



## PROJECT ON GOVERNMENT OVERSIGHT

September 14, 2011

House Committee on Financial Services  
2129 Rayburn House Office Building  
Washington, DC 20515

Dear Chairman Bachus and Ranking Member Frank:

In light of the widespread regulatory failures exposed by the recent financial crisis, we appreciate your ongoing leadership in ensuring that regulatory agencies such as the Securities and Exchange Commission (SEC) are addressing long-term structural problems that appear to have hindered their organizational and regulatory effectiveness. However, we are writing today to raise concerns about legislative proposals that would needlessly complicate the SEC's current initiatives to implement crucial reforms throughout the agency.

The Project On Government Oversight (POGO) is a nonpartisan independent watchdog that champions good government reforms. We have been highly critical of the SEC in the aftermath of the financial crisis, pointing to systemic problems such as the revolving door<sup>1</sup> and the agency's slow progress in implementing recommendations issued by the SEC Office of Inspector General (OIG).<sup>2</sup> At the same time, we believe that SEC Chairman Mary Schapiro and other senior officials have taken important steps toward improving the SEC's effectiveness. We want to acknowledge this and lend our support for these reforms, allowing them to be fully implemented and evaluated before changing course. As such, we oppose legislation that would interfere with the important reforms that are already underway at the agency.

The Committee recently announced a discussion draft of the "SEC Modernization Act of 2011," offered by Chairman Bachus.<sup>3</sup> A memorandum distributed to Committee Members<sup>4</sup> describes how the legislation builds in part on recommendations made by the Boston Consulting Group

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<sup>1</sup> Project On Government Oversight, *Revolving Regulators: SEC Faces Ethic Challenges with Revolving Door*, May 13, 2011. <http://www.pogo.org/pogo-files/reports/financial-oversight/revolving-regulators/fo-fra-20110513.html> (hereinafter "POGO Revolving Door Report")

<sup>2</sup> Project On Government Oversight, "POGO Letter to SEC Chairman Mary Schapiro Regarding Inspector General Recommendations for Disciplinary Action," March 8, 2011. <http://www.pogo.org/pogo-files/letters/financial-oversight/fo-fra-20110308.html>

<sup>3</sup> House Committee on Financial Services, "Financial Services Committee Chairman Bachus Proposing "SEC Modernization Act," August 2, 2011. <http://financialservices.house.gov/News/DocumentSingle.aspx?DocumentID=254897> (Downloaded September 14, 2011); and "SEC Modernization Act of 2011." <http://financialservices.house.gov/UploadedFiles/SECModAct.pdf> (Downloaded September 14, 2011)

<sup>4</sup> Memorandum to Members of House Committee on Financial Services from Committee Staff regarding "Full Committee hearing titled 'Fixing the Watchdog: Legislative Proposals to Improve and Enhance the Securities and Exchange Commission,'" August 1, 2011. (hereinafter "Committee Memo")

(BCG) in its Dodd-Frank-mandated study of the SEC. The BCG study proposed various options for improving the SEC's efficiency and effectiveness, such as restructuring or consolidating certain SEC divisions and offices, changing the reporting structure for the SEC's regional offices, and reducing the burden on the SEC to create several new offices required by Dodd-Frank.<sup>5</sup> Among other things, Chairman Bachus's legislation would fold the SEC's Division of Risk, Strategy, and Financial Innovation and the Office of Compliance Inspections and Examinations (OCIE) into other agency divisions and offices. It would also add to the reporting structure for the SEC's regional offices in order to "rein in the semi-autonomy" with which these offices have operated.<sup>6</sup>

Before considering such a sweeping reorganization, we urge Congress to give the SEC more time and flexibility to review the BCG study and report to Congress on which reforms would be most appropriate for the agency.

Last week, the SEC issued a status report to Congress describing how the agency is still in the early stages of analyzing the BCG recommendations and determining the appropriate course of action:

The agency will focus on assessing the schedule, costs, and management bandwidth required for each initiative; identifying cross-work-stream integration points; and developing a detailed prioritization and implementation plan that sequences the various implementation activities. It is at that time that trade-offs and hard decisions must be made about how to best expend resources, time and funding.<sup>7</sup>

As the SEC pointed out, "successful implementation of many of the ideas in the BCG study will require a long-term commitment and sustained effort over several years."<sup>8</sup> The SEC will also need to exercise caution to mitigate the risks associated with organizational restructuring that were identified in the BCG study, which include "losing some focus on day-to-day priorities, creating confusion around accountabilities and decision rights, misaligning roles and personnel from a capability perspective, and disengaging employees."<sup>9</sup> We believe it would be premature and heavy-handed for Congress to dictate precisely which reforms need to be implemented before the SEC has a chance to complete its review.

