upon a proper showing, a civil penalty to be paid by the person who committed such violation.

“(2) AMOUNT OF PENALTY.-

“(A) FIRST TIER.- The amount of the penalty shall be determined by the court in light of the facts and circumstances. For each violation, the amount of the penalty shall not exceed the greater of (i) \$5,000 for a natural person or \$50,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation.

“(B) SECOND TIER.-Notwithstanding subparagraph (A), the amount of penalty for each such violation shall not exceed the greater of (i) \$50,000 for a natural person or \$250,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if the violation described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

“(C) THIRD TIER.-Notwithstanding subparagraphs (A) and (B), the amount of penalty for each such violation shall not exceed the greater of (i) \$100,000 for a natural person or \$500,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if-

“(I) the violation described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

“(II) such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons.

“(3) PROCEDURES FOR COLLECTION.-

“(A) PAYMENT OF PENALTY TO TREASURY.-A penalty imposed under this section shall be payable into the Treasury of the United States.

“(B) COLLECTION OF PENALTIES.-If a person upon whom such a penalty is imposed shall fail to pay such penalty within the time prescribed in the court’s order, the Commission may refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court.

“(C) REMEDY NOT EXCLUSIVE.-The actions authorized by this subsection may be brought in addition to any other action that the Commission or the Attorney General is entitled to bring.

“(D) JURISDICTION AND VENUE.-For purposes of section 214 of this title, actions under this paragraph shall be actions to enforce a liability or a duty created by this title.

“(4) SPECIAL PROVISIONS RELATING TO A VIOLATION OF A CEASE-AND-DESIST ORDER.-In an action to enforce a cease-and-desist order entered by the Commission pursuant to section 203(k), each separate violation of such order shall be a separate offense, except that in the case of a violation through a continuing

failure to comply with the order, each day of the failure to comply shall be deemed a separate offense.”.

SEC. 403. CONFORMING AMENDMENT TO SECTION 214.

Section 214 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-14) is amended-

- (1) by inserting after “all suits in equity” the following: “and actions at law brought to enforce any liability or duty created by, or”; and
- (2) by inserting after “Any suit or action” the following: “to enforce any liability or duty created by, or”.

## TITLE V-PENNY STOCK REFORM

Penny Stock Reform

Act of 1990.

15 USC 78a note.

SEC. 501. SHORT TITLE.

This title may be cited as the “Penny Stock Reform Act of 1990”.

SEC. 502. FINDINGS.

15 USC 78o note.

The Congress finds the following:

(1) The maintenance of an honest and healthy primary and secondary market for securities offerings is essential to enhancing long-term capital formation and economic growth and providing legitimate investment opportunities for individuals and institutions.

(2) Protecting investors in new securities is a critical component in the maintenance of an honest and healthy market for such securities.

(3) Protecting issuers of new securities and promoting the capital formation process on behalf of small companies are fundamental concerns in maintaining a strong economy and viable trading markets.

(4) Unscrupulous market practices and market participants have pervaded the “penny stock” market with an overwhelming amount of fraud and abuse.

(5) Although the Securities and Exchange Commission, State securities regulators, and securities self-regulators have made efforts to curb these abusive and harmful practices, the penny stock market still lacks an adequate and sufficient regulatory structure, particularly in comparison to the structure for overseeing trading in National Market System securities.

(6) Investors in the penny stock market suffer from a serious lack of adequate information concerning price and volume of penny stock transactions, the nature of this market, and the specific securities in which they are investing.

(7) Current practices do not adequately regulate the role of “promoters” and “consultants” in the penny stock market, and many professionals who have been banned from the securities markets may have ended up in promoter and consultant roles, contributing substantially to fraudulent and abusive schemes.

(8) The present regulatory environment has permitted the ascendancy of the use of particular market practices, such as “reverse mergers” with shell corporations and “blank check” offerings, which are used to facilitate manipulation schemes and harm investors.

INTERNATIONAL SECURITIES ENFORCEMENT  
COOPERATION ACT OF 1989

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SEPTEMBER 12, 1989. – Committed to the Committee of the Whole House on the State  
of the Union and ordered to be printed

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Mr. DINGELI, from the Committee on Energy and Commerce,  
submitted the following

R E P O R T

[To accompany H. R. 1396]

[Including cost estimate of the Congressional Budget Office]

The Committee on Energy and Commerce, to whom was referred the bill (H.R. 1396) to amend the Federal securities laws in order to facilitate cooperation between the United States and foreign countries in securities law enforcement, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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not alter the Commission's responsibilities under the Right to Financial Privacy Act, 12 U.S.C. 3401 et seq., as limited by Section 21(h) of the Exchange Act, with respect to transfers of records covered by these statutes.

*Section 2(b).*-Section 2(b) provides conforming amendments to Section 45(a) of the Investment Company Act of 1940 and Section 210(b) of the Investment Advisers Act of 1940. These conforming amendments were added at Subcommittee markup. As originally introduced, the legislation would have granted the Commission the authority to withhold documents pursuant to Section 24(c) of the Exchange Act "notwithstanding any other provision of law," with the implicit reference to provisions of the Investment Company Act and the Investment Advisers Act. The conforming amendments now make explicit changes in the Investment Company and Advisers Acts, with references to Section 24(c) of the Exchange Act.

### SECTION 3

Section 3 of the Act amends the Exchange Act to authorize the Commission to impose sanctions on brokers or dealers, their associated persons, and individuals seeking to become associated persons of brokers or dealers on the basis of misconduct in a foreign country.

*Section 3(a).*-Section 3(a) of the Act amends Section 15(b) of the Exchange Act, the Exchange Act's registration provision. Subsection (a)(1) provides for Commission censure of, limitations on the activities of or revocation or suspension of the registration of brokers or dealers, based upon a conviction within ten years rendered by a foreign court of competent jurisdiction of a crime which is substantially equivalent to a felony or misdemeanor as provided by Section 15(b)(4)(B). The Act thus clarifies the Commission's authority to consider offenses from foreign jurisdictions that might not classify crimes formally as felonies or misdemeanors, e.g., noncommon law jurisdictions.

Section 15(b)(4)(B)(i) lists offenses involving the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense as within the class of felonies and misdemeanors that permit the Commission to sanction brokers or dealers. Subsection (a)(2) of the Act amends this provision by including within this list any substantially equivalent activity, however denominated by the laws of a foreign government. The Act therefore clarifies the Commission's authority to consider such activities even if the foreign government does not denominate them as precisely the same offenses that they constitute within the United States.

Section 15(b)(4)(B)(ii) also allows the Commission to consider offenses arising out of the conduct of various securities-related businesses, including the business of a broker, dealers, municipal securities dealer, government securities broker, government securities dealer, investment adviser, bank, insurance company, fiduciary, or transfer agent. Subsection 3(a)(3)(A) of the Act amends Section 15(b)(4)(B)(ii) by including any substantially equivalent activity, however denominated by the laws of a foreign government. The Act clarifies the Commission's authority to consider

to violations of any other provisions of the Exchange Act or of its corresponding rules or regulations. Section 6(c) of the Act extends this exception by forbidding limitations on investigations pursuant to Section 21(a)(2) of the Exchange Act to assist a foreign securities authority,

#### SECTION 4

In order to ensure that orders of any regulatory body, foreign or domestic, with authority to suspend or revoke registration or its equivalent are available to the Commission, Section 4 of the Act adds a new definition of the term “foreign financial regulatory authority,” as Section 3(a)(51) of the Exchange Act. A “foreign financial regulatory authority” is defined to include any foreign securities authority, which is defined in Section 3(a)(50) of the Exchange Act; governmental or regulatory bodies empowered to administer or enforce laws relating to enumerated financial matters; and membership organizations that regulate members’ participation in financial matters. Pursuant to the Act’s amendments to Section 3(a)(39) of the Exchange Act, orders of foreign financial regulatory authorities are deemed sufficient to result in “statutory disqualification,” as will such an order limiting registration of the foreign equivalent of any of the enumerated entities.

#### SECTION 5

Section 5 of the Act makes parallel amendments to the Investment Company Act of 1940 (1940 Act) and the Investment Advisers Act of 1940 (Advisers Act) to clarify and strengthen the Commission’s authority to impose sanctions, on the basis of violations of foreign law, on investment advisers or on persons associated or seeking to become associated with an investment adviser or a registered investment company.

*Section 5(a).*— Section 5(a) of the Act amends Section 9(b) of the 1940 Act. Section 9(a) of the 1940 Act generally prohibits a person convicted of a felony or misdemeanor involving securities or the securities business or subject to a temporary or permanent injunction restricting his ability to engage in the securities business from serving as an employee, officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, unit investment trust, or face-amount certificate company. The automatic statutory disqualification in Section 9(a) is supplemented by the Commission’s authority under Section 9(b). Under Section 9(b), the Commission may, after notice and opportunity for hearing, prohibit a person from serving in any of the capacities cited in Section 9(a) or as an affiliated person of a registered investment company’s investment adviser, depositor, or principal underwriter if the person has willingly caused a false or misleading statement to be made in any registration statement, application, or report filed with the Commission or if the person has willfully violated or willfully aided and abetted a violation of any provision (including rules and regulations) of the federal securities laws or the Commodity Exchange Act.

In an amendment parallel to Sections 3(a)(7) and 5(b)(8) of the Act, Section 9(b) is amended to add a new paragraph (4) that will authorize the Commission to restrict the activities of any person that has been found by a foreign authority to have (1) made any false or misleading statement in an application or report filed with a foreign securities authority or in a proceeding before the foreign securities authority, or (2) violated or aided and abetted the violation of foreign securities or commodities statutes [sic]. Paragraph (4) will, therefore, parallel the provisions of paragraph (1), (2), and (3) of Section 9(b), and extend the statute to equivalent foreign violations.

