



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Division of Enforcement

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The Honorable Charles E. Grassley
Ranking Member
Committee on the Judiciary
United States Senate
152 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Ranking Member Grassley:

Chairman Schapiro asked that I respond to your August 17, 2011 letter concerning the SEC Enforcement Division's document retention policy for "Matters Under Investigation." Your letter raises six specific questions, and I am writing to provide you with information responsive to those questions. In addition, we welcome the opportunity to discuss these issues further with you or your staff at your convenience.

As an initial matter, I want to clarify that the Division of Enforcement does not classify any of its activities as "Matters Under Investigation." Rather, the Division's policies and guidance recognize two general categories of matters: "Matters Under Inquiry" (MUI) and "Investigations." The distinction between a MUI and an investigation is important to an understanding of the document-related issues raised in your letter.

Based on the Division's longstanding guidance (going back to at least 1998), a MUI is a "pre-investigation inquiry" to evaluate whether opening an investigation would be an appropriate use of resources. Under that guidance, a MUI is designed to be "a quick look at readily available information, in order to determine whether an investigation should be opened." The threshold for opening a MUI is low, and a MUI can be opened based on very limited information. This low threshold is designed to encourage Enforcement staff to cast a wide net for potential violations. Because of a MUI's limited purpose, its duration also is limited. Since 1998, Enforcement staff has been directed either to close a MUI or convert it to an investigation within the earlier of 60 days or 80 hours of work. Beginning in 2003, Enforcement policy automatically converted any MUI that exceeded 60 days to an investigation. During this pre-investigation inquiry, staff does not have authority to issue subpoenas to compel testimony or the production of documents. In addition, since at least 1998, staff has been directed not to take voluntary testimony or incur non-local travel expenses. The threshold for closing a MUI is relatively low and the MUI closing procedures are abbreviated.

By contrast, an Enforcement investigation is designed to determine whether there have been violations of the federal securities laws and, if so, whether the staff should recommend that the Commission take enforcement action. According to the Division's guidance, an investigation is a more substantial undertaking than a MUI and involves a significantly greater level of work and analysis. Investigations are typically referred to as either "formal" or "informal." In a formal investigation, the Commission has issued a formal order of investigation and the staff may issue subpoenas to compel testimony and the production of documents. In an informal investigation, the staff may request voluntary testimony (which can be under oath) and the voluntary production of documents, but cannot compel testimony or document production through the issuance of subpoenas. In connection with either a formal or informal investigation, there is no prohibition on incurring appropriate travel expenses. Closing a formal or informal investigation requires a more complex analysis than closing a MUI, and involves compliance with a more detailed and extensive case closing process.

The questions raised in your letter relate to the Enforcement Division's previous document retention guidance concerning MUIs. That guidance, which had been in force since at least 1998, was changed in July 2010 after questions were raised regarding the guidance. Since that time, MUI documents have been handled under the Division's document retention policy for investigation files, which are covered by a records control schedule approved by the National Archives and Records Administration (NARA).¹

Below I have set out responses to your specific questions. Important principles to bear in mind include:

- The SEC retained key information regarding all MUIs even under the old MUI retention guidance. As part of the Division's case tracking systems, the SEC has electronic information concerning all MUIs going back approximately 20 years. This includes information such as the title of the matter, the source of the matter, the general subject matter of the inquiry, the SEC staff members involved, the dates the MUI was opened and closed, and other parties related to the inquiry. This MUI information is searchable, available to Enforcement staff, and is a useful resource for staff in assessing whether there are other pending or closed matters that may reflect patterns of related conduct.
- Most MUIs are subsequently converted to investigations and, once converted, files for those MUIs are covered by the records control schedule, approved by NARA, applicable to SEC investigative files. The remaining MUIs are closed without becoming investigations. For those closed MUIs, the Division's guidance (from at least 1998 until

¹ Recently, questions also have been raised regarding the Division's retention policy for investigation files. Even before those questions arose, SEC staff had been reviewing that policy with NARA. In light of those questions and the ongoing discussions with NARA, and because proper disposition of records involves issues of interpretation and judgment in the application of technical provisions of federal law, we recently decided the most appropriate course was to retain all documents created, received, or maintained for all Enforcement matters (including MUIs, investigations, and litigation) until we are certain that our document retention policies meet the standards set by NARA. We remain committed to working with NARA on a going forward basis to reach prompt agreement on policies for the Division.

July 2010) was that MUI files are “not stored as official files of the Commission” and documents obtained in connection with a MUI should be discarded.