In fact, the reforms proposed by Chairman Bachus may interfere with other important initiatives that are already underway at the SEC. For instance, a recent SEC study described several significant changes that are taking place at OCIE:

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<sup>5</sup> Boston Consulting Group, *U.S. Securities and Exchange Commission: Organizational Study and Reform*, March 10, 2011, pp. 84-102. <http://www.sec.gov/news/studies/2011/967study.pdf> (Downloaded September 14, 2011) (hereinafter "BCG Study")

<sup>6</sup> Committee Memo

<sup>7</sup> Securities and Exchange Commission, Staff of the Office of the Chief Operating Officer, *Report on the Implementation of SEC Organizational Reform Recommendations*, September 9, 2011, p. 3. <http://sec.gov/news/studies/2011/secorgreformreport-df967.pdf> (Downloaded September 14, 2011) (hereinafter "SEC Report on Organizational Reforms")

<sup>8</sup> SEC Report on Organizational Reforms, p. 3

<sup>9</sup> BCG Study, p. 88

For example, OCIE has implemented a new governance structure, which now includes senior leaders from the Regional Offices, who manage both the enforcement and examinations programs in each Regional Office, and is intended to improve communication and accountability. It has also hired senior specialized examiners, and created multiple specialist working groups, which will help build examiner knowledge base, train examiners, develop exam modules and focus risk-based exam strategies. OCIE continues to refine its techniques to identify the areas of highest risk, is coordinating with the Commission's Division of Risk, Strategy, and Financial Innovation to enhance its risk assessment analytics and modeling and is coordinating several initiatives with the Commission's Division of Enforcement. OCIE also has instituted several measures to better coordinate its own broker-dealer and investment adviser examination programs.<sup>10</sup>

We are concerned that Chairman Bachus's proposal to fold OCIE into other divisions and offices could stifle these sensible and much-needed reforms. In general, POGO opposes any legislation that would hamstring or even undermine the SEC's ongoing reform initiatives.

Meanwhile, we appreciate other proposals in Chairman Bachus's draft legislation that instead of undermining current reforms would complement and enhance them with little burden and disruption. These provisions would "require the Office of Ethics Counsel to memorialize guidance provided to SEC employees," and "require the Office of Ethics Counsel to develop a system for documenting employee recusals and identifying potential conflicts of interest that may arise when former SEC employees work on matters in which the former employee was personally and substantially involved while employed by the SEC."<sup>11</sup> These reforms would implement recommendations made by the Government Accountability Office in its report on the SEC's revolving door.<sup>12</sup>

However, we believe these proposals could be further improved by requiring the SEC to provide some level of public access to records related to ethics guidance, recusal statements, and potential conflicts of interest that may affect current and former SEC employees. In addition, the Committee may wish to review POGO's report on the SEC's revolving door, which offered additional recommendations such as strengthening and simplifying the SEC's post-employment restrictions, making post-employment statements available online, and strengthening restrictions for new employees who come to the SEC from the financial industry.<sup>13</sup>

In addition to Chairman Bachus's draft legislation, the Committee is considering the "SEC Regulatory Accountability Act" (H.R. 2308), introduced by Representative Scott Garrett.<sup>14</sup> H.R.

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<sup>10</sup> Securities and Exchange Commission, Staff of the Division of Investment Management, *Study on Enhancing Investment Adviser Examinations*, January 2011, p. 28. <http://www.sec.gov/news/studies/2011/914studyfinal.pdf> (Downloaded September 12, 2011)

<sup>11</sup> Committee Memo

<sup>12</sup> Government Accountability Office, *Securities and Exchange Commission: Existing Post-Employment Controls Could Be Further Strengthened* (GAO-11-654), July 2011, p. 25. <http://www.gao.gov/new.items/d11654.pdf> (Downloaded September 14, 2011)

<sup>13</sup> POGO Revolving Door Report

<sup>14</sup> "SEC Regulatory Accountability Act" (H.R. 2308), introduced by Representative Scott Garrett, June 23, 2011. <http://financialservices.house.gov/UploadedFiles/HR2308ai.pdf> (Downloaded September 14, 2011)

2308 would direct the SEC to follow President Obama's Executive Order 13563, issued on January 18, 2011, that provided agencies with guidance for analyzing the costs and benefits of potential regulatory decisions.<sup>15</sup> Specifically, Representative Garrett's legislation "requires the SEC to clearly identify the nature of the problem that a proposed regulation is designed to address, as well as assess the significance of that problem, before issuing a new rule." In addition, the bill "requires the SEC to utilize the Office of the Chief Economist to conduct the cost-benefit analysis of potential rules to ensure that the regulatory consequences on economic growth and job-creation are properly accounted for."<sup>16</sup>

It is always important for the SEC to analyze the potential economic impact of its regulations. However, we are concerned that H.R. 2308 would impose an unnecessary burden on the SEC at a time when it is juggling many high-priority responsibilities with limited staffing and resources.