Section 9(b) also is amended to add two new provisions, Section 9(b)(5) and 9(b)(6), that will allow the Commission by order to prohibit a person from serving in any of the designated capacities if the person has been convicted by a foreign court of any of the offenses designated in Section 9(a)(1) or has been enjoined by a foreign court in a manner set forth in Section 9(a)(2). Section 9(a)(1) and (2) automatically disqualify anyone who within the past 10 years has been convicted of any felony or misdemeanor involving, or is subject to a permanent or temporary injunction relating to, acting as an underwriter, broker, dealer, investment adviser, municipal securities dealer, or entity or person required to be registered under the Commodity Exchange Act, or as an affiliated person, salesman, or employee of any investment company, bank, insurance company, or entity or person required to be registered under the Commodity Exchange Act, or in the connection with the purchase or sale of any security. Although a conviction or injunction under Section 9(a)(1) or (2) results in an automatic statutory disqualification, a substantially equivalent foreign conviction or injunction would not. However, a substantially equivalent foreign finding will provide a basis for a Commission order prohibiting the individual's association with a registered investment company in any of the capacities designated in the statute. The automatic disqualification provisions of Section 9(a), coupled with the Commission's exemptive authority under Section 9(c) to avoid any inequitable results, are indispensable means of safeguarding the integrity of registered investment companies. The amended Section 9(b) does not automatically bar a person solely on the basis of a foreign finding of a violation of foreign law without any prior notice or opportunity for hearing by a U.S. court or administrative agency. Instead, amended Section 9(b) provides that the Commission may impose a bar on a case-by-case basis if it determines that the foreign finding justifies such a sanction. The amendment does not create competitive disparities because, just as Section 9(a) applies equally to U.S. and foreign persons that have been convicted or enjoined in a manner specified in the statute, Section 9(b), as amended, grants the Commission authority to institute an administrative proceeding against either a U.S. or foreign person that has committed an equivalent foreign violation and has been sanctioned by a foreign authority.

*Section 5(b).*- Section 5(b) of the Act amends Section 203(e) of the Advisers Act. Section 203(e) authorizes the Commission to censure, place limitations on the activities of, suspend for up to twelve months, or revoke the registration of an investment adviser where the adviser or an associated person of the adviser has committed,

or has been sanctioned for, certain specified violations. Section 5(b) of the Act amends Section 203(e) to include, among the factors that the Commission may consider, violations of foreign law that are substantially equivalent to a violation currently set forth in the statute.

Subsection 203(e)(2) of the Advisers Act authorizes the Commission to bring a proceeding based upon convictions within the past ten years of certain felonies and misdemeanors. Section 5(b)(1) of the Act amends this section to include convictions by a foreign court of competent jurisdiction of crimes substantially equivalent to a felony or misdemeanor. The Act thus clarifies the Commission's authority to consider foreign criminal findings that the foreign jurisdiction may not classify as a "felony" or "misdemeanor."

Section 203(e)(2)(A) of the Advisers Act lists offenses involving the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense as within the class of felonies and misdemeanors that authorize the Commission to discipline investment advisers. Section 5(b)(2) of the Act amends Section 203(e)(2)(A) by including within this list any substantially equivalent activity, however denominated by the laws of a foreign government.

Section 203(e)(2)(B) of the Advisers Act authorizes the Commission to consider offenses arising out of the conduct of various securities-related businesses. Included is any broker, dealer, municipal securities dealer, government securities broker, investment adviser, bank, insurance company, fiduciary, transfer agent, or entity or person required to be registered under the Commodity Exchange Act. Subsection 5(b)(3) of the Act amends Sections 203(e)(2)(B) and (e)(3) to include offenses arising out of the conduct of any foreign person performing a function substantially equivalent to any of the above.

Section 203(e)(2)(C) of the Advisers Act includes larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, and misappropriation of funds or securities within the list of offenses that may trigger Commission sanctions. Section 5(b)(4) of the Act adds any substantially equivalent offense, however denominated by the laws of a foreign government.

Section 203(e)(2)(D) of the Advisers Act includes violations of Sections 152, 1341, 1342, or 1343 or Chapter 25 or 47 of Title 18 of the U.S. Code within the list of offenses that the Commission may consider. These provisions concern concealment of assets, false oaths and claims, and bribery in connection with bankruptcy; mail fraud; wire fraud; counterfeiting and forgery; and fraud and false statements, respectively. Section 5(b)(5) of the Act amends Section 203(e)(2)(D) to include a violation of a substantially equivalent foreign statute.

Section 203(e)(3) of the Advisers Act authorizes the Commission to impose sanctions where an investment adviser or associated person has been enjoined from acting as an investment adviser, underwriter, broker, dealer, municipal securities dealer, government securities broker, government securities dealer, transfer agent, or entity or person required to be registered under the Commodity Exchange Act, or as an affiliated person or employee of any invest-

ment company, bank or insurance company or entity or person required to be registered under the Commodity Exchange Act; or from engaging in any practice in connection with any of these activities or in connection with the purchase or sale of any security. Sections 5(b)(3) and 5(b)(6) of the Act amend Advisers Act Section 203(e)(3) to include injunctions issued by any foreign court of competent jurisdiction that concern substantially equivalent activities.

Section 5(b)(7) of the Act is a technical amendment to Section 203(e)(5) of the Advisers Act. Section 203(e)(5) is amended to include violations of the Commodity Exchange Act. This technical amendment conforms Sections 203(e)(5) with Section 203(e)(4) of the Advisers Act and Sections 15(b)(4)(D) and 15(b)(4)(E) of the Exchange Act.

Section 5(b)(8) of the Act adds new Section 203(e)(7) to the Advisers Act. This new subsection empowers the Commission to base sanctions on findings by a foreign financial regulatory authority of (1) false or misleading statements in registration or reporting materials filed with a foreign securities authority, (2) violations of statutory provisions concerning securities or commodities transactions, or (3) aiding, abetting, or otherwise causing another person's violation of such foreign securities or commodities provisions, or failing to supervise a person who has committed such a violation. Subsection (e)(7) substantially parallels the provisions of existing Section 203(e) (1), (4), and (5) concerning such findings by the Commission or other securities and commodities regulatory authorities. This section of the Act parallels Sections 3(a)(7) and 5(a) of the Act, which add Section 15(b)(4)(7) of the Exchange Act and Section 9(b)(4) of the 1940 Act.

*Section 5(c).*- Section 5(c) of the Act amends Section 203(f) of the Advisers Act, which authorizes the Commission to impose sanctions upon persons associated or seeking to become associated with an investment adviser if the person has committed or omitted any act or omission set forth in Sections 203(e) (1), (4), or (5) or has been convicted or enjoined as set forth in Sections 203(e)(2) or 203(e)(3). Section 203(f) is amended to include a reference to new Section 203(e)(7), thus authorizing the Commission to consider such findings when imposing sanctions upon persons who are, or seek to become, associated with an investment adviser.

## SECTION 6

Section 6 amends Section 2(a) of the 1940 Act and Section 202(a) of the Advisers Act to include definitions of "foreign securities authority" and "foreign financial regulatory authority". These definitions are identical to the definitions of foreign securities authority in Section 3(a)(50) of the Exchange Act and the definition of foreign financial regulatory authority added by Section 4 of the Act.

## SECTION 7

Section 7 adds a new subsection (f) to Section 4 of the Exchange Act to authorize the Commission to accept reimbursement of expenses from or on behalf of foreign securities authorities for expenses incurred by the Commission in conducting investigations on their behalf or in providing other assistance. This new subsection is similar to subsection (c) of the section, which authorizes the Com-

mission to accept reimbursement from private sources for the expenses incurred by Commission members and employees in attending meetings and conferences concerning the functions or activities of the Commission.

#### AGENCY VIEWS

U.S. SECURITIES AND EXCHANGE COMMISSION,  
*Washington, DC, March 1, 1989.*

Hon. JOHN D. DINGELL,  
*Chairman, House Committee on Energy and Commerce, Rayburn House Office Building, Washington, DC.*

DEAR CHAIRMAN DINGELL: The Securities and Exchange Commission is pleased to transmit the attached legislative proposal, the "International Securities Enforcement Cooperation Act of 1989." This proposal would amend the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. On June 3, 1988, the Commission submitted to Congress a substantially similar legislative proposal, entitled the "International Securities Enforcement Cooperation Act of 1988." Part of that proposal was enacted by Congress as Section 6 of the Insider Trading and Securities Fraud Enforcement Act of 1988, Public Law No. 100-704, 102 Stat. 4677.

This legislative proposal incorporates the three provisions of the Commission's June 1988 proposal that were not enacted. It also contains two new provisions. The first would expand the authority of securities self-regulatory organizations to exclude convicted felons from membership in, or association with members of, the organizations. The second would authorize the Commission to accept reimbursement from foreign securities authorities of expenses incurred by the Commission in providing assistance to such authorities.

The Commission believes that enactment of this legislation would strengthen international cooperation in the enforcement of securities laws.

The views expressed here and in the accompanying materials are those of the Commission and do not necessarily express the views of the President. These materials are being submitted simultaneously to the Office of Management and Budget. We will inform you of any advice received from OMB concerning the relationship of these materials to the program of the administration.

Questions concerning the proposed legislation may be direct to Nina Gross, Director of Legislative Affairs (272-2500).

