

The fact is, many of the firms that are now returning to prosperity owe a debt to the American people. They were not the cause of this crisis, and yet American taxpayers, through their government, had to take extraordinary action to stabilize the financial industry.

Just as we are asking the private sector to think about the long term, I recognize that Washington has to do so as well. When my administration came through the door, we not only faced a financial crisis and costly recession, we also found waiting a trillion dollar deficit. So yes, we have to take extraordinary action in the wake of an extraordinary economic crisis. But I am absolutely committed to putting this nation on a sound and secure fiscal footing. That's why we're pushing to restore pay-as-you-go rules in Congress, because I will not go along with the old Washington ways which said it was okay to pass spending bills and tax cuts without a plan to pay for it. That's why we're cutting programs that don't work or are out of date. That's why I've insisted that health insurance reform—as important as it is—not add a dime to the deficit, now or in the future.

There are those who would suggest that we must choose between markets unfettered by even the most modest of regulations, and markets weighed down by onerous regulations that suppress the spirit of enterprise and innovation. If there is one lesson we can learn from last year, it is that this is a false choice. Common-sense rules of the road don't hinder the market, they make the market stronger. Indeed, they are essential to ensuring that our markets function fairly and freely.

One year ago, we saw in stark relief how markets can spin out of control; how a lack of common-sense rules can lead to excess and abuse; how close we can come to the brink. One year later, it is incumbent upon us to put in place those reforms that will prevent this kind of crisis from ever happening again, reflecting painful but important lessons that we've learned, and that will help us move from a period of reckless irresponsibility, a period of crisis, to one of responsibility

and prosperity. That's what we must do. And I'm confident that's what we will do. [...]

SEC/SRO Update

SEC Establishes New Division of Risk, Strategy, and Financial Innovation; Madoff Report Ushers in a Potential Shift In SEC Funding; Chairman Schapiro Issues Open Letter to Broker-Dealer CEOs; SEC Proposes Flash Order Ban

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SEC Establishes New Division of Risk, Strategy, and Financial Innovation

On Sept. 16, the Securities and Exchange Commission Chairman Mary L. Schapiro announced that University of Texas School of Law Professor Henry T. C. Hu will serve as the Director of the newly-established Division of Risk, Strategy, and Financial Innovation.¹

The new division will be responsible for three broad areas:

- risk and economic analysis;
- strategic research; and
- financial innovation.²

Specifically, the new division will perform all of the functions previously performed by the Office of Economic Analysis and the Office of Risk Assessment, along with the following:

- strategic and long-term analysis;

- identifying new developments and trends in financial markets and systemic risk;
- making recommendations as to how these new developments and trends affect the Commission's regulatory activities;
- conducting research and analysis in furtherance and support of the functions of the Commission and its divisions and offices; and
- providing training on new developments and trends and other matters.³

According to the SEC's press release, Prof. Hu's expertise in derivatives, hedge funds, derivative markets and other financial innovations should be, as Chairman Schapiro stated, "put to good use" as the leader of the new division.⁴

Chairman Schapiro believes that the "new division will enhance the [SEC's] capabilities and help identify developing risks and trends in the financial markets [b]y combining economic, financial, and legal analysis in a single group," adding "this new unit will foster a fresh approach to exchanging ideas and upgrading agency expertise."⁵

The SEC now has five divisions with the addition of the Division of Risk, Strategy and Financial Innovation, including the Division of Corporation Finance, the Division of Enforcement, the Division of Investment Management, and the Division of Trading and Markets.

Madoff Report Ushers in a Potential Shift in SEC Funding

In connection with the SEC's failure to detect Bernard Madoff's multibillion-dollar fraud and the release of the 22-page executive summary detailing such failure, Sen. Charles Schumer (D-NY), a member of the Senate Banking Committee, announced his intention to propose legislation that, if enacted, would change how the SEC is funded.

