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.

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

SECTION 1. 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.–

(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.

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regulations providing for the expeditious conduct of hearings and rendering of decisions under section 21C of this title, section 8A of the Securities Act of 1933, section 9(f) of the Investment Company Act of 1940, and section 203(k) of the Investment Advisers Act of 1940.".

SEC. 205. CONFORMING AMENDMENTS TO SECTION 15B.

Section 15B(c)(6)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(c)(6)(A)) is amended–

(1) by striking "and the nature" and inserting ", the nature"; and

(2) by striking "proposed action and" and inserting "proposed action, and whether the Commission is seeking a monetary penalty against such municipal securities dealer or such associated person pursuant to section 21B of this title; and".

SEC. 206. SIGNATURE GUARANTEES.

Section 17A(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78q-9(d)(4)) is amended by adding at the end the following:

"(5) A registered transfer agent may not, directly or indirectly, engage in any activity in connection with the guarantee of a signature of an endorser of a security, including the acceptance or rejection of such guarantee, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest, for the protection of investors, to facilitate the equitable treatment of financial institutions which issue such guarantees, or otherwise in furtherance of the purposes of this title.".

TITLE III–AMENDMENTS TO THE INVESTMENT COMPANY ACT OF 1940

SEC. 301. CIVIL REMEDIES IN ADMINISTRATIVE PROCEEDINGS.

Section 9 of the Investment Company Act of 1940 (15 U.S.C. 80a-9) is amended–

(1) by redesignating subsection (d) as subsection (g);

(2) by inserting after subsection (c) the following new subsections:

"(d) MONEY PENALTIES IN ADMINISTRATIVE PROCEEDINGS.–

"(1) AUTHORITY OF COMMISSION.–In any proceeding instituted pursuant to subsection (b) 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 Advisers 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; or

"(C) has willfully made or caused to be made in any registration statement, application, or report required to be filed with the Commission under this title, 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;

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 pecuniary gain to the person who committed the act or 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 the Investment Advisers Act of 1940;

"(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, 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.

"(e) 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.

"(f) 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, any 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 the Commission 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 proceeding, 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 40(a) of this title, determines that notice and hearing prior to entry would be impractica-

ble or contrary to the public interest. A temporary order shall become effective upon service upon the respondent and, 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 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 43 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 subsection (f)(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."; and

(3) in redesignated subsection (g), by striking "subsections (a) through (c) of".

SEC. 302. MONEY PENALTIES IN CIVIL ACTIONS.

Section 42 of the Investment Company Act of 1940 (15 U.S.C. 80a-41) 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 9(f) 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.

"(2) 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 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 his 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

Calendar No. 645

101ST CONGRESS **SENATE** **REPORT**
2d Session **101-337**

THE SECURITIES LAW ENFORCEMENT REMEDIES ACT OF 1990

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

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

REPORT

[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

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.[14] The Commission intends to phrase "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.[15] 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 these 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

[14] 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."

[15] "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 a 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.[16] 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 other persons from committing such acts or omissions." This factor is an important consideration in cases in which the violation is one that requires strong deterrrence [sic] 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-

[16] *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.[17] 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

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

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.[19] 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.[20] 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-

[19] *See* 7 U.S.C. 139b).

[20] 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).

desist proceedings. The authority granted under this section parallels new Section 8A of the Securities Act.

Section 204

Section 204 of the Act amends Section 15B(c)(6)(A) of the Exchange Act. The section references in the following analysis refer to Section 15B(c)(6)(A) of the Exchange Act, as amended by S. 647.

Section 15B(c)(6)(A)–Conforming amendments to section 15B.–Section 15B requires the SEC to inform the appropriate regulatory agency for a municipal securities dealer when the SEC is seeking a penalty pursuant to an administrative proceeding against the dealer pursuant to Section 21B of the Exchange Act.

Section 205

Section 205 of the Act amends Section 17A(d) of the Exchange Act by adding new subsection (5). The section references in the following analysis refer to Section 17A(d) of the Exchange Act, as amended by S. 647.

Section 17A(d)(5)–Signature guarantees.–Section 17A(d)(5) provides that a registered transfer agent may not engage in any activity in connection with the guarantee of a signature of an endorser of a security, including the acceptance or rejection of such guarantee, in contravention of such rules and regulations as the SEC may prescribe as necessary or appropriate in the public interest, for the protection of investors, to facilitate the equitable treatment of financial institutions which issue such guarantees.

TITLE III: AMENDMENTS TO THE INVESTMENT COMPANY ACT OF 1940

This title of the bill amends the Investment Company Act to authorize a court, in civil actions brought by the SEC, and the SEC, in administrative actions, to impose civil money penalties for violations of the Investment Company 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 301

Section 301 of the Act amends Section 9 of the Investment Company Act by redesignating subsection (d) as subsection (g) and adding new subsections (d), (e) and (f). The section references in the following analysis refer to Section 9 of the Investment Company Act, as amended by S. 647.

Section 9(d)–Money penalties in administrative proceedings.–Section 9(d)(1) authorizes the SEC to impose civil penalties in administrative proceedings instituted pursuant to Section 9(b) of the Investment Company 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; or (3) has willfully made or caused to be made in any registration application or report required to be filed with the SEC under the Investment Company Act, 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, 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 21B(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-