Sincerely yours,

DAVID S. RUDER, *Chairman*

Attachment:

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF  
THE INTERNATIONAL SECURITIES ENFORCEMENT COOPERATION ACT OF  
1989

#### I. INTRODUCTION

On June 3, 1988, the Commission submitted to Congress a legislative proposal entitled the "International Securities Enforcement

the Commission by rule deems appropriate if the person receiving such records or information provides such assurances of confidentiality as the Commission deems appropriate.

The Commission is proposing the foregoing amendment, which grants the Commission rulemaking authority, rather than an amendment which would list the specific persons to whom access may be given. As a result, the Commission will have flexibility in adjusting its access rules in the future. In addition, by specifying that the Commission may permit access by foreign persons, the Commission's authority as to this matter will be made explicit.<sup>8</sup> The provision as to confidentiality of records is intended to ensure that the Commission will not provide records to persons who will make the records public for purposes other than those stated in an access request.<sup>9</sup>

*C. Legislation authorizing the Commission to impose sanctions on securities professionals for violations of foreign laws.*

*1. The need for legislation*

*a. Overview.-* One likely result of efforts by foreign securities authorities to strengthen their securities law enforcement will be an increase in the number of enforcement or disciplinary proceedings brought against securities professionals, such as brokers, dealers, and investment advisers. Indeed, such actions may result at least in part from the assistance provided to foreign authorities by the Commission pursuant to recently enacted Section 21(a)(2) of the Exchange Act. The Commission, however, currently does not have explicit authority to impose administrative sanctions against professionals based upon foreign findings of their illegal or improper foreign activities (although, as discussed below, the Commission has some authority in this area). The proposed legislation provides that the Commission may, in its discretion, impose sanctions on securities professionals who have been found to have engaged in misconduct abroad when, had the order or finding of violation been made in a United State [sic] proceeding, the professional would have been subject to a Commission disciplinary proceeding. Sections 3 through 6 of the bill therefore would amend Sections 15(b)(4) and 3(a)(39) of the Exchange Act; Section 9(b) of the Investment Company Act; and Section 203(e) of the Investment Advisers Act to provide the Commission with this express authority and to add to the Commission's existing authority.

*b. Specific concerns.-* U.S. broker-dealers, investment advisers, and investment companies have increased significantly their activi-

<sup>8</sup> By including the phrase "notwithstanding any other provision of law," the amendment will supersede the disclosure provisions of Section 45(a) of the Investment Company Act and Section 210(b) of the Investment Advisers Act.

<sup>9</sup> Commission policy now requires that the person making the access request state the purposes for which the requested information will be used and certify that no public use will be made of the information except for the purposes specified. It is expected that these or similar procedures would continue to be used after the legislation is enacted. In the international context, where the Commission has entered into MOUs, such MOUs delineate the public uses that can be made of information which the Commission provides pursuant to the access program.

ties in foreign markets.<sup>10</sup> The activities of foreign professionals in the U.S. markets also are likely to increase.<sup>11</sup> As a result, the Commission is likely to confront a growing number of securities professionals who have been disciplined abroad for illegal or improper activities working or seeking to work in this country.

The Commission currently has substantial authority to curtail the securities activities of certain convicted criminals and other wrongdoers for illegal or improper conduct in this country. Under Section 15(b)(4) and (b)(6) of the Exchange Act, the Commission may censure, limit the activities, functions, or operations of, suspend for up to twelve months, or revoke the registration of any broker or dealer, or bar from association with any broker or dealer, any person: found to have violated the federal securities laws, rules, or regulations thereunder; convicted of a “felony or misdemeanor” within the preceding ten years involving specified crimes; who willfully has filed a false or misleading statement in any registration statement or report filed with the Commission; or who has willfully aided and abetted a violation of any portion of the federal securities or commodities laws. Such a person also is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act.<sup>12</sup> Section 203 (e) and (f) of the Investment Advisers Act provides the Commission with disciplinary authority over investment advisers and persons associated with registered investment advisers similar to that in Section 15(b) (4) and (6) of the Exchange Act.<sup>13</sup>

<sup>10</sup> See Internationalization of the Securities Markets, Report of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Energy and Commerce, dated July 27, 1987, at Chapter VII. The report states that there has been a dramatic increase in the number of U.S. investment companies that emphasize foreign securities, in their portfolios and that it has become more common for investment companies registered in the United States to issue their securities in foreign markets. As of January 1988, there were 154 registered investment companies of all types that concentrate their portfolio securities, in foreign securities. These funds, which are widely held by U.S. investors, use foreign broker-dealers to execute portfolio transactions, foreign custodians to hold portfolio securities, and foreign advisers to help manage their portfolios. With respect to broker-dealers, major foreign markets usually facilitate entry by granting national treatment to U.S. securities firms. France has substantially increased access to its markets by foreign firms, *id.* at V-3, and the Tokyo Stock Exchange recently increased the number of seats allocated to foreign firms. Affiliates of U.S. broker-dealers now engage in significant market-making activities in London. *Id.* at V-21.

<sup>11</sup> See *id.* at I-14-16; II-78-90. The report indicates that over 120 investment advisers from 20 countries have registered with the Commission. In 1984, the Commission transmitted a legislative proposal to Congress that would amend Section 7(d) of the Investment Company Act to give the Commission greater flexibility in permitting foreign investment companies access to the U.S. securities markets. Although this proposal never was introduced in either House of Congress, the Commission anticipates renewed interest in a legislative proposal to amend Section 7(d). In addition, the Commission is considering the possibility of reciprocal arrangements between the United States and foreign nations with respect to multinational offering of mutual fund securities. Finally, recently-adopted Rule 6c-9 will facilitate the offering of foreign bank securities in the United States. Investment Company Act Release No. 16093 (Oct. 29, 1987).

With respect to broker-dealers, about 150 foreign firms had established branches in the United States as of 1987; for their part, U.S. firms had over 250 branches in foreign countries, excluding Canada and Mexico. *Id.* at Chapter V, Appendix B-66 (remarks of James M. Davin, Vice-Chairman, NASD).

<sup>12</sup> As a result, when such a person seeks to become associated with a member of an SRO, that SRO and the Commission have the opportunity to give special review to the person’s employment application or to restrict or prevent reentry into the business where appropriate for the protection of investors. See Section 15A(g)(2) of the Exchange Act and Rule 19h-1 thereunder.

<sup>13</sup> Section 15(b)(6) of the Exchange Act and Section 203(f) of the Investment Advisers Act authorize the Commission to limit the activities of a person associated or seeking to become associated with a broker-dealer or investment adviser if the Commission finds that the person has committed any of the acts or has been convicted or enjoined as designated in Section 15(b)(4) or Section 203(e). As a result, any addition to the Commission’s authority under Section 15(b)(4) or Section 203(e) will, by implication, expand the Commission’s authority under Section 15(b)(6) and Section 203(f).



In addition, Section 9(a) of the Investment Company Act generally prohibits a person convicted of a securities-related crime or subject to a securities-related injunction from serving as an employee, officer, director, member of an advisory board, investment adviser, or depositor of a registered investment company, or principal underwriter for any registered open-end company, unit investment trust, or face-amount certificate company. The automatic statutory disqualification in Section 9(a) is supplemented by the Commission's authority under section 9(b). Under Section 9(b), the Commission may prohibit a person from serving in any of the capacities cited in Section 9(a) or as an affiliated person of a registered investment company's investment adviser, depositor, or principal underwriter if the person willfully has caused a false or misleading statement to be made in any registration statement or report filed with the Commission or if the person has willfully violated or aided and abetted a violation of any provision of the federal securities or commodities laws.

Although the foregoing provisions do not mention the Commission's authority to impose sanctions based on foreign misconduct, certain of the provisions can be so applied. In particular, Sections 15(b)(4)(B) of the Exchange Act, 203(e)(2) of the Investment Advisers Act, and 9(a)(1) of the Investment Company Act refer to a "felony or misdemeanor" conviction for specified crimes; neither the statutes nor their legislative histories specify that the crime or conviction must take place in the United States.<sup>14</sup> Thus, pursuant to Section 15(b)(4)(B), the Commission revoked the U.S. registration of a Canadian broker-dealer who was convicted of crimes in Canada involving the purchase or sale of securities.<sup>15</sup> Likewise, under Sections 15(b)(4)(C) of the Exchange Act and 203(e)(3) of the Investment Advisers Act, the Commission may impose sanctions based upon a securities-related injunction entered by a "court of competent jurisdiction," and, under Section 9(a)(2) of the Investment Company Act, such an enjoined person's association with a registered investment company is limited. These statutes are not explicitly limited to injunctions entered by U.S. courts. See L. Loss, *supra* at 1305 (stating that a "court of competent jurisdiction" as set forth in section [sic] 15(b)(4)(C) may include a foreign court).

As to other provisions, however, such authority needs to be clarified and, in some cases, expanded. First, the Commission's authority to impose sanctions on a professional<sup>16</sup> and to restrict association with a registered investment company<sup>17</sup> for a misstatement in an application for registration or report filed with the Commission does not extend to misstatement made to foreign regulatory au-

<sup>14</sup> Investment Trusts and Investment Companies: Hearings Before a Subcommittee on the Senate Committee on Banking and Currency, 76<sup>th</sup> Cong., 3d Sess. 7, 31, 559 (1940) (statement of Honorable Charles F. Adams); Investment Trusts and Investment Companies: Hearings Before a Subcommittee on the House of Representatives Committee on Interstate and Foreign Commerce, 76<sup>th</sup> Cong., 3d Sess. 13, 46, 97(1940). As to Section 15(b)(4)(B) of the Exchange Act (originally Section 15(b)(5)(B)), see Report to Accompany H.R. 6793, H. Rep. No. 1418, 88<sup>th</sup> Cong., 2d Sess. 21 (1964).

