

*Exposing Corruption* *Exploring Solutions*  
**Project On** **Government Oversight**

March 8, 2011

The Honorable Mary Schapiro  
Chairman  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Dear Chairman Schapiro:

The Project On Government Oversight (POGO) is a nonpartisan independent watchdog that champions good government reforms. As such, POGO has a keen interest in ensuring that agencies are responsive to investigations conducted by their Office of Inspector General (OIG).

We wrote to you in late 2009 to raise concerns that the Securities and Exchange Commission (SEC) had delayed implementing recommendations made in investigative and audit reports issued by the OIG over the past few years, many of which included key reforms for improving the agency's management culture and regulatory effectiveness.<sup>1</sup>

In your response, you indicated that you have made it a "top management priority and have taken action to strengthen the agency's program for ensuring appropriate and timely follow up on OIG recommendations."<sup>2</sup> We appreciate your commitment to taking final action on the OIG's proposed reforms.

However, we are concerned by recent updates regarding the SEC's response to OIG recommendations for disciplinary action in cases of serious wrongdoing by SEC employees and contractors. This updated information was included in a letter you sent to House Oversight and Government Reform Committee Chairman Darrell Issa on January 31, 2011.<sup>3</sup>

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<sup>1</sup> Letter from Danielle Brian, Executive Director, Project On Government Oversight to Mary Schapiro, Chairman, Securities and Exchange Commission, regarding the SEC's failure to act on hundreds of Inspector General recommendations, December 16, 2009. <http://www.pogo.org/pogo-files/letters/financial-oversight/er-fra-20091216.html>

<sup>2</sup> Letter from Mary Schapiro, Chairman, Securities and Exchange Commission, to Danielle Brian, Executive Director, Project On Government Oversight, regarding the progress of the SEC in addressing OIG recommendations, January 8, 2010. <http://pogoarchives.org/m/fo/schapiro-response-20100108.pdf>

<sup>3</sup> Letter from Mary Schapiro, Chairman, Securities and Exchange Commission, to Darrell Issa, Chairman, House Committee on Oversight and Government Reform, regarding various SEC reforms, January 31, 2011. <http://pogoarchives.org/m/fo/schapiro-letter-20110131.pdf>

First, we want to acknowledge that the SEC has made some progress in closing out recommendations that were still open when we wrote to you in 2009.<sup>4</sup> However, upon reviewing the information you provided to Chairman Issa, and comparing it to the findings and recommendations made by the OIG in its investigative reports, we remain concerned that many SEC employees have not been adequately disciplined for their alarming misconduct. While much of this misconduct occurred before you took office, we urge the SEC to disclose additional information on the following matters so that the public can have a better understanding of the agency's treatment of OIG disciplinary recommendations.

### **SEC's history of deflecting and dismissing OIG disciplinary recommendations**

SEC rules state that the agency "has been entrusted by Congress with the protection of the public interest in a highly significant area of our national economy." Therefore, it is essential for SEC employees to "maintain unusually high standards of honesty, integrity, impartiality and conduct."<sup>5</sup>

OIG investigations have uncovered countless instances in which SEC employees failed to meet these high standards. In many cases, the OIG has recommended that the SEC take disciplinary action against employees whose misconduct would damage the public's confidence in the integrity of the agency.

In recent years, however, the SEC has repeatedly taken steps to deflect or dismiss the OIG's findings and recommendations. For instance, the SEC has often delayed or blocked the public release of OIG investigative reports. Even when it does release reports through the Freedom of Information Act (FOIA), it rarely posts these reports online.<sup>6</sup> As a result, it can take months or even years for the public to learn about serious misconduct uncovered by the OIG's investigations. This lack of transparency also makes it all too easy for the SEC to delay, deflect, or ignore the OIG's recommendations.

### **SEC employees and contractors still rarely terminated for misconduct**

Given the SEC's history of hiding and dismissing OIG investigations, we believe it is important to examine the agency's recent responses to OIG disciplinary recommendations.

