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Project On Government Oversight

Testimony of
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Project On Government Oversight
before the House Committee on Financial Services
on "Legislative Proposals to Address Concerns Over the
SEC's New Confidentiality Provision"
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Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for inviting me to testify today. I am the Director of Public Policy at the Project On Government Oversight (POGO). Founded in 1981, POGO is an independent nonprofit that investigates and exposes corruption and other misconduct in order to achieve a more effective, accountable, open, and ethical federal government.

POGO has a keen interest in ensuring that the public has a way of holding our nation's financial regulatory agencies accountable for protecting the interests of taxpayers, investors, and consumers. The Freedom of Information Act (FOIA) is just such a tool, and is not only a cornerstone for open government but also a hallmark of our democracy. This is why we are deeply concerned about Section 929I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). This provision would provide the Securities and Exchange Commission (SEC, Commission, or agency) with an unnecessary and overly broad exemption to FOIA and a blanket authority to withhold public records.

Section 929I states that the SEC cannot be compelled to disclose records or other information obtained from its registered entities—including entities such as hedge funds, private equity funds, and venture capital funds which will now come under greater regulation by the SEC—if this information is used for "surveillance, risk assessments, or other regulatory and oversight activities" outlined in three statutes: the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940.[1]

Although we fully understand the need to protect against the disclosure of certain information collected by the SEC, existing FOIA exemptions are more than adequate. In fact, the SEC has a history of wielding these exemptions to withhold more than it discloses. Although President Obama mandated that FOIA be implemented with a presumption in favor of disclosure,[2] the SEC Office of Inspector General (OIG) concluded that SEC FOIA practices "have the effect of

[1] "Dodd-Frank Wall Street Reform and Consumer Protection Act," Pub. L. No. 111-203, Section 929I. http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173enr.txt.pdf (Downloaded September 8, 2010)
[2] "Memorandum of January 21, 2009 - Freedom of Information Act," Federal Register, Vol. 74, No. 15, January 26, 2009. http://edocket.access.gpo.gov/2009/pdf/E9-1773.pdf (Downloaded September 8, 2010)

creating a presumption of withholding."[3] If implemented, Section 929I will further hinder the public's ability to access critical information related to the activities of the SEC.

The public-interest stakes in more—not less—transparency and accountability at the SEC cannot be overstated. American families continue to suffer from the financial crisis fueled in part by systemic regulatory failures. The SEC's particularly dramatic failure to fulfill its core mission of protecting investors is exemplified in the Madoff and Stanford cases.[4] If allowed to stand, the 929I secrecy provision could significantly undermine this Committee's work and Congress' intent to provide greater transparency and accountability in the financial regulatory system when it passed the landmark Dodd-Frank Act.

Indeed, limiting disclosure to public information should not be done lightly. The OPEN FOIA Act now requires Congress to explicitly state its intention to provide a statutory exemption to FOIA in new legislation.[5] One of the authors of the OPEN FOIA Act, Senator Patrick Leahy, had raised concerns about the growing number of "so-called 'FOIA (b)(3) exemptions' in proposed legislation—often in very ambiguous terms—to the detriment of the public's right to know." He stated that the OPEN FOIA Act is intended to help "ensure that FOIA remains a meaningful tool to help future generations of Americans access Government information."[6]

FOIA and subsequent amendments require careful crafting of Exemption 3, or information specifically exempted by statute, so that "the matters be withheld from the public in such a manner as to leave no discretion on the issue," or establish "particular criteria for withholding or [refer] to particular types of matters to be withheld."[7] Yet, Section 929I is uniquely broad in that it protects records obtained by the SEC for the purposes of "surveillance, risk assessments, *or other regulatory and oversight activities*" (emphasis added). It is unclear to us how such ambiguous language could qualify as an Exemption 3 statute.