<sup>15</sup> *In the Matter of R.P. Clarke & Co.*, 10 S.E.C. 1072 (1942). See also L. Loss, *Securities Regulation* 1303, n. 51 (2d ed. 1961) (citing *R.P. Clarke* decision and stating that the Commission may impose sanctions under Section 15(b)(4)(B) based upon a conviction in a foreign court).

<sup>16</sup> See Section 15(b)(4)(A) of the Exchange Act and Section 203(e)(1) of the Investment Advisers Act.

<sup>17</sup> See Section 9(b)(1) of the Investment Company Act.

thorities. Second, the Commission's authority to impose sanctions on the professional<sup>18</sup> or to restrict association with a registered investment company<sup>19</sup> for willful violation of the U.S. securities and commodities laws does not extend to violation of foreign securities laws. Finally, the Commission's authority to impose sanctions on professionals for aiding and abetting a violation or failing reasonably to supervise a person subject to the professional's control in violation of the U.S. securities laws<sup>20</sup> and to restrict association with a registered investment company of personnel who are found to have aided and abetted such violations<sup>21</sup> does not extend to activities that violates [sic] foreign securities and commodities laws. The legislation would provide the Commission with authority to act in each of these circumstances.

In addition, as to the provisions under which, as discussed above, the Commission has authority to impose sanctions, the legislation would make such authority explicit and would preclude certain challenges which might be possible under the existing statutes. In particular, Section 15(b)(4)(B) of the Exchange Act, Section 203(e)(2) of the Investment Advisers Act, and Section 9(a)(1) of the Investment Company Act refer to convictions for a "felony or misdemeanor" as the basis for a Commission sanction. A securities professional who was convicted in a country that does not define crimes as "felonies" or "misdemeanor" might challenge the Commission's authority under these sections. A Commission administrative sanction also might be challenged when the foreign offense for which the securities professional was convicted is not one of the exact offenses specifically covered by the statutory provisions. As discussed below, the proposed legislation would undercut such defenses by providing for Commission sanctions based upon foreign convictions for crimes "substantially equivalent" to those listed in the statute. The legislation also would foreclose the potential argument that the statutory provisions that allow the Commission to impose sanctions on professionals who have been enjoined from acting in specific capacities, such as underwriters or investment advisers,<sup>22</sup> do not apply to persons whose profession is not so defined in a foreign country. The proposed amendments would resolve the potential difficulties posed by differences in employment terms by permitting sanctions based upon an injunction entered against a professional who performs a "substantially equivalent" function to the activities currently listed in the statute.

Section 3(b) of the proposed legislation would create a "statutory disqualification," as defined in Section 3(a)(39) of the Exchange Act, when a foreign securities authority or foreign court makes findings of illegal or improper conduct.

The Commission's action against a securities professional would not be automatic. The statutory procedure for imposing sanctions

<sup>18</sup> See Section 15(b)(4)(D) of the Exchange Act and Section 203(e)(4) of the Investment Advisers Act.

<sup>19</sup> See Section 9(b)(2) of the Investment Company Act.

<sup>20</sup> See Section 15(b)(4)(E) of the Exchange Act and Section 203(e)(5) of the Investment Advisers Act.

<sup>21</sup> See Section 9(b)(3) of the Investment Company Act.

<sup>22</sup> Section 9(b)(4)(C) of the Exchange Act; Section 203(e)(3) of the Investment Advisers Act; and Section 9(2)(a)(2) of the Investment Company Act.

for foreign misconduct would be the same as that currently in place for imposing sanctions for domestic misconduct. The Commission would provide the securities professional with notice and an opportunity for a hearing prior to taking such action. The securities professional would thus have an opportunity to present evidence on his own behalf, in order to demonstrate that the imposition of sanctions would not be in the public interest. In addition, if the professional makes a persuasive due process or jurisdictional attack on the foreign adjudicative proceedings, the Commission may be required to permit relitigation of the underlying offense. In such a case, as is presently the case in those situations in which the Commission may proceed against a securities professional based upon a foreign finding of misconduct, the foreign finding would provide the basis for a Commission administrative proceeding even though principles of collateral estoppel might not be available to the Commission.<sup>23</sup>

In addition, the legislation would amend newly redesignated subparagraph (F) of Section 3(a)(39) of the Exchange Act, which by cross reference to Section 15(b)(4) of that act makes persons convicted of specified felonies and misdemeanors subject to statutory disqualification, by adding “any other felony” to the crimes listed as possible for denial of SRO membership or participation or association with an SRO member. As explained above,<sup>24</sup> this provision would permit the Commission and the SROs to provide special scrutiny of persons who have been convicted of crimes that are not currently specified, such as taking of property, assault, murder, and drug trafficking.

## *2. The proposed legislation*

Sections 3 through 6 of the proposed legislation would add new Sections 15(b)(4)(G) to the Exchange Act, 203(e)(7) to the Investment Advisers Act, and 9(b)(4) to the Investment Company Act. These provisions would apply the proscriptions of Section 15(b)(4)(A), (D), and (E) of the Exchange Act, Section 2032(e)(1), (4), and (5) of the Investment Advisers Act, and Section 9(b)(1)-(3) of the Investment Company Act to an international extent. Thus, the Commission would be able to impose sanctions on the professional if he has been found by a “foreign financial regulatory authority”—a defined term in the Acts—to have made false or misleading statements in registration statements or reports filed with the authority; violated foreign statutory or regulatory provisions regarding securities or commodities transactions; or aided, abetted, or otherwise caused another person’s violation of such foreign securities or commodities provisions or failed to supervise a person who has committed a violation of such provisions. The term “foreign financial regulatory authority” would be defined in new Sections 3(a)(51) of the Exchange Act, 202(a)(24) of the Investment Advisers Act, and 2(a)(50) of the Investment Company Act to include a “foreign secu-

<sup>23</sup> Similarly, in a Commission review, pursuant to 15 U.S.C. 19(d)-(f), of an SRO disciplinary or membership proceeding against a persons subject to a statutory disqualification, the Commission might find it necessary to remand the proceeding to the SRO for relitigation of the underlying offense in cases where persuasive due process or jurisdictional challenges to the foreign proceeding are made.

<sup>24</sup> See supra at 3.

rities authority” or organization that is essentially equivalent to a self-regulatory organization. The term “foreign securities authority,” in turn, is defined in new Sections 202(a)(23) of the Investment Advisers Act, and 2(a)(49) of the Investment Company Act as “any foreign government or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws relating to securities.”<sup>25</sup>

Sections 15(b)(4)(G), 203(e)(7), and 9(b)(4) are substantially similar to Sections 15(b)(4), 203(e), and 9(b) described above. The most significant difference between the existing and the new provisions is that the legislation would not require that the foreign authorities find “willful” misconduct, i.e., a “willful” false filing, a “willful” statutory violation, or “willful” secondary liability. The Commission recommends this approach because of a potential disparity in standards of willfulness in different countries and because some countries may not require a “willful” violation. The proposed language would provide the Commission with flexibility in deciding whether the facts of a particular case warrant imposition of sanctions.

In addition, Section 15(b)(4)(B) of the Exchange Act and Section 203(e)(2) of the Investment Advisers Act would be amended to grant the Commission explicit authority to consider convictions by a foreign court of competent jurisdiction of any crime enumerated in current Section 15(b)(4)(B) and section 203(e)(2) or a “substantially equivalent” foreign crime; Section 15(b)(4)(C) of the Exchange Act and Section 203(e)(3) of the Investment Advisers Act would be amended to state explicitly that the Commission may consider injunctions imposed by a foreign court of competent jurisdiction in connection with any of the activities designated in the statute, or a connection with any of the activities designated in the statute, or a “substantially equivalent” foreign activity. The Commission would have authority to restrict association with a registered investment company based on the same factors in new Sections 9(b)(5) and (6).

It should also be noted that the Commission determined not to recommend an amendment to Section 9(a) of the Investment Company Act, which prohibits association in certain capacities with a registered investment company by persons who have been convicted of certain offenses or who have been subject to specified injunctions. Section 9(a) is a self-policing mechanism, the purpose of which “is to prevent persons with unsavory records from occupying these positions where they have so much power and where faithfulness to the fiduciary obligations is so important.”<sup>26</sup> The automatic disqualification provisions of Section 9(a), coupled with the Commission’s exemptive authority under Section 9(c) to avoid any inequitable results, are indispensable means of safeguarding the in-

<sup>25</sup> This is the same definition that was enacted as Section 3(a)(50) of the Exchange Act in Section 6 of the Insider Trading and Securities Fraud Enforcement Act of 1988. As noted above (supra note 13), Section 15(b)(6) of the Exchange Act and Section 203(f) of the Investment Advisers Act authorize the Commission to limit activities of a person associated or seeking to become associated with a broker-dealer or investment adviser if the Commission finds that the person has committed any of the acts or has been convicted or enjoined as designated in Section 15(b)(4) or Section 203(e). Because Sections 3 and 5 require the addition of new paragraphs to Section 15(b)(4) and Section 203(e), the legislation will provide for conforming amendments to Section 15(b)(6) and Section 203(f). It would also make conforming amendments to Sections 15B(c), 15 C(c), 15C(f) and 17A(c) of the Exchange Act.