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<sup>4</sup> For instance, it appears the SEC has taken final action on recommendations made in the following reports: *Allegations of Perjury and Obstruction of Justice by Former SEC Enforcement Attorney* (OIG-477), *Possession of a Dangerous Weapon in a Federal Facility by Division of Enforcement SK-14 Employee* (OIG-514), *Disclosure of Non-Public Procurement Information and Lack of Candor at Headquarters* (OIG-515), and *Misuse of Position, Government Resources and Official Time in Denver Regional Office and Home Office* (OIG-519)

<sup>5</sup> 17 CFR Part 200.735-2. <http://www.gpo.gov/fdsys/pkg/CFR-2010-title17-vol2/pdf/CFR-2010-title17-vol2-sec200-735-2.pdf> (Downloaded March 7, 2011)

<sup>6</sup> POGO has created a resource page with links to OIG investigative reports that were released through the Freedom of Information Act but are still nowhere to be found on the websites of the SEC or the OIG: <http://www.pogo.org/investigations/financial-oversight/sec-ig-investigative-reports.html>

By our count, there have been at least 98 SEC employees and contractors recommended for disciplinary action by the OIG from 2008 to the present.<sup>7</sup> In cases of egregious misconduct, the OIG specifically recommended disciplinary action up to and including dismissal or removal—were counted at least 27 employees and contractors who received such a recommendation in OIG reports issued since 2008.

However, it appears that only 11 employees and contractors were terminated or removed from their contract during this period. Many received lesser forms of disciplinary action, including counseling, suspensions, and reprimands. At least 16 employees resigned rather than face disciplinary action.<sup>8</sup> And the SEC took no action, whatsoever, in the case of 10 employees, many of whom were found to have committed serious offenses.

Furthermore, it would appear that disciplinary action is especially rare when it comes to high-ranking SEC officials. For instance, you received a letter last year from an anonymous whistleblower at the Los Angeles Regional Office (LARO) who complained that a supervisor was not punished after he was caught viewing pornography. The whistleblower explained that the lack of discipline for the supervisor had created “an inherently hostile work environment for the entire LARO examination staff.”<sup>9</sup> Meanwhile, lower-level employees and contractors who were caught viewing pornography have been subject to a wider range of disciplinary action, including reprimands, counseling, suspensions, and terminated contracts.<sup>10</sup>

### **Disciplinary action still pending for employees who failed to uncover Madoff and Stanford Ponzi schemes**

In your letter to Chairman Issa, you indicated that the SEC’s final action was still pending on disciplinary recommendations made in the OIG’s August 2009 report on the agency’s failures to uncover the Madoff Ponzi scheme. As you know, the OIG had recommended that you “carefully review the ROI [Report of Investigation] and share with OCIE [Office of Compliance Inspections and Examinations] and Enforcement management, the portions of the ROI that related to the performance failures by those employees who still worked at the SEC, so that appropriate action (which may include performance-based action, as appropriate) is taken, on an employee-by-employee basis, to ensure that future examinations and investigations are

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<sup>7</sup> This probably underestimates the total number of employees and contractors recommended for disciplinary action, since in some cases the recommendation covers multiple staff members within an SEC division or office.

<sup>8</sup> POGO has written about one case in which an enforcement attorney was found to have disclosed non-public information about a JPMorgan whistleblower, but ended up resigning and running for Congress rather than facing any meaningful disciplinary action. Michael Smallberg and Adam Zagorin, “Long Island Congressional Candidate Cited for Giving Up JPMorgan Whistleblower,” *Politics Daily*, January 28, 2010.

<http://www.politicsdaily.com/2010/01/28/long-island-congressional-candidate-cited-for-giving-up-jpmorgan> (Downloaded March 7, 2011)

<sup>9</sup> Letter from Senator Grassley, Ranking Member, Senate Committee on Finance, to Mary Schapiro, Chairman, Securities and Exchange Commission, regarding disciplinary actions for employees who engaged in inappropriate use of SEC computer systems to view pornography, April 27, 2010. <http://grassley.senate.gov/about/upload/SEC-4-27-10-Grassley-letter-to-Schapiro-about-SEC-response-to-porn-use-and-new-whistleblower-allegations.pdf> (Downloaded March 7, 2011)

<sup>10</sup> Ed O’Keefe, “SEC porn scandal results in zero firings, agency says,” *Federal Eye*, April 27, 2010. [http://voices.washingtonpost.com/federal-eye/2010/04/new\\_sec\\_porn\\_bust\\_details\\_rele\\_1.html](http://voices.washingtonpost.com/federal-eye/2010/04/new_sec_porn_bust_details_rele_1.html) (Downloaded March 7, 2011)

conducted in a more appropriate manner and the mistakes and failures outlined in this ROI are not repeated.”<sup>11</sup>