In response to concerns raised by POGO and others, bills have been introduced that would repeal the unnecessary and overly broad 929I provision. Legislation introduced by Representative Edolphus Towns (H.R. 6086)[8] and Senators Patrick Leahy, Charles Grassley, John Cornyn, and

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[3] Securities and Exchange Commission, Office of Inspector General, *Review of the SEC's Compliance with the Freedom of Information Act* (Report No. 465), September 25, 2009, p. 50. http://www.sec-oig.gov/Reports/AuditsInspections/2009/465.pdf (Downloaded September 8, 2010)

[4] Securities and Exchange Commission, Office of Inspector General, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme* (Report No. OIG-509), August 31, 2009. http://www.sec.gov/news/studies/2009/oig-509.pdf (Downloaded September 9, 2010); and Securities and Exchange Commission, Office of Inspector General, *Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme* (Report No. OIG-526), March 31, 2010. http://www.sec.gov/news/studies/2010/oig-526.pdf (Downloaded September 9, 2010)

[5] Department of Justice, Office of Information Policy, "Congress Passes Amendment to Exemption 3 of the FOIA," March 10, 2010. http://www.justice.gov/oip/foiapost/2010foiapost7.htm (Downloaded September 9, 2010)

[6] Senator Patrick Leahy, "Leahy-Authored Open Government Provision Set To Become Law," October 20, 2009. http://leahy.senate.gov/press/press_releases/release/?id=84bb8a0f-77f2-4fc4-9699-682af5cfb293 (Downloaded September 9, 2010)

[7] Department of Justice, "Exemption 3," *Department of Justice Guide to the Freedom of Information Act*, p. 207. http://www.justice.gov/oip/foia_guide09/exemption3.pdf (Downloaded September 9, 2010)

[8] 111th Congress, H.R. 6086, introduced by Representative Towns, August 10, 2010. http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h6086ih.txt.pdf (Downloaded September 9, 2010)

Ted Kaufman (S. 3717)[9] would strike the blanket exemptions found in Section 929I, and clarify that Exemption 8 will protect against the release of information contained in the records of entities that will now be regulated by the SEC under the Dodd-Frank Act (a specific concern raised by the SEC). POGO and other good government groups[10] support these bills, which will prevent additional secrecy and send a clear message that public access is vital to accountability. Representatives Darrell Issa, John Campbell, and Ron Paul also have offered supportable legislation to strike Section 929I.[11]

Congress must ensure a proper balance between the need for limited confidentiality for effective financial regulation and the public's right to know. For these reasons, we thank you for your willingness to revisit the blanket FOIA exemptions contained in the Dodd-Frank Act, examine the problematic culture of secrecy at the SEC, and consider H.R. 6086 to repeal Section 929I.

A Shield from Accountability

Although the SEC claims that Section 929I is necessary to protect confidential information provided by its regulated entities,[12] the FOX Business News case raises concerns that the agency could also use its blanket exemptions to cover up its own mistakes—including mistakes from past cases that are no longer open.

FOX Business News reported that the SEC may be seeking to invoke Section 929I in litigation to block the release of records in response to a FOIA request FOX filed in February 2009 seeking "any information related to the agency's response to complaints, tips and inquiries or any potential violations of the securities law or wrongdoing by Stanford."[13]

In response to questions about Section 929I submitted by Representative Darrell Issa, Chairman Schapiro confirmed that SEC counsel in the FOX case "explained in telephone conversations with opposing counsel and the judge's law clerk that Section 929I exists and could provide an additional basis for withholding documents the Commission has already withheld pursuant to other FOIA exemptions."[14]

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[9] 111th Congress, S. 3717, introduced by Senators Leahy, Grassley, Cornyn and Kaufman, August 5, 2010. http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s3717is.txt.pdf (Downloaded September 9, 2010)

[10] Project On Government Oversight, "Groups Support Bipartisan Senate Bill to Strike SEC FOIA Exemptions," August 10, 2010. http://www.pogo.org/pogo-files/letters/financial-oversight/fo-fra-20100810.html