<sup>26</sup> Hearings on S. 3580 Before a Subcomm. of the Sen. Comm. on Banking and Currency, 76<sup>th</sup> Cong., 3d Sess. 46 (1940).

*to any material fact, or has omitted to state in any application or report to a foreign securities authority any material fact that is required to be stated therein;*

*(B) violated any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade;*

*(C) aided, abetted, counseled, commanded, induced, or procured the violation by any other person of an [sic] foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade;*

*(5) within 10 years has been convicted by a foreign court of competent jurisdiction of a crime, however denominated by the laws of the relevant foreign government, that is substantially equivalent to an offense set forth in paragraph (1) of subsection (a); or*

*(6) by reason of any misconduct, is temporarily or permanently enjoined by any foreign court of competent jurisdiction from acting in any of the capacities, set forth in paragraph (2) of subsection (a), or a substantially equivalent foreign capacity, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security.*

\* \* \* \* \*

INFORMATION FILED WITH COMMISSION

SEC. 45. (a) The information contained in any registration statement, application, report, or other document filed with the Commission pursuant to any provision of this title or of any rule or regulation thereunder (as distinguished from any information or document transmitted to the Commission) shall be made available to the public, unless and except insofar as the Commission, by rules and regulations upon its own motion, or by order upon application, finds that public disclosure is neither necessary nor appropriate in the public interest or for the protection of investors. [It shall be unlawful] *Except as provided in section 24(c) of the Securities Exchange Act of 1934, it shall be unlawful* for any member, officer, or employee of the Commission to use for personal benefit, or to disclose to any person other than an official or employee of the United States or of a State, for official use, or for any such official or employee to use for personal benefit, any information contained in any document so filed or transmitted, if such information is not available to the public.

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INVESTMENT ADVISERS ACT OF 1940

\* \* \* \* \*

DEFINITIONS

SEC. 202.(a) When used in this title, unless the context otherwise requires—

(1) \* \* \*

\* \* \* \* \*

(23) “Foreign securities authority” means any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters.

(24) “Foreign financial regulatory authority” means any (A) foreign securities authority, (B) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for future delivery, or other instruments traded on or subject to the rules of a contract market, board of trade or foreign equivalent, or other financial activities, or (C) membership organization a function of which is to regulate participation of its members in activities listed above.

\* \* \* \* \*

REGISTRATION OF INVESTMENT ADVISERS

SEC. 203. (a) \* \* \*

\* \* \* \* \*

(e) The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any investment adviser if it finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest and that such investment adviser, or any person associated with such investment adviser, whether prior to or subsequent to becoming so associated—

(1) \* \* \*

(2) has been convicted within ten years preceding the filing of any application for registration or at any time thereafter of any felony or misdemeanor or has been convicted within 10 years of a substantially equivalent crime by a foreign court of competent jurisdiction which the Commission finds—

(A) involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, any substantially equivalent activity however denominated by the laws of the relevant foreign government, or conspiracy to commit any such offense;

(B) arises out of the conduct of the business of a broker, dealer, municipal securities broker, government securities dealer, investment adviser, bank, insurance company, government securities dealer, fiduciary, transfer agent, foreign person performing a function substantially equivalent to any of the above, or entity or person required to be reg-

istered under the Commodity Exchange Act *or any substantially equivalent statute or regulation;*

(C) involves the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities *or substantially equivalent activity however denominated by the laws of the relevant foreign government;* or

(D) involves the violation of section 152, 1341, 1342, or 1343 or chapter 25 or 47 of title 18, United States Code, *or a violation of a substantially equivalent foreign statute;*

(3) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction, *including any foreign court of competent jurisdiction* from acting as an investment adviser, underwriter, broker,, dealer, municipal securities dealer, government securities broker, government securities dealer, transfer agent, *foreign person performing a function substantially equivalent to any of the above,* or entity or person required to be registered under the Commodity Exchange Act *or any substantially equivalent statute or regulation,* or as an affiliated person or employee of any investment company, bank, insurance company, *foreign entity substantially equivalent to any of the above,* or entity or person required to be registered under the Commodity Exchange Act *or any substantially equivalent statute or regulation,* or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security.

\* \* \* \* \*

(5) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, this title, *the Commodity Exchange Act,* the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this paragraph (5) no person shall be deemed to have failed reasonably to supervise any person, if—

(A) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and

(B) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

\* \* \* \* \*

(7) has been found by a foreign financial regulatory authority to have—

(A) made or caused to be made in any application for registration or report required to be filed with a foreign securities authority, or in any proceeding before a foreign securities authority with respect to registration, any statement that was at the time and in light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any application or report to a foreign securities authority any material fact that is required to be stated therein;

(B) violated any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade; or

(C) aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade, or has been found, by the foreign financial regulatory authority, to have failed reasonably to supervise, with a view to preventing violations of statutory provisions, and rules and regulations promulgated thereunder, another person who commits such a violation, if such other person is subject to his supervision.

(f) The Commission, by order shall censure or place limitations on the activities of any person associated, seeking to become associated, or, at the time of the alleged misconduct, associated or seeking to become associated, with an investment adviser, or suspend for a period not exceeding twelve months or bar any such person from being associated with an investment adviser, if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person has committed or omitted any act or omission enumerated in [paragraph (1), (4), or (5)] *paragraph (1), (4), (5), or (7)* of subsection (e) of this section or has been convicted of any offense specified in paragraph (2) of said subsection (e) within ten years of the commencement of the proceedings under this subsection, or is enjoined from any action, conduct, or practice specified in paragraph (3) of said subsection (e). It shall be unlawful for any person as to whom such an order suspending or barring him from being associated with an investment adviser in effect willfully to become, or to be, associated with an investment adviser without the consent of the Commission, and it shall be unlawful for any investment adviser to permit such a person to become, or remain, a person associated with him without the consent of the Commission, if such investment adviser knew, or in the exercise of reasonable care, should have known, of such order.

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PUBLICITY

SEC. 210.(a)\*\*\*



(b) Subject to the provisions of [subsections (c) and (e) of section 209] *subsections (c) and (d) of section 209 of this Act and section 24(c) of the Securities Exchange Act of 1934*, the Commission, or any member, officer, or employee thereof, shall not make public the fact that any examination or investigation under this title is being conducted, or the results of or any facts ascertained during any such examination or investigation; and no member, officer, or employee of the Commission shall disclose to any person other than a member, officer, or employee of the Commission any information obtained as a result of any such examination or investigation except with the approval of the Commission. The provisions of this subsection shall not apply—

- (1) in the case of any hearing which is public under the provisions of section 212; or
- (2) in the case of a resolution or request from either House of Congress.

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THE SECURITIES LAW ENFORCEMENT REMEDIES ACT OF 1990

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JUNE 26 (legislative day, JUNE 11), 1990. – Ordered to be printed

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Mr. RIEGLE, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

**R E P O R T**

[To accompany S. 647]

INTRODUCTION

On May 4, 1990, the Senate Committee on Banking, Housing, and Urban Affairs marked up and ordered to be reported a bill, the Securities Law Enforcement Remedies Act of 1990, to amend the Federal securities laws in order to provide additional enforcement remedies for violations of those laws. The Committee voted to adopt the legislation by a voice vote, without objection, and to report the bill to the Senate.

PURPOSE AND SUMMARY

The Securities Law Enforcement Remedies Act is designed to strengthen the enforcement powers of the Securities and Exchange Commission (SEC) and provide the agency with a broader range of remedies to protect investors and maintain the integrity of the nation's securities markets. The legislation addresses the disturbing levels of financial fraud, stock manipulation and other illegal activity in the U.S. markets by authorizing new civil money penalties to deter unlawful conduct by increasing the financial consequences of securities law violations. It provides the SEC with new cease-and-desist authority, enhancing the agency's ability to protect investor funds when they are at risk, and broadening the SEC's administrative procedures to curb a wider range of securities violations. The bill is designed to combat recidivism and protect investors from those whose unlawful conduct demonstrates their unfitness to serve as an officer or director by expressly authorizing courts to

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**5451**

**Item 294**

third tier maximum of \$100,000 for natural persons or \$500,000 for other persons.

The same tiering of penalties applies to court proceedings, with one major difference: within each tier, the maximum penalty is the greater of the dollar amount specific *or* the gross amount of pecuniary gain to the defendant as a result of the violation.<sup>14</sup> The Committee intends the phrase [sic] “gross amount of pecuniary gain to such defendant as a result of the violation” to mean the amount by which the defendant was unjustly enriched as a result of the violation.<sup>15</sup> Thus, for example, if a violation involves fraud and resulted in substantial losses to other persons, a court (in addition to ordering disgorgement of profits) may assess a civil penalty equal to a violator’s gain, even when that gain exceeds the applicable \$100,000 or \$500,000 limitation. Under current law, a district court may assess a civil money penalty of up to three times the profits derived from an insider trading violation, based upon “the facts and circumstances” of the case. Penalties under ITSA are not fixed by a statutory maximum amount. S. 647 extends this principle of ITSA penalties to other types of securities law violations.

*Penalties in administrative proceedings.*—The proposed legislation authorizes the SEC to assess money penalties in administrative proceedings, by adding new provisions to the Exchange Act (new Section 21B), the Investment Company Act of 1940 (new Section 9(d)) and the Investment Advisers Act of 1940 (new Section 203(i)). These provisions permit the SEC to impose monetary penalties on persons who are found to have violated the Federal securities laws in proceedings under Section 15(b)(4), 15(b)(6), 15B, 15C, and 17A of the Exchange Act, under Section 9(b) of the Investment Company Act, and under Sections 203 (e) and (f) of the Investment Advisers Act.