First, it is worth pointing out that after issuing his Executive Order for executive agencies, President Obama issued an additional Executive Order in July calling on independent regulatory agencies to comply with the same provisions.<sup>17</sup> Last week, for instance, the SEC issued a release seeking public comment on the process it should use to conduct retrospective reviews.<sup>18</sup>

In fact, the SEC's release describes several formal and informal processes that are already in place to review existing rules:

- The Commission and staff review existing regulations retrospectively as part of studies of broad substantive program areas....
- Consistent with section 610(a) of the Regulatory Flexibility Act, the Commission annually reviews each of its rules that has become final within the past ten years....
- The Commission and staff frequently receive and consider suggestions to review existing rules through various types of communications, ranging from formal petitions for rulemaking to informal correspondence from investors, investor and industry groups, Congress, fellow regulators, the bar and the public.
- The Commission and staff frequently discuss the need to revisit existing rules through formal and informal public engagement, including advisory committees, roundtables, town hall meetings, speeches, conferences and other meetings.
- The Commission staff may identify existing regulations that may merit review through its compliance inspection and examination functions, enforcement

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<sup>15</sup> The White House, "Improving Regulation and Regulatory Review" (Executive Order 13563), January 18, 2011, *Federal Register*, Vol. 76, No. 14, January 21, 2011. <http://www.gpo.gov/fdsys/pkg/FR-2011-01-21/pdf/2011-1385.pdf> (Downloaded September 14, 2011)

<sup>16</sup> Representative Scott Garrett, "Garrett Introduces Bill to Ensure SEC Regulation are More Effective and Less Burdensome," June 23, 2011. <http://garrett.house.gov/News/DocumentSingle.aspx?DocumentID=248496> (Downloaded September 14, 2011)

<sup>17</sup> White House, "Executive Order—Regulation and Independent Regulatory Agencies," July 11, 2011. <http://www.whitehouse.gov/the-press-office/2011/07/11/executive-order-regulation-and-independent-regulatory-agencies> (Downloaded September 14, 2011)

<sup>18</sup> Securities and Exchange Commission, "SEC to Seek Comment on Review of Existing Regulations," September 6, 2011. <http://sec.gov/news/press/2011/2011-178.htm> (Downloaded September 14, 2011)

investigations, and the receipt of requests for exemptive relief or Commission or staff guidance.

- A significant portion of the Commission's rulemaking activity already involves the consideration of changes to existing rules. Commission staff, in preparing rulemaking proposals, routinely consider related existing rules and assess whether to recommend changes to, or the elimination of, those existing rules.<sup>19</sup>

We would also point out that an existing statute already requires the SEC to weigh several factors when issuing new rules, including their impact on efficiency and capital formation:

Whenever pursuant to this chapter the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.<sup>20</sup>

Furthermore, as it is currently written, H.R. 2308 would apply not only to SEC rules, but also to enforcement orders and similar actions. In her written testimony, Chairman Schapiro points out that "[r]equiring cost-benefit analyses for orders could undermine our ability to issue enforcement orders against wrongdoers, delay exemptive orders needed to facilitate the introduction of new investment products to the market, and impede the capital formation process by delaying orders to registrants that accelerate the registration of their securities."<sup>21</sup> Especially in cases where the SEC must issue an enforcement order against a law-breaking firm or individual, the agency should be primarily concerned with protecting investors and ensuring fair markets, rather than worrying about the potential cost to the wrongdoers.

Therefore, we are concerned that H.R. 2308 will impose unnecessary burdens on the SEC at a time when the agency is already struggling to keep up with its regulatory responsibilities. We agree with the public interest groups that recently urged Congress to improve the SEC's rulemaking process by providing the agency with adequate funding and resources:

If Congress is serious about wanting to improve cost-benefit analysis at the SEC, the best way to do that is to provide the necessary funding for the SEC to increase its staffing, and the expertise and experience of its staff in this area, not add new procedural hurdles designed to prevent it from fulfilling its mission to protect investors.<sup>22</sup>

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<sup>19</sup> Securities and Exchange Commission, "Retrospective Review of Existing Regulations," September 6, 2011. <http://sec.gov/rules/other/2011/33-9257.pdf> (Downloaded September 14, 2011)

<sup>20</sup> 15 U.S.C. § 78c(f) <http://www.gpo.gov/fdsys/pkg/USCODE-2009-title15/pdf/USCODE-2009-title15-chap2B-sec78c.pdf> (Downloaded September 14, 2011)

<sup>21</sup> Testimony of Mary Schapiro, Chairman, Securities and Exchange Commission, before the House Committee on Financial Services, "Fixing the Watchdog: Legislative Proposals to Improve and Enhance the Securities and Exchange Commission," September 15, 2011. <http://financialservices.house.gov/UploadedFiles/091511schapiro.pdf> (Downloaded September 14, 2011)

<sup>22</sup> Letter to Congress regarding the SEC Regulatory Accountability Act, August 17, 2011. <http://pogoarchives.org/m/fo/letter-sec-regulatory-accountability-act-20110817.pdf>

We appreciate your ongoing efforts to make the SEC more effective, efficient, transparent, and accountable. We would be pleased to discuss these issues in more detail with you or your staff. If you have questions or would like any additional information, please contact us at 202-347-1122 or [acanterbury@pogo.org](mailto:acanterbury@pogo.org) or [msmallberg@pogo.org](mailto:msmallberg@pogo.org).

Sincerely,

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cc: Members of the House Financial Services Committee