



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

THE CHAIRMAN

July 14, 2009

The Honorable Charles E. Grassley  
Committee on Finance  
United States Senate  
Washington, DC 20510-6200

Dear Senator Grassley:

Thank you for your letter dated June 8, 2009, regarding the SEC's Pequot Capital Management investigation. The SEC has gathered the information you requested. Your letter contained two queries:

(1) Identify how many additional referrals SROs have made related to Pequot since 2005, and of those how many have been the subject of investigative activity by the SEC.

**Answer:** Since 2005, the Enforcement Division has received a total of approximately 45 referrals from various SROs that included the word "Pequot." See attached spreadsheet.<sup>1</sup> With a single exception based on the age of the information provided, all of these referrals were either forwarded to staff to consider for new investigations, or forwarded to staff conducting pending investigations regarding related parties or issuers.

(2) Describe what steps have been taken or will be taken to automate the analysis of information in SRO referrals in order to identify patterns of misconduct.

**Answer:** Automated analysis of SRO referrals is part of a larger, comprehensive effort by the SEC to improve the intake, triage, and resolution of complaints, tips, and referrals ("CTRs"), including SRO referrals. On March 5, 2009, the Commission announced that it has hired the Mitre Group, a non-profit, federally funded research firm, to conduct a comprehensive review of the agency's systems and procedures for evaluating and tracking CTRs. Mitre's work is being conducted in three phases:

(1) Phase One involves a thorough examination of the agency's existing procedures for handling CTRs and recommendations as to how the CTR intake, triage, and resolution process can be improved to ensure that enforcement leads and areas for high risk examinations are more effectively identified;

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<sup>1</sup> Technological limits on our automated search capability give rise to a slight possibility that our search may have omitted a small number of SRO referrals. Given the low risk of error (fewer than four or five omitted referrals), we have not undertaken to manually review the hundreds of post-2005 referrals.

(2) Phase Two involves the drafting of new policies and procedures that each SEC Office and Division with significant CTR responsibilities will follow; and

(3) Phase Three will involve the procurement and implementation of a centralized IT solution that will enable, among other things, automated tracking and reporting on CTR handling activities on an agency-wide basis.

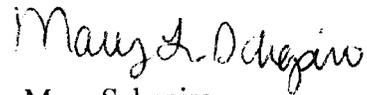
Parallel to this agency-wide CTR initiative, the Division of Enforcement has formed a Risk Advisory Group which is responsible for evaluating the Division's handling of CTRs, as well as the Division's risk assessment functions and strategic planning capabilities, and how these functions can be integrated into one unit within the Division of Enforcement. The Risk Advisory Group is currently assessing the resource and structural requirements for coordinating the Division's CTR intake, triage, and resolution process with the agency-wide centralized information technology solution that will likely be recommended and implemented by the Mitre Group.

The automated analysis of SRO referrals also is related to another strategic effort of the Division of Enforcement concerning automated analysis of trading or "bluesheet" data to identify possible federal securities law violations. Through the Automated Bluesheet Analysis Project, the Division is using relationship, identification, and pattern analysis to identify and investigate federal securities law violations involving a range of market abuses by institutions, market professionals, and persons connected to them. The Commission maintains a "bluesheet" database of roughly 850 million electronic equities and options trading records dating back roughly 20 years. At the beginning of an SEC or SRO trading investigation, a "bluesheet" request is made to clearing brokers for trading data related to the investigation and the incoming data is automatically loaded into the database. The Division has successfully developed systems to recognize trading patterns and identify connections and relationships among multiple traders across multiple securities, thereby generating significant enforcement leads and investigative entry points.

The Division of Enforcement is currently looking for ways to automatically intersect SRO referrals with our Bluesheet database in order to search for suspicious trading patterns among the individuals identified in such referrals. Although challenges still remain, the Division believes it will eventually be possible to create intersection tables between such databases. The types of violations that this investigative approach will attack are large scale insider trading networks and rings (including violations by hedge funds and other institutional traders), large cap market manipulations, naked short selling, rumor manipulations, and other serious abusive market conduct. The Division is still in the early stages of developing these automated capabilities. For a recent enforcement action that was originated and brought using automated pattern analysis (and, significantly, that was not the subject of any SRO referral, informant tip, investor complaint, media report or other external source), please see SEC v. Nicos Stephanou et al. (S.D.N.Y. Feb. 5, 2009) and the accompanying press release <http://www.sec.gov/news/press/2009/2009-18.htm> discussing the Divisions's efforts to use technology to identify patterns of unlawful trading.

We hope you find the foregoing information responsive to your inquiries. Please call me at (202) 551-2100 or have your staff call Julie Davis in the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010 if you have any questions or comments.

Sincerely,

A handwritten signature in black ink that reads "Mary Schapiro". The signature is written in a cursive, flowing style.

Mary Schapiro  
Chairman