Sections 202, 301, and 401 of the legislation provide that the SEC may impose a penalty if it finds, on the record after notice and opportunity for hearing, that the person committed the violation and that the penalty is in the public interest. Each of the provisions sets forth the following factors that the SEC may consider in determining whether, and to what extent, a penalty is in the public interest:

- (1) Whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;
- (2) The harm to other persons resulting either directly or indirectly from such act or omission;
- (3) The extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior;
- (4) Whether such person previously has been found by the SEC, another appropriate regulatory agency, or self-regulatory

<sup>14</sup> The third tier for judicially-ordered penalties also drops the phrase “or results in substantial pecuniary gain to the person who committed the act or omission.”

<sup>15</sup> “Gross amount of pecuniary gain” is used in Section 3571 of the Federal Criminal Code, 18 U.S.C. 3571(d), which authorizes a criminal fine equal to twice the defendant’s gross pecuniary gain from an offense or twice the losses to others. In view of the different purposes served by this provision in S. 647, the Committee does not intend courts to be bound by previous interpretations of Section 3571.

organization to have violated the federal securities laws, state securities laws, or the rules of a self-regulatory organization, or has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted of certain securities-related offenses;

(5) The need to deter such person and other persons from committing such acts or omissions; and

(6) Such other matters as justice may require.

The Committee believes that the determination to impose a penalty is appropriately based on consideration of the public interest. Under the legislation, the SEC may consider the specific factors enumerated in determining whether penalty is in the public interest. The Committee recognizes that not all of the factors will apply in any given case, and that the factors that are applicable should not be accorded the same weight in every case. The factors are permissive considerations in the sense that the SEC may determine that a penalty is in the public interest, even if a respondent presents evidence that one or a number of the factors is inapplicable.

The SEC has advised the Committee that the six factors generally reflect the type of analysis that the SEC makes in determining appropriate remedies under its current enforcement policy. The Committee believes that these standards provide guidance to the SEC and the public without being unnecessarily rigid.

The first factor is “whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.” This factor recognizes that the SEC may assess the violator’s culpability, including whether the violator acted with scienter. The SEC may assess penalties not only in cases involving fraud, but also in cases in which the respondent fails to satisfy a regulatory obligation (for example, an investment adviser who fails to maintain required books and records notwithstanding prior warnings). This factor is consistent with the three-tiered structure of the penalty provisions, which contemplate that lesser penalties will be assessed against those who are less culpable.

The second factor is “the harm to other persons resulting either directly or indirectly from such act or omission.” This factor relates to the gravity of a violation and focuses primarily on the consequences of the violation to others.

The third factor is “the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior.” While consideration of this factor does not address the respondent’s underlying culpability, the fact of restitution may go toward mitigation of a civil money penalty. The phrase “any person” takes into account those situations in which the respondent may not be the only person unjustly enriched as a result of the violation.

The fourth factor is “whether such person previously has been found by the Commission, other appropriate regulatory agency, or self-regulatory organization to have violated the federal securities laws, state securities laws, or the rules of a self-regulatory organization, or has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a

court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in [Section 15(b)(4)(B) of the Exchange Act or Section 203(e)(2) of the Investment Company Act].” This recognizes that the SEC may properly impose higher civil money penalties on recidivists than on first-time offenders. The SEC has applied other sanctions more stringently to recidivists.<sup>16</sup> This fourth factor will help in achieving the goal of improved deterrence through the use of money penalties, by providing flexibility to assess higher penalties when lesser ones have proven insufficient to deter the violative conduct.

The fifth factor is “the need to deter such person and others persons from committing such acts or omissions.” This factor is an important consideration in cases in which the violation is one that requires strong deterrence or where assessing civil money penalties is likely to encourage better compliance. For example, for some violations, the effectiveness of deterrence may be a function of the economic gain to be derived from a violation and the probability that a violation will be detected. Indeed, this was the basis on which Congress determined to authorize substantial penalties for insider trading violations. The Committee believes it is appropriate to enable the SEC to impose a higher penalty if the violation is of a type that is difficult to detect.

The SEC also may consider “such other matters as justice may require.” This gives the SEC the latitude to take into account equitable considerations that are not foreseeable and not readily susceptible to statutory delineation. The SEC may wish to consider information similar to that specified in the other five factors, even though those factors are not directly implicated. For example, even when the second factor is not applicable because no actual harm has occurred, the SEC may wish to consider the threat of harm that a violation engendered. Indeed, the third tier of the three-tier structure of the penalty provisions contemplates that the SEC will consider the threat of harm in connection with the amount of penalty. That same threat may likewise bear on the consideration of whether to assess a penalty. Similarly, the SEC may wish to consider a history of noncompliance by a respondent even when the fourth factor is not involved because no prior adjudication has occurred. For example, in cases of failures to file periodic reports, the SEC may appropriately consider a prior history of delinquency even though the SEC had refrained from taking administrative or judicial action earlier.

The Committee also believes that the ability of respondents to pay a civil penalty is an important consideration in determining the amount of the penalty to be imposed. Sections 202, 301, and 401 of the legislation add Section 21B(d) to the Exchange Act, Section 9(d)(4) to the Investment Company Act, and Section 203(i)(4) to the Investment Advisers Act, to provide respondents an opportunity to present evidence about their ability to pay a penalty. Such evidence, for example, could include information relating to the extent of the respondent’s ability to continue in business, the col-

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<sup>16</sup> See e.g., *Hammon v. SEC*, 817 F. 2d 106 (9th Cir. 1987) (court affirmed imposition of SEC sanctions against petitioner found to have engaged in repeated willful violations of record-keeping requirements under the Investment Advisers Act).

lectability of a penalty, claims of the United States or third parties upon the respondent's assets, and the amount of those assets. The SEC, in its discretion, would be able to consider this evidence in determining what sanction is in the public interest. The Committee believes it is appropriate that respondents have the obligation to present evidence of their ability to pay, since they have better access to their financial records than does the SEC.

SEC orders imposing a money penalty, like other final orders in administrative proceedings, may be appealed to the U.S. court of appeals in the circuit in which the respondent resides or has his principal place of business, or in the District of Columbia Circuit. Thus, while this legislation would empower the SEC to impose civil money penalties in certain of its administrative proceedings, its use of this sanction would be subject to judicial review in each case.

*Disgorgement orders in administrative proceedings.*—Sections 202, 301, and 401 of the legislation add Section 21B(e) to the Exchange Act, Section 9(e) to the Investment Company Act, and Section 203(j) to the Investment Advisers Act, respectively. Under the legislation, each of these sections provide that the SEC may enter disgorgement orders in its administrative proceedings. The SEC does not have express authority to order disgorgement under current law, although it has obtained agreements from respondents to disgorge profits or make restitution to injured customers as part of settlement of administrative proceedings.<sup>17</sup> The SEC currently may sanction a respondent taking into account the respondent's representation that it will disgorge profits or make restitution, while reserving the right to impose a more severe sanction if the respondent fails to do so.

The bill includes as a factor relating to the imposition of administrative penalties the extent to which a respondent has made restitution, and thus give a respondent an incentive voluntarily to disgorge ill-gotten gains. The Committee believes, however, that the SEC should have the express authority to order disgorgement in its administrative proceedings in order to ensure that respondents in administrative proceedings do not retain ill-gotten gains. In contrast to damage granted in private actions, which are designed to compensate the victims of a violation, disgorgement forces a defendant to give up the amount by which he was unjustly enriched.

*Penalties in civil actions.*—In addition to authorizing the SEC to impose money penalties in its own administrative proceedings, the legislation also authorizes the SEC to seek court orders imposing civil money penalties against persons who have violated the Federal securities laws.

These penalties may be imposed in addition to orders of disgorgement directing a defendant to return the full amount of profits derived from a violation, and other forms of equitable relief. When a civil money penalty is sought by the SEC, the district court will have discretion to determine whether a penalty should be imposed and the amount of such penalty. This discretion will permit the court to impose a civil money penalty even if it determined that injunctive or other equitable relief against the defendant was not

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<sup>17</sup> See, e.g., *In the Matter of Anderson & Strudwick, Inc.*, Exchange Act Release No. 22089, 33 SEC Doc. 286 (May 29, 1985).

warranted. Thus, for example the courts will have the flexibility to order injunctive or other equitable relief only, injunctive or other equitable relief and a penalty, or a penalty only, depending upon the facts of a particular case. Whether to impose a penalty, and the amount of such penalty, will be determined by the court in light of the facts and circumstances of the particular case.

The SEC's February 9, 1990 legislative proposal provided a minimum penalty for failure to comply with a cease-and-desist order issued for violations of Section 16(a) of the Exchange Act. The committee determined not to include this provision in the legislation because it believes that the permanent cease-and-desist and civil penalty provisions will provide appropriate remedies in many cases of noncompliance. Nevertheless, the Committee is concerned about the disturbingly low levels of compliance with that section.

The Committee believes that the civil money penalty provisions should be applicable to corporate issuers, and the legislation permits penalties against issuers. However, because the costs of such penalties may be passed on to shareholders, the Committee intends that a penalty be sought when the violation results in an improper benefit to shareholders. In cases in which shareholders are the principal victims of the violations, the Committee expects that the SEC, when appropriate, will seek penalties from the individual offenders acting for a corporate issuer. Moreover, in deciding whether and to what extent to assess a penalty against the issuer, the court may properly take into account whether civil penalties assessed against corporate issues will ultimately be paid by shareholders who were themselves victimized by the violations. The court also may consider the extent to which the passage of time has resulted in shareholder turnover.

