

FS Regulatory Briefs*

SEC Expands Sweeping Investigation of Market Manipulation; FBI Probes Financial Companies

On September 19, 2008, the SEC announced a sweeping expansion of its ongoing investigation into possible market manipulation in the securities of certain financial institutions. The SEC stated that the expansion will include obtaining statements under oath from market participants.

According to the SEC, hedge fund managers, broker-dealers, and institutional investors with trading activity in certain financial issuers or positions in credit default swaps, will be required, under oath, to disclose position and transaction information to the SEC for the period September 1-19, 2008 as well as other information.

In addition, press reports have indicated that the FBI has opened investigations into the activities of several financial services companies. Initial reports indicate that federal law enforcement officials are looking into whether fraud or criminal conduct was involved in the circumstances surrounding these companies. The New York State Attorney General Andrew Cuomo has reportedly opened a probe into short selling practices.

The SEC also approved a formal order of investigation that will allow SEC enforcement staff to obtain additional documents and testimony by subpoena. Investigators from NYSE Regulation and FINRA, according to the SEC, will be conducting separate, parallel inquiries in coordination with the SEC. These investigations will involve on-site visits to broker-dealers to address concerns about recent short selling activity.

These actions come in the context of the unprecedented regulatory action by the SEC, the UK FSA, and others suspending short sales in certain issuers of securities. Taken together, they indicate that financial market participants, both here in the US and possibly overseas, will be subject to a series of investigations and inquiries concerning their and their customers' short selling activities. It further indicates that, in the wake of the current financial crisis, the

regulatory fall-out and examination process will linger on past the immediate high profile actions being taken by the Administration and the Congress.

Potential Criminal Liability

Based on discussions with industry contacts and clients over recent days, the following points of focus have emerged. We encourage you to consider them as you develop a plan for your firm's response to any or all of these investigations.

Points of Focus

- The SEC's order in particular is a broad industry-wide order. Letters under the order thus far have been sent to approximately two dozen hedge funds, broker-dealers and institutional investors. The SEC has the authority to undertake such investigations under the Exchange Act--but it is relatively rarely exercised.
- Under the SEC's authority, financial institutions can be compelled to provide statements, generally under oath, and subject to penalty of perjury.
- Given the number of investigations underway, it is expected that the SEC would contemplate sharing the results of its investigation with any or all of the other bodies conducting similar investigations, including the FBI, the New York State Attorney General, and FINRA.

- Market participants should review all policies and procedures governing short sales, not only to ensure compliance with the SEC's short sale orders, but to anticipate requests for information in connection with these investigations.
- Document retention and preservation policies must be adhered to. Failure to maintain required records may subject a financial institution to more serious charges, including criminal investigation.
- Financial institutions should develop a communications strategy and response protocol for dealing with what may be numerous requests for testimony and documents coming from different sources and touching many areas of the firm.
- It is anticipated that a focal point of the investigations will involve potential fraudulent rumors. Therefore areas of financial institutions that may be impacted could include sales, trading, investment banking, operations and prime brokerage.
- Legal and compliance departments should begin advising on each of the above steps, as well as working to assist in the information gathering process around requested firm and client trade and other documentation.

As additional information comes to light, we will communicate that information to our clients. If you have any questions in the interim, please contact the individuals identified below.

Additional Information

If you would like additional information about the topic discussed in this FS Regulatory Brief, please call:

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