[11] 111th Congress, "SEC Freedom of Information Restoration Act," H.R. 5924, introduced by Representative Darrell Issa, July 29, 2010. http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h5924ih.txt.pdf; 111th Congress, H.R. 5948, introduced by Representative John Campbell, July 29, 2010. http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h5948ih.txt.pdf; and 111th Congress, "SEC Transparency Act of 2010," H.R. 5970, introduced by Representative Ron Paul, July 29, 2010. http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h5970ih.txt.pdf (All downloaded September 14, 2010)

[12] Letter from SEC Chairman Mary Schapiro to Representative Barney Frank and Senator Christopher Dodd, July 30, 2010. http://voices.washingtonpost.com/market-cop/frank.pdf and http://voices.washingtonpost.com/market-cop/dodd.pdf (Downloaded September 8, 2010)

[13] Dunstan Prial, "SEC Says New Financial Regulation Law Exempts it From Public Disclosure," *FOX Business News*, July 28, 2010. http://www.foxbusiness.com/markets/2010/07/28/sec-says-new-finreg-law-exempts-public-disclosure/ (Downloaded September 9, 2010)

[14] Letter from SEC Chairman Mary Schapiro to Representative Darrell Issa, August 24, 2010, p. 3. http://pogoarchives.org/m/er/schapiro-letter-20100824.pdf (Downloaded September 13, 2010)

There is no way to know exactly what information may be contained in the records requested by FOX. But FOX had previously used FOIA to obtain a 2005 survey that the SEC's Fort Worth Regional Office (FWRO) had sent to Stanford investors. The existence of the survey confirmed that the SEC had suspicions about Stanford for years prior to the fraud being exposed and shut down. In fact, an SEC OIG report found that FWRO examiners were uncovering red flags on Stanford's operations as early as 1997.[15]

The SEC's inability to crack down on the Stanford and Madoff Ponzi schemes over years of leads and evidence exposed serious problems with the agency's operations, including mishandling whistleblower tips and failures to coordinate between different offices within the agency. If these shortcomings are kept hidden from the public, the media, and other outside stakeholders, the SEC will be shielded from external pressure to improve the agency's oversight of its regulated entities.

Standard FOIA Exemptions are More than Adequate

The SEC's failure in the Stanford and Madoff cases did not stem from a lack of information. Of all the problems at the SEC that require a legislative fix, the ability of the SEC to withhold information is not one. Since passage of the blanket FOIA exemptions, Chairman Schapiro has argued that Section 929I is needed to assure registered entities that their sensitive and proprietary information will not be released through FOIA or private litigation.[16]

In Chairman Schapiro's response to Representative Issa, she asserts that "Commission examinations unquestionably have been hindered by registered entities' refusal to produce certain information requested by staff during an examination due to concerns about the Commission's ability to protect the information from compelled third party disclosure."[17] To support this claim, she provides some examples, mostly involving investment advisers, in which regulated entities either refused to provide information or insisted that SEC examiners review certain records on-site without making copies.

What Chairman Schapiro neglected to mention is that the SEC has the power to compel registered entities to provide information and records. Under the Securities Exchange Act of 1934, the SEC has the authority to subpoena witnesses and require the production of any records from its registered entities. If these entities fail to comply, the SEC has the authority to suspend them, impose significant monetary penalties, and refer cases to the Department of Justice (DOJ) for possible criminal proceedings.[18]

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[15] Securities and Exchange Commission, Office of Inspector General, *Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme* (Report No. OIG-526), March 31, 2010, p. 16. http://www.sec.gov/news/studies/2010/oig-526.pdf (Downloaded September 9, 2010)

[16] Letter from SEC Chairman Mary Schapiro to Representative Barney Frank and Senator Christopher Dodd, July 30, 2010. http://voices.washingtonpost.com/market-cop/frank.pdf and http://voices.washingtonpost.com/market-cop/dodd.pdf (Downloaded September 8, 2010)

[17] Letter from SEC Chairman Mary Schapiro to Representative Darrell Issa, August 24, 2010, p. 5. http://pogoarchives.org/m/er/schapiro-letter-20100824.pdf (Downloaded September 13, 2010)

[18] Securities Exchange Act of 1934, Section 21(b)—(d), Section 32. http://www.sec.gov/about/laws/sea34.pdf (Downloaded August 2, 2010).