The Committee also expects that the SEC will not ordinarily seek penalties against registered investment companies. Generally, an investment company is a managed portfolio of liquid assets, with all expenses being passed on to shareholders. While the legislation permits civil penalties based on violations of the Investment Company Act, the penalties generally would be assessed against the responsible individuals.

#### B. CEASE-AND DESIST AUTHORITY

The legislation gives the SEC authority to issue permanent and temporary cease-and-desist orders to enforce the provisions of the Securities Act, the Exchange Act, the Investment Company Act, and the Investment Advisers Act.

In general, a cease-and-desist order is an administrative remedy that directs a person to refrain from engaging in conduct or a practice which violates the laws. The Committee believes the power to impose a cease-and-desist order will enhance the SEC's ability to flexibly tailor remedies to the facts and circumstances of a particular case. Cease-and-desist authority also will give the SEC a useful enforcement tool to be applied against certain conduct and practices for which currently available enforcement remedies might be inappropriate.

Under its current authority, the SEC typically addresses on-going violations of the federal securities law by filing a civil injunctive

action in federal district court. The SEC has been successful in urging courts to grant injunctive relief, including emergency relief, in the form of preliminary injunctions against further violations, temporary restraining orders, orders freezing assets, and the appointment of receivers. However, injunctive relief is not always appropriate. For example, imposition of a civil injunction may result in collateral consequences that are not necessary or appropriate.<sup>18</sup> Under the cease-and-desist authority provided in the legislation, the SEC may be able to resolve cases without protracted negotiation or litigation on that part of defendants seeking to avoid the collateral consequences of an injunction. Cease-and-desist authority also will provide the SEC with an alternative remedy against persons who commit isolated infractions and present a lesser threat to investors. Moreover, given the extremely congested nature of federal court dockets, which often results in considerable delays in cases being heard, the authority to issue an administrative cease-and-desist order will enable the SEC to respond in a more timely fashion to violate conduct or practices.

Under its current authority, the SEC also has the option of proceeding administratively in cases involving regulated entities. This authority has limitations, however. For example, in its proceedings against regulated entities or their associated persons, the SEC may not initiate enforcement actions against persons who are not associated (or seeking to become associated) with a regulated entity. The cease-and-desist authority under S. 647 will significantly broaden and enhance this authority by making an administrative forum available in virtually all types of cases within the SEC's jurisdiction. For example, if an issuer engaging in a self-underwritten offering of securities violated the broker-dealer registration provisions because its selling efforts were outside the safe-harbor provided by Exchange Act Rule 3a4-1, the SEC could enter a cease-and-desist order to halt further sales. This remedy also could be used to address unregistered offerings that violate Section 5 of the Securities Act. The Committee anticipates, however, that the SEC will continue to seek civil injunctive relief in cases involving the most serious violations.

A cease-and-desist order also will provide a more effective remedy than is currently available under Section 15(c)(4) of the Exchange Act, which gives the SEC authority to bring administrative proceedings against persons who fail to comply with the reporting provisions of the Exchange Act. A violation of a cease-and-desist order may be punishable by a court-imposed civil penalty in addition to a mandatory injunction directing compliance with the order. By contrast, the violation of a Section 15(c)(4) order does not result in any penalty other than a court order directing compliance, the subsequent violation of which may lead to a contempt proceeding. In addition, the legislation expressly permits the SEC to order disgorgement in conjunction with the cease-and-desist order.

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<sup>18</sup> These collateral effects might include the statutory disqualification of certain persons from serving as an officer or director of an investment company pursuant to Section 9(a)(2) of the Investment Company Act.



The Committee notes that various Federal agencies have long been authorized to issue cease-and-desist orders against persons who have violated or are about to violate statutory provisions administered by those agencies. For example, the CFTC is authorized to issue cease-and-desist orders when it finds that any person has manipulated or attempted to manipulate the price of any commodity, or has violated any provision of the Commodity Exchange Act or the rules, regulations, or orders of the CFTC thereunder.<sup>19</sup> The Federal Trade Commission, the National Labor Relations Board, and each of the federal bank regulatory agencies also are empowered to issue cease-and-desist orders.<sup>20</sup> Indeed, of all the federal financial regulatory agencies, only the SEC does not have authority to issue a cease-and-desist order.

In view of the significant new authority to act through administrative proceedings granted to the SEC in S. 647, the Committee expects that the SEC will review its Rules of Practice to determine whether any changes to the administrative process are necessary or appropriate.

*Permanent cease-and-desist orders.*—Sections 102, 203, 301, and 401 add Section 8A to the Securities Act, Section 21C to the Exchange Act, Section 9(f) to the Investment Company Act, and Section 203(k) to the Investment Advisers Act, respectively, to authorize the SEC to issue cease-and-desist orders to enforce the provisions of these Acts. The legislation provides for both permanent and temporary cease-and-desist orders.

A permanent cease-and-desist order directs the respondent to refrain from future violations and could also order the respondent to make disgorgement or to take affirmative steps to ensure compliance. Before the SEC may issue a permanent order, the SEC must provide a respondent with notice and opportunity for a hearing. A hearing before an administrative law judge must be set to commence no earlier than thirty days and no later than sixty days after issuance of the notice, unless the respondent consented to an earlier or later date. A respondent has the right to appeal an adverse decision by an administrative law judge to the full SEC, which considers the evidence *de novo*, the same right that respondents currently have in other SEC administrative proceedings. If the SEC affirms on appeal, the entry of a permanent cease-and-desist order may be appealed to a U.S. court of appeals in the same way as any other SEC order entered under the securities laws. This procedure is similar to that provided under the Federal Deposit Insurance Act with respect to FDIC cease-and-desist proceedings.

*Temporary cease-and-desist orders.*—The legislation authorizes the SEC to issue a temporary cease-and-desist order against broker-dealers, investment advisers, investment companies, and other regulated entities and persons associated with them if it has determined that a respondent is engaging, or about to engage in a violation that is likely to result in significant dissipation of assets, conversion of property, or significant harm to investors, or that is oth-

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<sup>19</sup> See 7 U.S.C. 13(b).

<sup>20</sup> Federal Trade Commission Act, 15 U.S.C. 45 (a), (b) (deceptive trade practices); Labor-Management Relations Act, 29 U.S.C. 160(c) (unfair labor practices); Federal Deposit Insurance Act, 12 U.S.C. 1818(b) (as amended by FIRREA).

erwise likely to result in substantial harm to the public interest before the completion of a permanent cease-and-desist proceeding. A temporary order requires the respondent to refrain from a violation, or to take action to prevent a violation, pending a hearing on a permanent order.

The availability of a temporary cease-and-desist remedy will enable the SEC to take emergency action before completion of a cease-and-desist proceeding when necessary to prevent significant harm to investors or the dissipation or conversion of assets. The proposed legislation gives the SEC the ability to commence enforcement proceedings rapidly, especially when ongoing conduct places investors in continuing jeopardy. For example, such authority may be used when information comes to the attention of the SEC that a broker-dealer is soliciting penny stock purchases in violation of the new “cold-calling” rule (Exchange Act Rule 15c2-6). Purchases are often solicited by a large group of persons who place numerous telephone calls in rapid succession to potential investors. When ongoing violations of this sales practice rule are discovered, the SEC will be able to act immediately to stop further calls in violation of the rule. This will prevent further harm that could result from subjecting unsophisticated investors to high pressure sales techniques. In addition, this authority may be used to prevent the dissipation of assets when, for example, the SEC discovers that a broker-dealer is about to disburse proceeds on a fraudulently closed “all or none” offering of penny stock, in violation of Exchange Act Rule 15c2-6. Issuance of a temporary cease-and-desist order also may be appropriate when the SEC learns that a mutual fund’s books and records are so inadequate that shares of the fund cannot be properly priced. The SEC will be able to act with the new authority to protect investors by halting the further purchase or sale of fund shares at incorrect values until the shares may be properly priced.

The issuance of a temporary cease-and-desist order also may be appropriate when emergency action is necessary to ensure that a registered broker-dealer maintains sufficient net capital. For example, the financial failure of Drexel Burnham Lambert Group, Inc., although not resulting in customer losses, illustrates the type of situation in which temporary cease-and-desist authority would facilitate the SEC’s ability to take prompt action for the purpose of protecting investor assets. Given the highly technical nature of the issues involved in such cases, the Committee believes that the SEC, as the financial regulator that monitors the operations of broker-dealers and which has the most expertise in measuring the adequacy of their capital, should have the authority to take such emergency action in appropriate circumstances.

The temporary cease-and-desist have been crafted to provide important due process protections for respondents. In view of the potential significant consequences of a cease-and-desist order, the SEC, as a general matter, will be required to provide prior notice to the respondent before the temporary cease-and-desist order becomes effective, to enable the respondent to show cause why such an order should not be issued. However, the Committee recognizes that there are instances where prior notice is inappropriate. Therefore, if the SEC determines that giving notice is im-

practicable or contrary to the public interest, a temporary cease-and-desist order would become effective upon service. The Committee believes that prior notice would be contrary to the public interest when, for example, it is reasonably likely to result in a respondent's flight from prosecution, destruction of or tempering [sic] with evidence, transfer of assets or records, improper conversion of assets, impeding the SEC's ability to identify or trace the source or disposition of funds, or further harm to investors.