In addition, you indicated that the SEC’s final action was still pending on the OIG’s March 2010 report on the agency’s failure to uncover the Stanford Ponzi scheme, which included a similar recommendation for appropriate action to be taken on an employee-by-employee basis “to ensure that future decisions about when to open an investigation and when to recommend that the Commission take action are made in a more appropriate manner.”<sup>12</sup>

At a July 2010 hearing, you pointed out that many of the Enforcement and OCIE staff who worked on the Madoff investigation had already left the agency (in fact, many have moved on to high-paying jobs in the private sector<sup>13</sup>). You also indicated that the SEC “can’t just look at the inspector general report and make a decision based on that” since the agency is bound by civil service laws and procedures concerning disciplinary and remedial action for federal employees. Nonetheless, you stated that the SEC had appointed a recommending official and a deciding official for potential discipline, and that “the process is coming to a conclusion in the near future.”<sup>14</sup>

So as we review the updated records several months later, we are surprised to see that final action is still pending with respect to the remaining employees who were involved in both the Madoff and Stanford investigations, especially given the significant congressional and media attention focused on the SEC’s embarrassing failures to detect these massive Ponzi schemes.

### **No action taken in response to whistleblower retaliation**

We also have serious concerns about the SEC’s decision to take no action in response to the OIG’s investigation into allegations of whistleblower retaliation at the Fort Worth Regional Office (FWRO).

In that investigation, the OIG largely confirmed allegations that two senior FWRO officials took retaliatory actions against veteran examiners who protested a new program that would have required them to focus their attention on quick-hit, superficial examinations, diverting resources away from in-depth examinations of broker-dealers designed to uncover fraud similar to the Stanford Ponzi scheme. The OIG recommended that performance-based or disciplinary action be

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<sup>11</sup> Securities and Exchange Commission, Office of Inspector General, *Semiannual Report to Congress: April 1, 2009 – September 30, 2009*. <http://www.sec-oig.gov/Reports/Semiannual/2009/semifall09.pdf> (Downloaded March 7, 2011)

<sup>12</sup> Securities and Exchange Commission, Office of Inspector General, *Investigation of the SEC’s Response to Concerns Regarding Robert Allen Stanford’s Alleged Ponzi Scheme* (OIG-526), March 31, 2010. <http://www.sec.gov/news/studies/2010/oig-526.pdf> (Downloaded March 7, 2011)

<sup>13</sup> Josh Margolin, “SEC officials who missed Madoff now in top spots at major law firms,” *New York Post*, February 7, 2011. [http://www.nypost.com/p/news/national/they\\_no\\_evil\\_OD3nrM7wa063pBmionEdGK](http://www.nypost.com/p/news/national/they_no_evil_OD3nrM7wa063pBmionEdGK) (Downloaded March 7, 2011)

<sup>14</sup> Hearing on SEC Oversight before the House Financial Services Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises, July 20, 2010. <http://democrats.financialservices.house.gov/Hearings/hearingDetails.aspx?NewsID=1326> (Downloaded March 7, 2011)

taken against the two officials.<sup>15</sup>

However, the Fort Worth *Star-Telegram* reported that the SEC decided to take no action because the FWRO officials had “cleared their moves with human resources.”<sup>16</sup> This prompted a letter from Senator Charles Grassley, who raised concerns that the SEC’s explanation implied that “a retaliatory personnel action can be laundered of its retaliatory intent by simply consulting with others who had no retaliatory intent and obtaining their concurrence. Such a policy would make a mockery of whistleblower protections throughout government.” Senator Grassley concluded that the agency’s response to the OIG’s recommendations was “extremely disturbing,” and that it painted a picture of a culture at the SEC that “endorses retaliation against employees who attempt to improve operations by reporting mismanagement to headquarters.”<sup>17</sup>

## Recommendations

Based on our review of the updated information you provided to Chairman Issa, POGO offers the following recommendations:

- As a general practice, the SEC should commit to implementing OIG recommendations in a timely fashion, including recommendations for disciplinary action, or explaining in the public record why it disagrees with the OIG’s findings.
- The SEC should make it a goal to release and post OIG investigative reports that are of public interest or have already been released through FOIA, making only the legally necessary redactions.
- Some agencies have disclosed their internal procedures for taking disciplinary action, including guidance on alternative disciplinary measures.<sup>18</sup> Especially given the recent controversies surrounding SEC disciplinary actions, the SEC should publicly disclose any statutory provisions or agency rules that guide officials in determining what form of disciplinary action to take. If you believe the current laws and regulations are overly restrictive, you should ask Congress for more flexibility in making disciplinary determinations, or propose such changes through agency rulemaking.
- If the SEC decides to utilize an alternative process for reviewing the OIG’s findings, it should take every possible step to ensure that the process is fair, transparent, and accountable.
- The SEC should take immediate disciplinary action against any remaining employees who were cited in the OIG reports on the agency’s failures to detect the Madoff and

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<sup>15</sup> Securities and Exchange Commission, Office of Inspector General, *Allegations of Retaliatory Personnel Actions* (OIG-494A), September 15, 2009. <http://pogoarchives.org/m/fo/sec-oig-report-20090915.pdf>

<sup>16</sup> Darren Barbee, “Divided Fort Worth office of SEC was plagued by inaction,” *Ft. Worth Star-Telegram*, July 10, 2010. <http://www.star-telegram.com/2010/07/10/2325562/divided-fort-worth-office-of-sec.html> (Downloaded March 7, 2011)

<sup>17</sup> Letter from Senator Charles Grassley, Ranking Member, Senate Committee on Finance, to Mary Schapiro, Chairman, Securities and Exchange Commission, August 24, 2010. <http://grassley.senate.gov/about/upload/2010-08-24-Letter-to-SEC.pdf> (Downloaded March 7, 2011)

<sup>18</sup> Department of the Interior, *Handbook on Charges and Penalty Selection for Disciplinary and Adverse Actions*. <http://www.doi.gov/hrm/guidance/attpb1-4.htm> (Downloaded March 7, 2011); and Department of Health and Human Services, *Guide for Implementing an Alternative Discipline Program*, September 10, 2002. <http://www.hhs.gov/ohr/discipline.html> (Downloaded March 7, 2011)

Stanford Ponzi schemes, or else explain to the public why disciplinary action is not warranted for those employees. The SEC should also strongly reconsider its decision not to take any action against the Fort Worth officials who were found to have retaliated against whistleblowers in their office, especially in light of the important questions raised by Senator Grassley.

To be sure, we recognize that the SEC is currently facing the daunting task of carrying out its expanded duties under the Dodd-Frank Wall Street Reform and Consumer Protection Act with severely limited staffing and resources. POGO has joined with other groups urging Congress to provide adequate funding for the SEC to fulfill its mandates under Dodd-Frank.<sup>19</sup>

At the same time, the SEC should be fostering an internal culture that promotes the detection of waste, fraud, and abuse, protects employees who blow the whistle, and holds employees and contractors fully accountable for their misconduct. Especially at a time when the SEC is encouraging outside whistleblowers to come forward with information on misconduct in the securities industry, it is more important than ever for the SEC to hold wrongdoers accountable within the agency. In order to reassure the public that the SEC is making employee and contractor accountability a top priority, we urge you to take more aggressive measures to implement the OIG's recommendations for disciplinary action.

Thank you for your leadership on this important matter, and we look forward to your response. If you have any questions or need further information or evidence to aid your efforts, please contact Michael Smallberg at 202-347-1122.

Sincerely,



Danielle Brian  
Executive Director

CC: SEC Office of Inspector General  
Darrell Issa, Chairman, House Committee on Oversight and Government Reform  
Elijah Cummings, Ranking Member, House Committee on Oversight and Government Reform  
Spencer Bachus, Chairman, House Committee on Financial Services  
Barney Frank, Ranking Member, House Committee on Financial Services  
Tim Johnson, Chairman, Senate Committee on Banking, Housing and Urban Affairs  
Richard Shelby, Ranking Member, Senate Committee on Banking, Housing and Urban Affairs

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<sup>19</sup> Project On Government Oversight, "POGO Joins Groups Urging Congress to Ensure Adequate Funding for Financial Regulators," February 16, 2011. <http://pogoblog.typepad.com/pogo/2011/02/pogo-joins-groups-urging-congress-to-ensure-adequate-funding-for-financial-regulators.html>

Senator Charles Grassley