

# Project On Government Oversight

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June 9, 2010

Members of the Financial Reform Conference Committee  
Members of the Senate Committee on Banking, Housing and Urban Affairs  
U.S. Senate  
Washington, DC 20510

Members of the Financial Reform Conference Committee  
Members of the House Committee on Financial Services  
U.S. House of Representatives  
Washington, DC 20515

Dear Conferees and Committee Members:

The Project On Government Oversight (POGO) offers the following recommendations to ensure that the final financial regulatory reform legislation incorporates the strongest features of the bills passed by the House (H.R. 4173, "The Wall Street Reform and Consumer Protection Act of 2009") and the Senate (S. 3217, "The Restoring American Financial Stability Act of 2010"). As you put the finishing touches on this landmark legislation, we strongly urge you to include the following provisions in order to make our nation's financial regulatory system more effective, accountable, open, and ethical.

## SUMMARY OF RECOMMENDATIONS

- 1) **BRING FULL TRANSPARENCY TO THE CONFERENCE PROCEEDINGS:** Make the conference proceedings fully transparent by broadcasting them on C-SPAN and webcasting them online.
- 2) **PROTECT FINANCIAL SERVICES INDUSTRY WHISTLEBLOWERS:** Extend best-practices whistleblower protections to financial service industry employees.
- 3) **AUDIT THE FEDERAL RESERVE:** Give the Government Accountability Office the authority to conduct an ongoing audit of the Federal Reserve, and require the Fed to make key information about its emergency lending programs publicly available online.

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**4) CREATE A STRONG AND INDEPENDENT CONSUMER FINANCIAL PROTECTION AGENCY:** Create a truly independent, stand-alone Consumer Financial Protection Agency with full authority to issue rules and regulations to protect consumers.

**5) REWARD WHISTLEBLOWERS WHO MAKE DISCLOSURES TO THE SEC AND CFTC:** Expand the whistleblower bounty program at the Securities and Exchange Commission and create an identical program at the Commodity Futures Trading Commission. Additionally, replace secrecy provisions and FOIA exemptions with authentic whistleblower confidentiality protections.

**6) EXPAND SARBANES-OXLEY WHISTLEBLOWER PROTECTIONS:** Extend Sarbanes-Oxley whistleblower protections to employees of subsidiaries and affiliates of publicly traded companies, and of nationally recognized statistical rating organizations.

**7) ADDRESS CONFLICTS OF INTEREST AT CREDIT RATING AGENCIES:** Create a Credit Rating Agency Board to help address the basic conflict of interest arising from “ratings shopping.”

**8) STRENGTHEN THE INDEPENDENCE OF FINANCIAL AGENCY WATCHDOGS:** Strengthen the independence of certain agency appointed Inspectors General (IGs), including the IGs at many financial regulatory agencies.

**9) ADDRESS CONFLICTS OF INTEREST AT FEDERAL RESERVE BANKS:** Amend the election process for directors at Federal Reserve Banks in order to limit the influence of the financial services industry.

## **1) BRING FULL TRANSPARENCY TO THE CONFERENCE PROCEEDINGS**

We urge you to make these and all other conference negotiations fully transparent by broadcasting them live on C-SPAN and webcasting them online. The American people need to be able to watch the proceedings from start to finish in order to 1) see which Members of Congress stand up for their interests, 2) ensure that the strongest provisions aren't watered down through secretive backroom deals, and 3) make an informed decision about the final bill. The live broadcast and webcast should include all meetings, votes, and deliberations.

## **2) PROTECT FINANCIAL SERVICES INDUSTRY WHISTLEBLOWERS**

Corporate whistleblowers play a key role in protecting consumers, investors, and taxpayers from waste, fraud, and abuse in the financial services industry.<sup>1</sup> It is essential

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<sup>1</sup> Alexander Dyck, Adair Morse, and Luigi Zingales, “Who Blows the Whistle on Corporate Fraud?” forthcoming article in *Journal of Finance*. <http://www.afajof.org/afa/forthcoming/4820p.pdf> (Downloaded May 25, 2010)

that these employees be protected from retaliation when they blow the whistle on financial industry misconduct.