- We do not believe that current or future investigations have been harmed by the Division’s old MUI retention guidance. We believe the electronic MUI information that we retain allows staff to “connect the dots” between current and closed matters. Moreover, starting in 2003, the Division automatically converted any MUI that was open for 60 days to an investigation, which took the MUI outside of the old MUI retention guidance. Thus, after 2003 the only MUIs that were subject to the old guidance were those closed within 60 days based on a judgment by the staff that an investigation was not warranted. Given that limited time period, and the other limitations on collecting information as part of a MUI, it is less likely that significant information would have been obtained in a MUI that would be both important to a current matter and not available either from the staff who handled the closed MUI, other internal SEC information resources, or third parties.

1. Has the SEC routinely destroyed MUIs, and if so, why?

As described above, the SEC has retained significant information concerning all MUIs, even under the Division’s old MUI retention guidance. As part of the Division’s case tracking systems, the SEC maintains electronic information concerning all MUIs opened during the past twenty years (and some going back further in time). This includes key information such as the title of the matter, the source of the matter, the general subject matter of the inquiry, the SEC staff members involved, the dates the MUI was opened and closed, and other third parties related to the inquiry. The MUI information is searchable and available to Enforcement staff.

The electronic MUI information was designed to be, and is in practice, a useful resource for Enforcement staff. Under the Division’s guidance, the staff is required to search the case tracking system that contains the MUI information before opening a new MUI or investigation. The MUI information provides an important source of data about whether there are other pending or closed matters that could potentially reflect patterns of related conduct, and whether other staff members are already reviewing or have previously reviewed a matter (so as to avoid duplication of effort).

In addition to the electronic MUI information, for most MUIs – those that are subsequently converted to investigations – documents from the MUI phase of the matter are required to be retained in accordance with the Division’s guidance concerning investigation files. This Division guidance implements an SEC records control schedule, approved by NARA in 1992, which applies to “Investigative Case Files” and establishes disposition standards for those files.² This category represents the majority of MUIs opened from FY 1993 to the

² A copy of the records schedule is located at: http://www.archives.gov/records-mgmt/rcs/schedules/independent-agencies/rg-0266/n1-266-91-002_sf115.pdf.

present, as well as the significant majority (approximately 70%) of MUIs opened from FY 2003 to the present.³

For other MUIs – those that were closed without being converted to an investigation – the Division’s longstanding guidance (from at least 1998 until July 2010) was that MUI files “are not stored as official files of the Commission” and documents obtained in connection with a MUI should be discarded. In addition to the conclusion that MUI files “are not stored as official files of the Commission,” we assume that this guidance also was premised in part on a view that, in light of the electronic MUI information and the staff’s judgment that an investigation was not warranted, documents obtained during the course of a MUI that was closed were unlikely to be of significant additional value. We are not aware of evidence that, prior to 2010, any question had been raised about the guidance or whether it was consistent with legal requirements. As mentioned, in July 2010, the guidance was modified to instruct staff to treat documents generated in closed MUIs in the same manner as documents related to investigations.⁴ As described in more detail below, we believe it is likely that documents obtained or generated in closed MUIs were retained in certain instances prior to July 2010, particularly those from more recent time periods, while in many other instances they likely were not retained because that was consistent with the longstanding guidance.

2. Is the SEC not concerned that destroying these files may have harmed future investigations? If not, please explain why not?

We do not believe that current or future investigations have been harmed by the old MUI retention guidance. The searchable MUI information allows us to identify potential relationships between parties and matters and “connect the dots” between present and past inquiries. It allows Enforcement staff to consult directly with staff members who conducted a prior inquiry, and efficiently determine whether there are relationships to be evaluated and pursued.

Moreover, particularly with respect to more recent time periods, the automatic conversion of MUIs to investigations within 60 days if not closed and the limited nature of a MUI make it unlikely that underlying documents from closed MUIs would be both important to a current matter and not available either from the staff who conducted the MUI or from another source.⁵ Beginning in 2003, the Division automatically converted any MUI that was open for 60 days into an investigation. As a result, since 2003, the only MUIs that would have been subject to the old MUI retention guidance were those open for fewer than 60 days. Given that short time period, it is unlikely that significant information would have been generated that

³ The corresponding calendar periods are from October 1, 1992 through mid-August 2011, and from October 1, 2002 through mid-August 2011.