A respondent may seek judicial review of the SEC's determination to issue a temporary cease-and-desist order immediately or within ten days of service of the order, but the order will be effective and enforceable unless the court stays or suspends it. Moreover, at any time after a respondent has been served with a temporary cease-and-desist order he is permitted to apply to the SEC to have the order set aside, limited, or suspended. In addition, the SEC may vacate or modify a temporary order at any time, and the temporary order will immediately cease to be effective if the SEC, after conducting a hearing, determines that a permanent cease-and-desist order should not be issued. If the SEC does issue a permanent cease-and-desist order, the respondent may seek review of the SEC's determination in the appropriate Federal court of appeals.

The SEC may seek enforcement of both temporary and permanent cease-and-desist orders in Federal district court. In addition to seeking a court order directing compliance, the SEC may request, and the court may impose, a civil money penalty for each violation as provided for in this bill.

#### C. OFFICER AND DIRECTOR BARS

The legislation provides express statutory authority for Federal courts to bar or suspend certain individuals from serving as officers or directors of any company required to file reports with the SEC.

Sections 101 and 201 of the bill would amend Sections 20(b) of the Securities Act and Section 21(d) of the Exchange Act, respectively, to expressly authorize the Federal courts to bar or suspend an individual who has violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, or the rules or regulations thereunder, from serving as an officer or director of any company required to file reports with the SEC. The individual's conduct also must demonstrate substantial unfitness to serve as an officer or director. The court may tailor the bar to the particular facts and circumstances and impose the bar on a temporary or permanent basis. A permanent bar might be appropriate if the violation were particularly egregious or the violator was a recidivist.

Although this remedy represents a potentially severe sanction for individual misconduct, persons who have demonstrated a blatant disregard for the requirements of the Federal securities laws should not be placed in a position of trust with a publicly held corporation. Officers and directors have a fiduciary obligation to their shareholders. Moreover, their actions can directly affect the integrity of the securities markets. There is ample precedent for employing this kind of remedy. Banking regulators, for example, have broad authority to remove persons serving as officers and directors

the tie and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such registration statement, or report any material fact which was required to be stated therein.

Section 9(d)(2) provides for maximum amounts for such penalties, Section 9(d)(3) provides factors that the SEC may consider when determining whether the penalty is in the public interest and Section 9(d)(4) allows respondents to show evidence concerning their ability to pay administratively imposed penalties. These sections are parallel to new Sections 21B(b), 21B(c) and 21 B(d) of the Exchange Act, respectively.

Section 9(e) provides that the SEC may enter an order requiring an accounting and disgorgement, including reasonable interest, in any proceeding in which a penalty may be imposed under Section 9(d). This section is parallel to new Section 21B(e) of the Exchange Act.

Section 9(f) authorizes the SEC to issue permanent and temporary cease-and-desist orders to enforce the provisions of the Investment Company Act and to enter an order requiring an accounting and disgorgement in permanent cease-and-desist proceedings. The authority granted under this section parallels new Section 8A of the Securities Act and new Section 21C of the Exchange Act.

Section 9(g) provides that the term “investment adviser” applies to all of Section 9.

### *Section 302*

Section 302 of the Act amends Section 42 of the Investment Company Act by adding new subsection (e). The section references in the following analysis refer to Section 42 of the Investment Company Act, as amended by S. 647.

*Section 42(e)—Money penalties in civil actions.*—Section 42(e)(1) provides that whenever it appears to the SEC that any person has violated any of the provisions of the Investment Company Act, or the rules or regulations promulgated thereunder, or a cease-and-desist order issued pursuant to the SEC’s authority under the Investment Company Act, the SEC may bring an action in Federal district court to seek a civil penalty to be paid by the person who committed such violation. Section 42(e)(1) also provides that a Federal district court may impose such penalties upon a proper showing. This section parallels new Section 20(d)(1) of the Securities Act and new Section 21(d)(3)(A) of the Exchange Act.

Section 42(e)(2) provides three tiers of maximum penalty amounts, similar to those provided in new Section 20(d)(2) of the Securities Act and new Section 21(d)(3)(B) of the Exchange Act. Similarly, Sections 42(e)(3) and 42(e)(4), dealing with procedures for collections of such fines and the scope of each violation, parallel new Sections 20(d)(3) and 20(d)(4) of the Securities Act and new Sections 21(d)(3)(C) and 21(d)(3)(D) of the Exchange Act, respectively.

## TITLE IV: AMENDMENTS TO THE INVESTMENT ADVISERS ACT OF 1940

This title of the bill amends the Investment Advisers Act to authorize a court, in civil actions brought by the SEC, and the SEC, in administrative actions, to impose civil money penalties for viola-

tions of the Investment Advisers Act, and to authorize the SEC to issue both temporary and permanent cease-and-desist orders and enter an order requiring an accounting and disgorgement.

*Section 401*

Section 401 of the Act amends Section 203 of the Investment Advisers Act by adding new subsections (i), (j) and (k). The section references in the following analysis refer to Section 203 of the Investment Advisers Act, as amended by S. 647.

*Section 203(i)—Money penalties in administrative proceedings.*—Section 203(i)(1) authorizes the SEC to impose civil penalties in administrative proceedings instituted pursuant to Section 203(e) or 203(f) of the Investment Advisers Act. The SEC may assess a penalty if it finds that the penalty is in the public interest and the respondent (1) has willfully violated any provision of the Securities Act, the Exchange Act, the Investment Company Act, the Investment Advisers Act, or the rules or regulations thereunder; (2) has willfully aided, abetted, counseled, commanded, induced, or procured a violation by any other person; (3) has willfully made or caused to be made in any application for registration or report required to be filed with the SEC under the Investment Advisers Act, or in any proceeding before the SEC with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such registration statement, application or report any material fact which was required to be stated therein; or (4) failed reasonably to supervise, within the meaning of Section 203(e)(5) of the Investment Advisers Act, with a view to preventing violations of the Investment Advisers Act and such rules or regulations, another person who committed a violation, if the other person was subject to his supervision. This section is parallel to new Section 21B(a) of the Exchange Act.

Section 203(i)(2) provides for maximum amounts for such penalties. Section 203(i)(3) provides factors that the SEC may consider when determining whether the penalty is in the public interest and Section 203(i)(4) allows respondents to show evidence concerning their ability to pay administratively imposed penalties. These sections are parallel to new Sections 21B(b), 21B(c), and 21B(d) of the Exchange Act, and new Sections 9(d)(2), 9(d)(3), and 9(d)(4) of the Investment Company Act, respectively.

Section 203(j) provides that the SEC may enter an order requiring an accounting and disgorgement, including reasonable interest, in any proceeding in which a penalty may be imposed under Section 203. This section is parallel to new Section 21B(e) of the Exchange Act and new Section 9(e) of the Investment Company Act.

Section 203(k) authorizes the SEC to issue permanent and temporary cease-and-desist orders to enforce the provisions of the Investment Advisers Act and to enter an order requiring an accounting and disgorgement in permanent cease-and-desist proceedings. The authority granted under this section parallels new Section 8A of the Securities Act, new Section 21C of the Exchange Act and new Section 9(f) of the Investment Company Act.

*Section 402*

Section 402 of the Act amends Section 209 of the Investment Advisers Act by adding new subsection (e). The section references in the following analysis refer to Section 209 of the Investment Advisers Act, as amended by S. 647.

*Section 209(e)—Money penalties in civil actions.*—Section 209(e) provides that whenever it appears to the SEC that any person has violated any of the provisions of the Investment Advisers Act, or the rules or regulations promulgated thereunder, or a cease-and-desist order issued pursuant to the SEC’s authority under the Investment Advisers Act, the SEC may bring an action in Federal district court to seek a civil penalty to be paid by the person who committed such violation. Section 209(e) also provides that a Federal district court may impose such penalties upon a proper showing. This section parallels new Section 20(d)(1) of the Securities Act, new Section 21(d)(3)(A) of the Exchange Act, and new Section 42(e)(1) of the Investment Company Act.

Section 209(e)(2) provides three tiers of maximum penalty amounts, similar to those provided in new Section 20(d)(2) of the Securities Act, new Section 21(d)(3)(B) of the Exchange Act and new Section 42(e)(2) of the Investment Company Act. Similarly, Sections 209(e)(3) and 209(e)(4), dealing with procedures for collections of such fines and scope of each violation parallel new Sections 20(d)(3) and 20(d)(4) of the Securities Act, new Sections 21(d)(3)(C) and 21(d)(3)(D) of the Exchange Act and new Sections 42(e)(3) and 42(e)(4) of the Investment Company Act, respectively.

*Section 403*

Section 403 of this Act amends Section 214 of the Investment Advisers Act. The section references in the following analysis refer to Section 214 of the Investment Advisers Act, as amended by S. 647.

*Section 214—Conforming amendments to section 214.*—Section 214 is amended to expand the jurisdiction of the Federal district courts to include actions at law, as well as equitable or injunctive actions, under the Investment Advisers Act. This amendment is necessitated by the addition of new Section 209(e), the civil penalty provision, to the Investment Advisers Act, since that section confers jurisdiction over penalty actions to the Federal district courts.

## TITLE V: AMENDMENTS TO THE CRIMINAL CODE

This title of the bill amends the United States Criminal Code to authorize a court, upon motion of an attorney for the government, to disclose grand jury materials to identified personnel of the SEC.

*Section 501*

Section 501 of this Act amends the United States Criminal Code by adding new Section 3323. The section references in the following analysis refer to Section 3323 of the United States Criminal Code, as amended by S. 647.

*Section 3323—Disclosure of certain matters occurring before grand jury for use in enforcing securities laws.*—Section 3323 provides that upon motion of an attorney for the government, a court may direct disclosure of matters occurring before a grand jury