

# The New eDiscovery Rules

## Law.com's In-House Counsel

Select '**Print**' in your browser menu to print this document.

©2005 *In-House Counsel Online*

Page printed from: <http://www.inhousecounsel.com>

[Back to Article](#)

## SEC's Local Head Says He Follows the Evidence

Beth Bar  
New York Law Journal  
March 28, 2007

Mark K. Schonfeld, 44, oversees nearly 400 enforcement attorneys, accountants, investigators and compliance examiners as director of the New York regional office of the Securities and Exchange Commission.

A graduate of Harvard Law School and a former private litigator, he began working for the commission in 1996 as a staff attorney in its Boston office. He came to New York two years later, and was named Northeast regional director in 2004.

Schonfeld agreed to answer some questions about what it is like to run the SEC's outpost in the nation's financial capital.

**Q: You have been working for the Securities and Exchange Commission for more than a decade. What originally attracted you to the agency?**

A: It's hard to believe that it's been that long. Two things primarily drew me to the SEC -- the work and the people. The work is interesting, challenging and rewarding. As far back as law school, I expected to devote part of my career to government service. That also coincided with the SEC's prominence in the headlines with the big insider trading cases of the 1980's. To this day, I am still struck by how often greed leads people to cheat the system. It reminds me of the question that Bud Fox poses to Gordon Gekko in the movie "Wall Street": "How much is enough?"

The agency also draws an exceptionally talented and dedicated group of attorneys. Several of my colleagues when I was in private practice came to work at the SEC and were very enthusiastic about their experience. I have to say that from the first day I started working here it has been extremely rewarding.

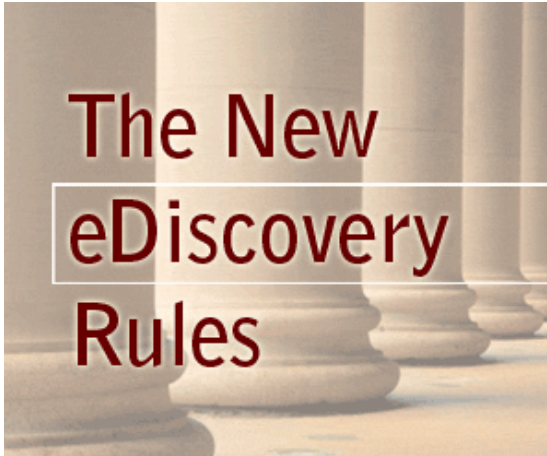
**Q: What functions does the regional office perform within the agency? What are the biggest rewards and**



COUNTLESS HOURS  
OF LAW SCHOOL.  
70-HOUR WEEKS.

  
**SUNTRUST**  
Seeing beyond money

SunTrust Bank, Member FDIC.



# The New eDiscovery Rules

**challenges of your position?**

A: The New York regional office is the largest of the SEC offices outside of Washington. As with all the SEC field offices, about half the New York office is devoted to enforcement work and the other half is devoted to examinations of registered broker-dealers and investment advisers.

One of the most rewarding things about the job is the freedom to go where the evidence leads. Our primary job is to detect, investigate and prosecute violations of the securities laws. When we uncover evidence of wrongdoing, we pursue it. If, in the end, the evidence doesn't support a case, we don't pursue it.

Every decision, on every case, is governed by one overriding principle -- what is the right thing to do? This job also affords us the opportunity to make a difference in people's lives by getting compensation to victims of securities fraud.

There are two primary challenges to the job. First, managing an office this large. Nothing really prepares you for the breadth of issues you may have to confront, from evaluating the evidence in complex cases to relocating the office, which we have done twice since Sept. 11, 2001. Second, managing scarce resources. As a government agency, we always face resource limitations. So one of the biggest challenges is continually evaluating priorities to insure we are using our resources efficiently.

**Q: How does the office's proximity to Wall Street affect its activities and importance?**

A: Being in the nation's financial capital affects to some extent the issues on which we place emphasis. For example, one area of concern is what we broadly refer to as information leakage -- basically insider trading based on information about market activity.

Last year we charged several individuals in what we called "squawk box" cases. These were brokers who leaked information about institutional customer orders (disseminated within a firm over a "squawk box") to day traders enabling them to front-run the orders and profit from the resulting price movement. This was a particularly graphic example of information leakage, but we continue to investigate other examples of potential misconduct.

**Q: What are some of the most significant cases that the New York office has handled in the past several years?**

A: We have been working on an industry-wide investigation of accounting fraud by insurance companies. Within the last year, this has resulted in an \$800 million settlement with AIG, settled enforcement actions against MBIA and Renaissance Re, and enforcement actions against several former executives of General Re, AIG and Renaissance Re.

We also have a number of other investigations ongoing in this area. I think these cases have had a significant impact on the way insurance and reinsurance companies do business.

Last year we uncovered a widespread international insider trading ring that had been stealing information from Merrill Lynch, *Business Week* and even a sitting grand jury. This case was interesting because it began with the detection of unusual trading in Reebok options just before its acquisition. The trading had occurred in an account in the name of a 63 year-old Croatian retired seamstress.

Through a lot of detective work, the SEC lawyers tracked the trading to her nephew here in New York, a former Goldman Sachs employee, as well as numerous other traders in the U.S. and Europe. In total, we charged 17 defendants with trading in at least 25 stocks over the course of a year.