The House bill<sup>2</sup> would prohibit any company or individual that provides consumer financial products from retaliating against employees who blow the whistle (Section 4507). Specifically, employees would be protected if they 1) provide information to the Consumer Financial Protection Agency or any other government entity, 2) initiate a proceeding under consumer protection laws, 3) testify in a proceeding resulting from the administration or enforcement of consumer protection laws, or 4) refuse to participate in an activity that they believe to be a violation of a law, rule, or regulation, or that they believe to be harmful to consumers (Section 4507(a)). Employees who experience retaliation as a result of their whistleblowing could file a complaint with the Department of Labor (DOL). If DOL agrees that retaliation has occurred, employees would be eligible for reinstatement at their previous position, back-pay, and compensatory damages. Employees would also have the option to appeal DOL's decision before a jury at an appropriate district court (Section 4507(b)(4)).

The Senate bill<sup>3</sup> also would extend whistleblower protections to financial employees who work on consumer products (Section 1057), but differs from the House bill in several important ways. The Senate bill would go beyond the House bill in protecting employees who "caused to be provided" or are "about to provide or cause to be provided" information on a violation of consumer protection laws (Section 1057(a)(1)). It would protect employees who make a disclosure to their employer, which isn't mentioned in the House bill (Section 1057(a)(1)). And it would protect employees who refuse to participate in an activity only if they believe the activity to be a violation of a law, rule, or regulation (Section 1057(a)(4)).

***POGO recommends keeping the Senate's proposal to cover employees who "caused to be provided" or are "about to provide or cause to be provided" information on a violation of consumer protection laws; keeping the Senate's proposal to cover employees who make a disclosure to their employer; and keeping the House's proposal to cover employees who refuse to participate in any activity that they believe to be a violation of a law, rule, or regulation, or that they believe to be harmful to consumers.***

### **3) AUDIT THE FEDERAL RESERVE**

POGO supports giving the Government Accountability Office (GAO) the authority to audit some of the most significant activities undertaken by the Federal Reserve, including the emergency assistance provided by the Fed in response to the financial crisis. At one

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<sup>2</sup> H.R. 4173, "The Wall Street Reform and Consumer Protection Act of 2009."  
[http://financialservices.house.gov/Key\\_Issues/Financial\\_Regulatory\\_Reform/FinancialRegulatoryReform/hr4173eh.pdf](http://financialservices.house.gov/Key_Issues/Financial_Regulatory_Reform/FinancialRegulatoryReform/hr4173eh.pdf) (Downloaded May 26, 2010)

<sup>3</sup> S. 3217, "The Restoring American Financial Stability Act of 2010."  
[http://banking.senate.gov/public/\\_files/HR\\_4173\\_Senate\\_passed\\_as\\_amended.pdf](http://banking.senate.gov/public/_files/HR_4173_Senate_passed_as_amended.pdf) (Downloaded May 26, 2010)

point, total lending provided by the Fed exceeded \$2 trillion as the central bank invoked its emergency authority to provide direct assistance to a wide range of struggling firms.<sup>4</sup> But despite this massive increase in government assistance, very little is known about the Fed's emergency lending programs, in large part because the GAO is statutorily restricted from auditing these and other lending programs run by the Fed.

The House bill would remove these statutory restrictions, and would require the GAO to conduct its audit within a year of enactment (Section 1254(c)(4)). At the same time, it would seek to protect the Fed's ability to set monetary policy free of political influence. For instance, the House bill would impose a 180-day time lag for the release of details on the Fed's market actions (Section 1254(c)(2)), and makes clear that the GAO cannot make recommendations on the Fed's monetary policy (Section 1254(c)(4)).

The Senate bill would modify the proposed GAO audit in several important ways (Section 1159). Most significantly, it would only require a "one-time audit of all loans and other financial assistance provided" from December 1, 2007, until enactment, whereas the House bill would allow for an ongoing audit (Section 1159(a)(1)). In addition, the Senate bill would require the Fed to make key information about the emergency lending programs available to the public on its website—information such as the names of the firms that accessed the emergency lending facilities, the amounts borrowed, and the lending terms (Section 1159(c))—whereas the House bill does not have this public transparency requirement.

***POGO recommends keeping the House's proposal to allow for an ongoing GAO audit, and keeping the Senate's proposal requiring the Fed to make key information about its emergency lending programs available online.***

#### **4) CREATE A STRONG AND INDEPENDENT CONSUMER FINANCIAL PROTECTION AGENCY**

The recent financial crisis made it painfully clear that consumers have not been adequately protected against a wide range of unfair, deceptive, and abusive financial products. POGO supports creating a consumer financial protection agency and giving it the independence and authority it needs to protect consumers from these dangerous products.