We certainly understand that the SEC's job is made more difficult when registered entities refuse to cooperate with examinations. But we're not convinced the agency should have to defer to the entities it regulates, especially when it has the power of subpoena.

Furthermore, the existing FOIA exemptions are sufficient to protect against the release of sensitive business information through a FOIA request. It's surprising that the SEC doesn't express more confidence in the existing FOIA exemptions given its track record for withholding information. In fact, the SEC has only provided one specific example in which a court actually overturned the SEC's invocation of Exemption 4, and in that case no confidential registrant information was disclosed.

Chairman Schapiro claims that "existing FOIA exemptions were insufficient to allay concerns [about public disclosure] due in part to limitations in FOIA."[19] In order for Congress to evaluate the need for additional exemptions, I'd like to address this assertion and examine the existing Exemptions 4 and 8.

Chairman Schapiro has raised some questions about the types of firms that are considered to be "financial institutions" for the purposes of Exemption 8.[20] FOIA Exemption 8 protects matters that are "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." Although the legislative history of the Government in the Sunshine Act provided some clarity as to the definition of "financial institutions,"[21] Chairman Schapiro questions whether the definition covers other entities that now fall under the SEC's expanded oversight, such as credit rating agencies, transfer agents, and municipal advisers.

It's important to note that the courts have consistently ruled that Congress intended for Exemption 8 to be broad and all-inclusive.[22] In fact, there is sufficient concern that Exemption 8 is too broad, and should be re-examined and more narrowly tailored. The Administrative Conference of the United States made the recommendation that "Agencies should not withhold information on the basis that it is 'related to' operating, condition or examination reports unless they determine that nondisclosure is properly justified."[23]

But if Congress shares the SEC's concern that certain newly regulated entities may not fall under the definition of "financial institutions" for Exemption 8, we believe the appropriate solution would be legislation clarifying that any entity regulated by the SEC will be covered by Exemption 8—as in H.R. 6086.

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[19] Letter from SEC Chairman Mary Schapiro to Representative Barney Frank and Senator Christopher Dodd, July 30, 2010, p. 2. http://voices.washingtonpost.com/market-cop/frank.pdf and http://voices.washingtonpost.com/market-cop/dodd.pdf (Downloaded September 8, 2010)

[20] Letter from SEC Chairman Mary Schapiro to Representative Darrell Issa, August 24, 2010, pp. 3-4. http://pogoarchives.org/m/er/schapiro-letter-20100824.pdf (Downloaded September 13, 2010)

[21] Department of Justice, "Exemption 8," *Department of Justice Guide to the Freedom of Information Act*, p. 659. http://www.justice.gov/oip/foia_guide09/exemption8.pdf (Downloaded September 9, 2010)

[22] Department of Justice, "Exemption 8," *Department of Justice Guide to the Freedom of Information Act*, p. 660. http://www.justice.gov/oip/foia_guide09/exemption8.pdf (Downloaded September 9, 2010)

[23] Florida State University College of Law, *Recommendations of the Administrative Court of the United States* (1 C.F.R. s 305.95-1 Recommendation 95-1, Application and Modification of Exemption 8 of The Freedom of Information Act). http://www.law.fsu.edu/library/admin/acus/305951.html (Downloaded September 9, 2010)