**Q: What are some of the most significant pending cases?**

A: Earlier this month we announced "Operation Spamalot," an initiative to attack the problem of microcap stock fraud and e-mail spam. The first public step was last week's trading suspension of 35 stocks, the largest trading suspension the commission has ever done on spammed stocks. For many people, stock spam is nothing more than an annoyance. But it's a serious problem.

Thus far, we estimate investor losses on these 35 stocks in the last year alone was in the tens of millions of dollars. We are continuing our investigation of the individual perpetrators who profited from this conduct.

In the options backdating area, we recently filed a case against the former general counsel of Monster Worldwide, Inc. That investigation, as well as other options backdating investigations in the office, is continuing.

Currently, we have pending a large case against 20 former NYSE specialists who are charged with trading for their proprietary account ahead of customer orders.

**Q: Have the office's priorities changed with the accession of Christopher Cox as chairman in August 2005?**

A: Yes and no. To a large extent, our priorities are determined by the misconduct we see in the securities market. For example, currently options backdating is a significant area because it turns out that a lot of companies were doing it. Before that, mutual fund trading was a big priority for us, and before that it was major accounting frauds at public companies.

However, Chairman Cox has also identified certain additional areas as important, such as microcap fraud and the protection of senior citizens, and we have brought a number of cases recently in these areas as well.

**Q: How much freedom of action does the office and you as director enjoy?**

A: That's an interesting question. On the one hand, as a legal matter, I have a client -- the commission -- with the ultimate authority to approve my office's charging and settlement recommendations. In addition, as a national regulatory agency, it's important that enforcement actions be consistent with broader regulatory policies.

On the other hand, we are on the front lines of enforcement and we have a great deal of discretion in deciding what to pursue and independence in how we develop and prosecute our cases.

One example is the matter I mentioned earlier -- Operation Spamlot. This operation was developed by a team of staff in the New York office that wanted to come up with a more effective and efficient way to address the problem of stock spam. We typically do trading suspensions on a single stock at a time. Here, the team came up with the idea of doing it on a much broader scale and, as a result, having a much bigger impact.

**Q: Describe the relationship between your office and the local U.S. Attorney's Offices? What kind of cases have the two offices successfully collaborated on?**

A: We have had a very strong and effective working relationship with the U.S. Attorneys' Offices for both the Southern and Eastern Districts of New York for many years. This is in part because both of those offices devote significant resources to securities cases and make them a priority for their offices.

At the same time, we are careful to maintain an appropriate separation between our parallel civil and criminal investigations. The cases on which we have successfully collaborated run the gamut from accounting fraud by major public companies, to insider trading, to organized crime infiltrating securities businesses. We often detail staff attorneys to the U.S. Attorneys' Offices to assist with trials of significant cases.

**Q: How effective do you think the agency and the regional office have been in enforcing securities laws that protect investors? Do you see the need for any changes?**

A: It probably won't surprise anyone for me to say that the SEC is highly effective in enforcing the securities laws and protecting investors. While there are a lot of factors that make the U.S. capital markets one of the most successful in the world, one factor is the confidence level that comes from having markets that are fair and honest, and that is a result of vigorous enforcement.

There has been a lot of debate lately about whether the regulatory pendulum swung too far to the point of diminishing the competitiveness of the domestic capital markets. However, I have seen instances in the last few years in which Sarbanes-Oxley has had tremendous positive effects. For example, we have seen a number of cases in which the requirement that senior officers certify a company's financial statements has caused misconduct to come to light, that otherwise would have remained concealed.

The fair funds provision has also empowered us to return penalty money we recover to harmed investors. There is always room for improvement and I think we are always striving to use our limited resources to get things done more quickly.

**Q: If you were on the board of a public company, what types of internal compliance controls would you be urging that board to take?**

A: It would be impossible to come up with a one-size-fits-all approach to compliance controls. Each company or market participant needs to assess where the risks are for their business and how to minimize those risks.

Having said that, I think the "tone from the top" remains important to creating a compliance culture within a business. That means more than just having a policy on paper, but also having senior management that demonstrates through their actions that compliance with the law is more important than burnishing the financial statements. This also means giving the legal and compliance function within the business the support it needs to carry out its mission.

Conversely, I also think it's helpful to facilitate the flow of information from the bottom up, that is, having a mechanism by which middle and lower level employees can (anonymously, if necessary) elevate potential problems or concerns to a legal or compliance function. Too often we have seen employees get drawn into misconduct because they felt they had no alternative.

**Q: Has the proliferation of pooled investment vehicles -- hedge funds -- affected the operations of the office? Do you see a need for greater regulation of hedge funds?**

A: With the bulk of the hedge fund industry located in or near New York, hedge funds inevitably form a significant part of our work, both for inspections and enforcement. The sheer size of the industry, both in terms of assets under management and the trading volume it generates, makes it one of our key areas of focus.

The vast majority of hedge fund advisers have remained registered with the SEC, despite last year's D.C. Circuit Court of Appeals decision invalidating the registration rule. This gives our examination staff the ability to conduct inspections of registered hedge fund advisers. In addition, from an enforcement perspective, we have always had, and continue to have, the ability to investigate and prosecute hedge funds and their advisers, whether registered or not, if they commit fraud.

Recently, the SEC proposed additional investor protection measures that, if approved, would include raising the financial qualifications for hedge fund investors and clarifying the anti-fraud provisions applicable to hedge fund advisers. If additional measures are necessary, the commission has said it's prepared to respond appropriately.

In the meantime, we are all closely watching to see whether Congress will take any further legislative action to regulate hedge funds or authorize the SEC to adopt further regulation.