Sen. Schumer intends to propose legislation that would permit the SEC to use the fees collected from the institutions it regulates to fund its operations. Schumer estimates that under the proposed legislation, the SEC would see a 75% increase in its annual budget. In 2007, the SEC brought in

\$1.45 billion in fees but only secured \$881 million in funding that year. A significant amount of the fees have been allocated to the federal government's general funds. Under the new legislation, the \$1.45 billion in fees would be retained by the SEC, and allow it to bypass the congressional appropriations process to receive funds, according to news reports.⁶

Sen. Schumer said he hopes the potential increase in the SEC's budget that will result from the proposed legislation would allow the staff to better train, recruit, and retain skilled investigators and examiners as well as update the SEC's technology to better detect problems across the market.⁷

Notably, SEC Commissioner Luis Aguilar, among others, has publicly opposed any legislation that would permit the SEC to retain any fines obtained through enforcement actions. "I would not want any amount of the penalties to be part of the self-funding," said Mr. Aguilar, who supports instead the notion of allowing the SEC to keep the statutory fees it collects. "There's too great a potential for conflict."⁸ For the fiscal year ended Sept. 30, 2008, the SEC collected \$774 million in disgorgement amounts and another \$256 million in penalties.⁹

Chairman Schapiro Issues Open Letter to Broker-Dealer CEOs

On August 31, Chairman Schapiro issued an open letter to remind CEOs of broker-dealer firms of their supervisory responsibilities following reports that special recruitment programs at some firms are premised on enhanced compensation arrangements.¹⁰

According to the press release that accompanied the letter, Schapiro's letter states that some enhanced compensation arrangements could induce brokers to engage in conduct that is not in investors' best interest, and it reminds CEOs that they have an obligation to police for such conflicts. In addition, the letter reminds CEOs that, as their firms grow, their supervisory and compliance infrastructures should retain sufficient size and capacity.

SEC Proposes Flash Order Ban

On September 17, the SEC unanimously proposed a rule amendment that, if adopted, would prohibit the practice of flashing marketable orders.¹¹ According to the press release accompanying the announcement, a “flash order” enables a person who has not publicly displayed a quote to see orders less than a second before the public is given an opportunity to trade with those orders. The SEC has stated that “[i]nvestors who have access only to information displayed as public quotes may be harmed if market participants are able to flash orders and avoid the need to make the order publicly available.”

According to Chairman Schapiro, “[f]lash orders may create a two-tiered market by allowing only selected participants to access information about the best available prices for listed securities.” She also indicated that “[t]hese flash orders provide a momentary head-start in the trading arena that can produce inequities in the markets and create disincentives to display quotes.”

Currently, flash orders are permitted as result of an exception to Rule 602 of Regulation NMS that exempts these orders from requirements that apply generally to other orders. The Commission stated its concern that the Rule 602 exception may no longer be necessary or appropriate in today’s highly automated trading environment, and voted unanimously to propose the elimination of the flash order exception from Rule 602 and application of the restrictions on flash orders in a similar manner to rules for alternative trading systems and for locking and crossing quotations. If adopted, the proposed amendment would effectively prohibit all markets—including equity exchanges, options exchanges, and alternative

trading systems—from displaying marketable flash orders.

In its proposal, the Commission seeks public comment and data on a broad range of issues relating to flash orders, including the costs and benefits associated with the proposal. It also seeks comment on whether the use of flash orders in the options markets should be evaluated differently than in the equity markets.

Public comments on the proposal must be received by the Commission by Nov. 23, 2009.

NOTES

1. SEC Release No. 2009-199 (Sept. 16, 2009), available at <http://www.sec.gov/news/press/2009/2009-199.htm>.
2. SEC Release No. 2009-199.
3. SEC Release No. 2009-199.
4. SEC Release No. 2009-199.
5. See SEC Rel. No. 2009-199.
6. See <http://www.marketwatch.com/story/sen-schumer-eyes-proposal-to-expand-sec-funding-2009-09-03>.
7. Wall Street Journal Blogs at <http://blogs.wsj.com/washwire/2009/09/03/shocking-madoff-report-prompts-schumer-to-propose-a-self-funded-sec>.
8. See <http://www.investmentnews.com/article/20090908/REG/909089972>.
9. See <http://www.investmentnews.com/article/20090908/REG/909089972>.
10. See SEC Press Rel. No. 2009-189 (Aug. 31, 2009), available at <http://www.sec.gov/news/press/2009/2009-189.htm>. The letter is available at <http://www.sec.gov/news/press/2009/2009-181-letter.pdf>.
11. See SEC Press Rel. No. 2009-201 (Sept. 17, 2009), available at <http://www.sec.gov/news/press/2009/2009-201.htm>. A copy of the proposed release is available at <http://www.sec.gov/rules/proposed/2009/34-60684.pdf>.

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