However, further examination and guidance from Congress on the application of Exemption 8 is also needed to prevent expansive use, as there is recent evidence to suggest that the SEC has been abusing Exemption 8. POGO has learned that the SEC recently invoked Exemption 8 to redact the name of a problematic examinations program mentioned in a report by the SEC OIG. As detailed in its semiannual report to Congress, the OIG found that senior officials at the SEC's Fort Worth Regional Office (FWRO) retaliated against two employees who had raised concerns about a new initiative known as the broker-dealer Risk Assessment Verification Examinations (RAVEs) program. These two employees—one of whom had been attempting for years to get the agency to crack down on the Stanford Ponzi scheme—complained to officials in Washington, DC, that the RAVEs program would require examiners to focus too much of their attention on quick-hit, superficial examinations, diverting resources away from in-depth examinations of broker-dealers designed to uncover fraud such as the Stanford scheme.[24]

But even though the OIG had already identified the RAVEs program in its semi-annual report to Congress, which is public, the agency claimed Exemption 8 and redacted any mention of the program when it released the OIG report on allegations of retaliation in the Fort Worth office.[25] The SEC's aggressive interpretation of Exemption 8 in this case suggests that the agency may already be using the existing FOIA exemptions to block the release of embarrassing information, raising concerns about giving the agency a broader authority to withhold records from the public.

Chairman Schapiro has also claimed that FOIA Exemption 4, which protects "trade secrets and commercial or financial information obtained from a person [that is] privileged or confidential,"[26] is insufficient. Chairman Schapiro points out that Exemption 4 provides different levels of protection depending on whether information is submitted voluntarily or whether it is required by the government.[27] When information is required to be submitted, it is protected only if "disclosure of the information is likely to have either of the following effects: (1) to impair the Government's ability to obtain necessary information in the future; or (2) to cause substantial harm to the competitive position of the person from whom the information was obtained"[28] (referred to as the "impairment prong" and the "competitive harm prong").[29] Chairman Schapiro cites a few well-chosen court cases in an attempt to demonstrate that it is exceedingly difficult for agencies or private entities to clear these hurdles. "Given these impediments," she argues, "courts have frequently required disclosure of information that businesses endeavored to keep confidential."[30]

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[24] Securities and Exchange Commission, Office of Inspector General, *Semiannual Report to Congress: April 1, 2009 - September 30, 2009*, pp. 80-82. http://www.sec-oig.gov/Reports/Semiannual/2009/semifall09.pdf (Downloaded September 9, 2010)

[25] Securities and Exchange Commission, Office of Inspector General, *Allegations of Retaliatory Personnel Actions* (Case No. OIG-494A), September 15, 2009. http://pogoarchives.org/m/er/sec-oig-report-20090915.pdf (Downloaded September 9, 2010)

[26] Department of Justice, "Exemption 4," *Department of Justice Guide to the Freedom of Information Act*, p. 263. http://www.justice.gov/oip/foia_guide09/exemption4.pdf (Downloaded September 9, 2010)

[27] Letter from SEC Chairman Mary Schapiro to Representative Darrell Issa, August 24, 2010, p. 5. http://pogoarchives.org/m/er/schapiro-letter-20100824.pdf (Downloaded September 13, 2010)

[28] *National Parks & Conversation Association v. Morton*, 498 F.2d 770 (D.C. Cir. 1974)

[29] Department of Justice, "Exemption 4," *Department of Justice Guide to the Freedom of Information Act*, p. 274. http://www.justice.gov/oip/foia_guide09/exemption4.pdf (Downloaded September 9, 2010)

[30] Letter from SEC Chairman Mary Schapiro to Representative Darrell Issa, August 24, 2010, p. 7. http://pogoarchives.org/m/er/schapiro-letter-20100824.pdf (Downloaded September 13, 2010)

Upon closer examination, however, we believe that Chairman Schapiro is understating the broad protections typically provided by Exemption 4. In fact, Exemption 4 is notoriously favorable to companies, especially after the U.S. Court of Appeals for the District of Columbia ruled that the exemption offers even greater protections for information that is submitted voluntarily.[31] David Vladeck, who was previously at the Georgetown University Law Center, has remarked that this ruling "allows agencies to evade FOIA disclosure whenever they want to keep the information secret; an agency can always agree to accept 'voluntary' submission of information rather than compelling its submission, thus the information becomes off-limits under FOIA."[32]

But even when information is required to be submitted, there are numerous situations in which the information would still be protected under Exemption 4.