The House bill would establish a truly independent, stand-alone Consumer Financial Protection Agency (Section 4101), and would give this Agency the authority to write rules and issue orders and guidance in order to administer federal consumer financial laws (Section 4202(b)). The courts and the Comptroller of the Currency would be authorized to preempt state consumer protection laws if they "prevent, significantly interfere with, or materially impair the ability of a [national bank or thrift] to engage in the business of banking" (Section 4407(a)). State attorneys general could bring any action

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<sup>4</sup> David Glovin and Bob Van Voris, "Federal Reserve Must Disclose Bank Bailout Records," *Bloomberg*, March 19, 2010. <http://www.bloomberg.com/apps/news?pid=20601010&sid=av.qKiyQh6gA> (Downloaded May 26, 2010)

to enforce federal or non-preempted state laws against a national bank or thrift (Section 4402). The Agency could issue regulations prohibiting or imposing conditions on mandatory arbitration agreements for consumer financial products (Section 4208).

The Senate bill differs from the House bill in several important ways. The Senate bill would create a Bureau of Consumer Financial Protection within the Federal Reserve (Section 1011(a)). The Fed would be prohibited from interfering in matters before the Bureau or denying any of the Bureau's rules or orders (Section 1012(c)). However, any member of the Financial Stability Oversight Council<sup>5</sup> would be allowed to petition a rule issued by the Bureau, and upon a two-thirds vote of its members, the Council could permanently set aside a Bureau regulation (Section 1023). The Senate bill would also allow for preemption by the Comptroller of the Currency, but under the legal standard set by a 1996 Supreme Court case (Section 1044(a)). State attorneys general could bring civil actions to enforce consumer protection laws, but only in their home state (Section 1042(a)(1)). Furthermore, with respect to national banks and thrifts, state attorneys general could bring civil actions only to enforce Bureau *regulations*, and not *violations* of provisions in the Senate bill (Section 1042(a)(2)). The Bureau would have to conduct a study on the use of mandatory arbitration agreements for consumer financial products before prohibiting or limiting these agreements (Section 1028(a)).

***POGO recommends keeping the House's proposal to create an independent, stand-alone Consumer Financial Protection Agency with full authority to issue rules and regulations; keeping or strengthening the House's proposal to roll back federal preemption; keeping the House's proposal to allow state attorneys general to bring any action to enforce federal or non-preempted state laws against a national bank or thrift; and keeping the House's proposal to allow the Agency to issue regulations prohibiting or imposing conditions on mandatory arbitration agreements for consumer financial products.***

## **5) REWARD WHISTLEBLOWERS WHO MAKE DISCLOSURES TO THE SEC AND CFTC**

The Securities and Exchange Commission (SEC) is currently authorized to make reward payments to whistleblowers who provide the Commission with information regarding insider trading. But a recent audit by the SEC Office of Inspector General (OIG) revealed that the program has almost never been used, is barely recognized inside or outside the SEC, and has fundamental design flaws.<sup>6</sup> POGO believes this program should be strengthened and expanded to cover other types of securities fraud and further protect whistleblowers, so that whistleblowers have more of an incentive to make disclosures that will protect consumers, taxpayers, and investors from financial industry misconduct.

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<sup>5</sup> Both the House and Senate bills would create a Financial Stability Oversight Council—with the Treasury Secretary serving as chairman—to identify systemic risks to financial stability, impose stricter prudential standards on certain financial activities, promote market discipline, and respond to emerging threats to U.S. markets.

<sup>6</sup> U.S. Securities and Exchange Commission, Office of Inspector General, *Assessment of the SEC's Bounty Program* (Report No. 474), March 29, 2010. <http://www.sec-oig.gov/Reports/AuditsInspections/2010/474.pdf> (Downloaded May 26, 2010)

The same reward system should be created at the Commodity Futures Trading Commission (CFTC).

The House bill would authorize the SEC to award bounty payments tied to any judicial or administrative action brought by the SEC (i.e., not just insider trading cases) that results in monetary sanctions of over \$1 million. It would also enable the whistleblower to receive up to 30 percent of the amount recovered (the current limit is 10 percent) (Section 7203(a) - Securities Exchange Act of 1934, Section 21F(a)). The SEC's decision would be final and not subject to judicial review (Section 7203(a) - Securities Exchange Act of 1934, Section 21F(e)). In addition, the House bill would prohibit retaliation against any employee, contractor, or agent who makes disclosures to the SEC, and would allow individuals who suffer retaliation to file for relief in U.S. district court (Section 7203(a) - Securities Exchange Act of 1934, Section 21F(g)).