⁴ The new guidance for closed MUIs was implemented by a change to the Division’s Case Closing Manual, which directed that: “all Records and Non-Record Materials associated with the MUI” were to be handled according to the disposition guidance for investigations, including “all physical documents and objects, as well as all electronic media and documents obtained or generated during the inquiry.”

⁵ Our experience is that more recent closed matters have a greater potential to be relevant to current matters than historical ones – that is, it is more likely an inquiry closed in 2008 will be relevant to a 2011 investigation than one closed in 1998, 1988, or 1978.

could not in many instances be obtained elsewhere if necessary. In other words, and as described below, if information was generated in the course of a MUI that was in fact closed within 60 days, it still may be readily available from the staff or from another source either inside or outside of the SEC.

3. Is it possible for the SEC to retrieve any of this information?

We believe that, with respect to a number of MUIs that were closed without being converted to an investigation, staff members have retained some documents relating to the inquiry, notwithstanding the old MUI records guidance. For those MUIs, there would be no need to obtain the retained information from an outside source. Moreover, for documents relating to closed MUIs that were discarded, as discussed below they may be available from other sources either inside or outside of the SEC.

Many MUIs are opened based on public information such as news reports, and staff conducting a MUI frequently consult public information sources (such as press releases, EDGAR filings, and investment analyst reports) as part of the inquiry. To the extent that such information becomes relevant to a subsequent matter, it should remain readily available from those public sources. In addition, if documents obtained from a regulated entity become relevant to a current matter, they should be readily available from the entity during the statutory retention period.⁶

There also are internal Commission resources from which information concerning a closed MUI can be retrieved. These include:

- *Bluesheet Database.* Enforcement's Market Surveillance group maintains an electronic bluesheet database of the more than two billion electronic equities and options trading data obtained by the Division in connection with current and past MUIs and investigations stretching back nearly 20 years.⁷ In connection with many MUIs and investigations concerning possible market abuse, Market Surveillance staff submit bluesheet requests and load the resultant trading data into the bluesheet database. To the extent such trading data was obtained in connection with a closed MUI, it would remain available in the bluesheet database. As part of the Automated Bluesheet Database Project, in the last two years the Division's new Market Abuse Unit has been developing templates that enable staff to search across this aggregated collection of trading data, conducting automated searches for suspicious trading patterns and identifying relationships and connections among multiple traders and across multiple securities.

⁶ See 17 C.F.R. § 270.31a-2 (requiring permanent retention of many investment company books and records and a six-year retention period for others); 17 C.F.R. § 240.17a-4 (requiring retention of most broker-dealer books and records for three to six years); 17 C.F.R. § 275.204-2 (requiring retention of most registered investment adviser books and records for at least five years).

⁷ Each line of trading data includes: ticker symbol, date, purchaser or seller's name, address, the type of execution (buy or sell), account number, broker name, MPID number and related data.

- *SRO Market Surveillance Referral System (SMSR)*. SMSR is the internal component of a system that allows the receipt, tracking, and processing of electronic versions of referrals from SROs to the SEC. In use since 2003, SMSR is administered by Enforcement's Market Surveillance group. To the extent MUIs were opened as a result of SRO referrals, all of the materials supporting the referral can be obtained from the SMSR system.
- 4. Is Mr. Flynn correct that the SEC has destroyed MUIs related to Bernard Madoff, Goldman Sachs, Wells Fargo, Bank of America, Deutsche Bank, Lehman Brothers, and SAC Capital? If so, explain why.**

As explained above, the SEC has retained key electronic information concerning all MUIs for approximately the past 20 years, including the closed MUIs described in your letter.

Some of the MUIs referenced in your letter are relatively recent, while others date back almost 20 years. For each of these MUIs, the retained electronic MUI information provides the basic facts about the MUI. For some of these MUIs, the relevant entity is identified in the title of the matter; in others, it appears as a related party. In addition, for all of these MUIs that were opened since 2003, and for at least some opened prior to 2003, we believe we have certain additional information or documentation relating to the MUI. Nevertheless, given the old MUI retention guidance, we also believe it is likely that some documents from these closed MUIs were not retained.

- 5. Is it current SEC policy to destroy any files related to MUIs if the investigation does not progress to a formal order approved by the Commission?**

As described above, it is current Division policy to retain MUI-related files in the same manner as files relating to investigations. This is true whether the MUI is closed without being converted to an investigation, is converted to an investigation with no formal order, or is converted to an investigation in which the Commission issues a formal order. As described both above and below, we also have directed the staff to retain all documents for all matters pending our ongoing discussions with NARA on new procedures for retaining investigation files.