The Senate bill would go even further in offering incentives to whistleblowers (Section 922). It would ensure that the whistleblower receives no less than 10 percent of the monetary sanctions (Section 922(a) - Securities Exchange Act of 1934, Section 21F(b)(1)(A)). It also would allow the whistleblower to appeal the SEC's award decision before the appropriate U.S. court of appeals (Section 922(a) - Securities Exchange Act of 1934, Section 21F(f)).

In addition, the Senate bill would create the same whistleblower reward program at the Commodity Futures Trading Commission (CFTC) (Section 748).

Finally, there are secrecy provisions in the Senate bill that would create unnecessary exemptions to the Freedom of Information Act (FOIA) and would bar the public from obtaining information provided by the whistleblower if the agency decides not to act on it. These provisions would also prevent the whistleblower from accessing the information in order to establish a retaliation claim (S. 3217, Section 922 - Securities Exchange Act of 1934 Section 21F(h)(2), and Section 748 - Commodity Exchange Act, Section 23(h)(2)).

While the House bill does not directly prevent public access to the information provided by a whistleblower, it does create an unnecessary exemption to FOIA in an effort to protect the identity of whistleblowers (H.R. 4173, Section 7203(a) - Securities Exchange Act of 1934, Section 21F(g)(2)). To adequately protect the identity of whistleblowers, simple language stating the identity of whistleblowers must be kept confidential is all that is needed.

***POGO recommends keeping the Senate's legislation to establish a minimum award level, to allow for judicial review of the bounty decisions, and to create an identical whistleblower reward program at the CFTC. Additionally, POGO recommends removing the blanket gag order on information disclosed by the whistleblower, and replacing it with language similar to an amendment introduced by Senator Patrick Leahy (D-VT) that would strike the appropriate balance between whistleblower confidentiality, public access to information, and government accountability.***

## **6) EXPAND SARBANES-OXLEY WHISTLEBLOWER PROTECTIONS**

Passed in the wake of major corporate accounting scandals at Enron, WorldCom and other publicly traded companies, the Sarbanes-Oxley Act has gone a long way toward improving corporate accountability. POGO believes that the Sarbanes-Oxley whistleblower protections for employees of publicly traded companies should be expanded to include employees of subsidiaries and affiliates.

The House bill would amend the Sarbanes-Oxley Act to extend whistleblower protections to employees of “any subsidiary or affiliate whose financial information is included in the consolidated financial statements” of a publicly traded company (Section 7607).

Identical language can be found in the Senate bill (Section 929A). But the Senate bill would also extend Sarbanes-Oxley whistleblower protections to employees of nationally recognized statistical rating organizations (NRSRO) (Section 922(b)).

***POGO recommends extending Sarbanes-Oxley whistleblower protections to employees of subsidiaries and affiliates of publicly traded companies. POGO also recommends keeping the Senate’s proposal to extend these protections to NRSRO employees.***

## **7) ADDRESS CONFLICTS OF INTEREST AT CREDIT RATING AGENCIES**

The credit rating agencies helped pave the path to our financial crisis by misleading investors and giving overly optimistic ratings to mortgage bonds and other financial products. These overly-rosy credit ratings were hardly surprising given that rating agencies are paid by the issuers of the securities they examine. This blatant conflict of interest allows banks and financial firms to “ratings shop” to find the agency that will give their securities the best possible rating, and creates a perverse incentive for the agencies to give high ratings in order to secure future business.

The House bill would require any credit rating agency that provides ratings for a fee to register as a Nationally Recognized Statistical Rating Organization (NRSRO) (Section 6002), but it still would not eliminate the basic conflict of interest in the credit rating system.

The Senate bill would create the Credit Rating Agency Board, a self-regulatory organization overseen by the SEC that would designate certain NRSROs as “qualified nationally recognized statistical rating organizations” with respect to certain structured finance products, and assign the qualified NRSROs to provide initial ratings for these products (Section 939D).

***POGO recommends keeping the Senate’s proposal to create a Credit Rating Agency Board, which would at least begin to address the basic conflict of interest arising from “ratings shopping.”***

## 8) STRENGTHEN THE INDEPENDENCE OF FINANCIAL AGENCY WATCHDOGS

In many respects, the financial crisis represented a failure on the part of our financial regulatory agencies to protect taxpayers, investors, and consumers from financial industry misconduct. It is therefore imperative that IGs be given all the authority and independence they need to hold financial regulators accountable.