- 6. What is the SEC's understanding of its legal obligations to maintain and archive records related to MUIs and how is the SEC's policy and practice consistent with those obligations?**

We believe the SEC's current policy and practice for maintaining and archiving documents relating to MUIs is consistent with its legal obligations. The SEC has a records control schedule, approved by NARA in 1992, which covers investigative case files. This schedule establishes disposition standards for those files. As described above, the Division's current policy is to treat documents relating to MUIs in the same manner as investigation files that are subject to the NARA-approved disposition schedule.

In addition, your staff has asked whether a reference to "preliminary investigations" in the 1992 records control schedule was intended to refer to MUIs. The 1992 schedule states that

it applies to: “Investigative Case Files (also known as ‘complaint cases’ and ‘general assignment files’), including case files relating to “preliminary investigations.” Although longstanding Division policy and guidance differentiates MUIs from “investigations” of any type, it is difficult to conclude with certainty the intended meaning of the 1992 reference to “preliminary investigations.”

The references to “preliminary investigations,” “complaint cases,” and “general assignment files” in the 1992 schedule appear to have been carried over from a predecessor Enforcement schedule that was approved by NARA in 1975.⁸ The term “preliminary investigation” appears to date back to the early days of the Commission, well before the establishment of either the Division of Enforcement (in 1972) or the MUI category of matters (not later than 1981). Historical SEC references to the term “preliminary investigation” appear to describe what in more recent times is typically referred to as either a “formal” or “informal” investigation.⁹ (The references to “complaint cases” and “general assignment files” also appear to be historical and do not reflect terms that have been used by the Division in recent times.) To the extent that the term “preliminary investigation” has been used during the time period in which the 1992 schedule has been in effect, in one often-cited source it appears to refer to an informal investigation.¹⁰ While we believe this background suggests that the term “preliminary investigations” in the 1992 schedule was not intended to refer to MUIs, we are unable to answer your staff’s question with certainty.

The SEC has been reviewing the current Enforcement disposition schedule and its current policies and procedures governing documents and records retention for investigative case files with NARA, and we are committed to working with NARA to reach prompt agreement on procedures for the Division on a going forward basis. In light of this ongoing process, and because appropriate disposition of Enforcement records involves issues of interpretation and judgment in the application of technical provisions of federal law, we have

⁸ A copy of that schedule can be found at: http://www.archives.gov/records-mgmt/rcs/schedules/independent-agencies/rg-0266/nc-266-76-001_sf115.pdf.

⁹ *E.g., In the Matter of Harold T. White, et al.*, 1 S.E.C. 574, 1936 WL 32661, at *2-3 (July 14, 1936) (Commission opinion describing as “preliminary investigation” a matter where the Commission had issued a formal order of investigation, and Commission staff subsequently took testimony and reviewed evidence and made an enforcement recommendation to the Commission); 11 Fed. Reg. 177A-729 (Sept. 11, 1946) (promulgating 17 C.F.R. § 202.4(a), which provided: “Where . . . it appears that there may be violation of the acts administered by the Commission . . . a preliminary investigation is generally made. In such preliminary investigation no process is issued or testimony compelled. When it appears . . . that there is a likelihood that a violation has been . . . committed and that the issuance of process may be necessary, the matter is reported to the Commission, which may then order a formal investigation or examination if it is deemed necessary.”).

¹⁰ *See* W. McLucas, J. Taylor & S. Mathews, *A Practitioner’s Guide to the SEC’s Investigative and Enforcement Process*, 70 TEMP. L. REV. 53, 56 (1997) (“Commission investigations generally begin as ‘informal’ or ‘preliminary’ investigations. In an informal investigation, the staff cannot issue subpoenas and instead relies upon the cooperation of individuals and entities to obtain information, documents, and testimony.”). Mr. McLucas was the Director of the Division of Enforcement from December 1989 to May 1998. We also are aware that the Commission’s Inspector General is reviewing correspondence between staff and NARA in 2010 that uses the term “preliminary investigation.” At the Inspector General’s request, we have not attempted to review the facts concerning that correspondence or use of the term “preliminary investigation” in the correspondence.

directed the staff to retain all documents and records for all matters (MUIs, investigations, and litigation) until we reach agreement with NARA and implement approved procedures.

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Please feel free to contact me at (202) 551-4894, or Tim Henseler (Deputy Director of the Office of Legislative and Intergovernmental Affairs) at (202) 551-2015, if you have any questions or wish to discuss these matters further.

Sincerely,



Robert S Khuzami