Many, including POGO, have raised concerns that some IGs may not be truly independent because they are hired and fired by the agencies they oversee, and are required to report to an individual who is designated as the agency head. But if agency-appointed IGs report to a multi-person board or commission rather than an individual, they are protected by the fact that it takes more than one person to remove them from office.<sup>7</sup>

The House bill would seek to strengthen IG independence by converting the IGs at certain financial regulatory agencies to presidentially appointed positions (Section 3301). These watchdogs are currently classified as designated federal entities (DFE) IGs, and are appointed by their agency heads.

The Senate bill offers a different solution for strengthening the independence of these IGs. Instead of converting them to presidentially appointed positions, this provision would require all DFE IGs—including many of the financial agency watchdogs—to report to the entire board or commission at their agencies. Additionally, a two-thirds vote of the entire board or commission is required in order to remove a DFE IG, making it virtually impossible for any one individual agency head to unilaterally remove an IG for political reasons (Section 989B).

*POGO recommends keeping the Senate's proposal to strengthen the independence of DFE IGs, which will insulate these IGs from political pressure without creating a new set of presidential appointments which could potentially sit vacant for a long period of time.*<sup>8</sup>

## 9) ADDRESS CONFLICTS OF INTEREST AT FEDERAL RESERVE BANKS

Six of the nine individuals who serve on the board of directors at Federal Reserve Banks are supposed to represent the public's interest.<sup>9</sup> But even a cursory examination of the "public" directors at the Federal Reserve Bank of New York ought to raise serious

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<sup>7</sup> Testimony of Danielle Brian before the House Oversight and Government Reform Committee's Government Management, Organization, and Procurement Subcommittee on "The Roles and Responsibilities of Inspectors General within Financial Regulatory Agencies," March 25, 2009. <http://www.pogo.org/pogo-files/testimony/government-oversight/go-igi-20090325.html> (Downloaded May 27, 2010)

<sup>8</sup> John Solomon, "Where Are the Watchdogs? Congress, Administration Leave Many Top Oversight Jobs Unfilled," The Center for Public Integrity, May 3, 2010. <http://www.publicintegrity.org/articles/entry/2063/> (Downloaded May 27, 2010)

<sup>9</sup> Federal Reserve Board, "About the Directors of Federal Reserve Banks and Branches." <http://www.federalreserve.gov/generalinfo/listdirectors/about.htm> (Downloaded May 27, 2010)



questions about how effectively the public's interest is being represented. Recent public directors at the New York Fed include Jeffrey R. Immelt, Chairman and CEO of the General Electric Company; Jeffrey B. Kindler, Chairman and CEO of Pfizer;<sup>10</sup> Stephen Friedman, Chairman of Stone Point Capital and a director at Goldman Sachs;<sup>11</sup> and Richard S. Fuld, Jr., former Chairman and CEO of Lehman Brothers.<sup>12</sup>

The Senate bill would prohibit Fed-supervised companies, subsidiaries, and affiliates from voting for members of the board of directors at Federal Reserve Banks. It also would prohibit past or current officers, directors, and employees of these companies from serving on Federal Reserve Bank boards (Section 1157). No such provision exists in the House bill.

***POGO recommends keeping the Senate's proposal to limit the influence of industry on Federal Reserve Banks.***

Both versions of the legislation include significant proposals for protecting whistleblowers, increasing transparency, strengthening consumer protections, mitigating conflicts of interest, and making other sweeping improvements to the financial regulatory system. We urge you to incorporate the strongest of these proposals into the final version of the bill in order to foster a financial regulatory system that truly works in the best interest of taxpayers, investors, and consumers.

Thank you in advance for your leadership on this important matter. If you have any questions or need additional information, please contact POGO's director of public policy, Angela Canterbury at 202-347-1122 or [acanterbury@pogo.org](mailto:acanterbury@pogo.org).

Sincerely,



Danielle Brian  
Executive Director

cc: Senate Majority Leader Harry Reid  
House Speaker Nancy Pelosi

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<sup>10</sup> Federal Reserve Bank of New York, "Board of Directors," February 2010.

[http://www.newyorkfed.org/aboutthefed/org\\_nydirectors.html](http://www.newyorkfed.org/aboutthefed/org_nydirectors.html) (Downloaded May 27, 2010)

<sup>11</sup> Federal Reserve Bank of New York, "Directors of the Federal Reserve Bank of New York."

<http://www.newyorkfed.org/aboutthefed/annual/annual08/directors.pdf> (Downloaded May 27, 2010)

<sup>12</sup> Federal Reserve Bank of New York, "Directors of the Federal Reserve Bank of New York."

<http://www.newyorkfed.org/aboutthefed/annual/annual07/directors.pdf> (Downloaded May 27, 2010)