In accordance with Executive Order 12,600, the SEC must provide notification to a registered entity when the agency determines that it may be required to disclose sensitive information through FOIA.[33] The registered entity may then request that the information be withheld under FOIA Exemption 4. The executive order requires that "agencies give careful consideration to the submitters' objections and provide them with a written statement explaining why any such objections are not sustained." If the agency decides to invoke Exemption 4, 8, or others, and the decision is challenged in court, the registered entity's request for confidential treatment will then be examined by the court in determining the propriety of the exemption claim.[34]

Chairman Schapiro states that "courts have frequently required disclosure of information that businesses endeavored to keep confidential." Again, she provides only one example in which the courts required the SEC to release information it attempted to withhold under Exemption 4, *Aguirre v. SEC* (2008).[35] In this case, no confidential registrant information was released, but rather damning information about the failure of enforcement. We are not aware of any case where a court has required release of confidential information obtained through examinations.

We urge the Committee to review the Aguirre case in greater detail, since it illustrates how aggressive the SEC has been in attempting to withhold records from the public and the potential consequences for whistleblowers and enforcement at the SEC. The adversarial ruling for the SEC in the case might also provide some additional clues as to why the agency has been seeking the blanket withholding exemptions contained in Section 929I.

Gary Aguirre is a former SEC enforcement attorney who led the agency's investigation into numerous allegations of insider trading involving Pequot Capital Management and its Chairman and CEO, Arthur Samberg. As detailed in an exhaustive investigation by the Senate Finance and Judiciary Committees, Aguirre was fired after he complained about his superiors blocking his attempts to interview Wall Street titan John Mack, who was allegedly involved in one of the

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[31] *Critical Mass Energy Project v. NRC*, 975 F.2d, (D.C. Cir. 1992) (en banc)
[32] David C. Vladeck, "Freedom of Information – Overview," First Amendment Center. http://www.firstamendmentcenter.org/press/information/overview.aspx (Downloaded September 9, 2010)
[33] *Executive Order No. 12,600*, issued June 23, 1987, reprinted in Department of Justice, *FOIA Update*, Vol. VIII, No. 2, pp. 2-3. http://www.justice.gov/oip/foia_updates/Vol_VIII_2/viii2page2.htm (Downloaded September 9, 2010)
[34] Department of Justice, "Exemption 4," *Department of Justice Guide to the Freedom of Information Act*, pp. 306-307. http://www.justice.gov/oip/foia_guide09/exemption4.pdf (Downloaded September 9, 2010)
[35] Aguirre v. SEC, 551 F. Supp. 2d (D.D.C. 2008)

insider trading deals. Shortly after Aguirre was terminated, the SEC closed its investigation into Pequot without filing any charges.[36]

After he was fired, Aguirre sued the SEC seeking records related to his termination and the agency's decision to close the Pequot investigation. The SEC attempted to withhold thousands of pages of documents under FOIA Exemptions 3, 4, 6, and 7(C). In April 2008, the U.S. District Court for the District of Columbia ordered the SEC to disclose these records, and offered a scathing critique of the agency's attempt to withhold information under the FOIA exemptions.

The court rejected the SEC's argument that disclosure would impact the quality or reliability of the information available to the SEC because when the SEC issues a subpoena it informs witnesses that their testimony could be provided to "bar associations, other professional associations, witnesses, private collection agencies, consumer reporting agencies, members of Congress, other government agencies (local, state, national and foreign), the press, and the public." As a result, the court concluded that it is "hard to understand how disclosure under FOIA would constitute any type of impairment" of the SEC's ability to obtain necessary information.

It's worth pointing out that the SEC had also attempted to withhold portions of transcripts under Exemption 3. However, the court found that "the SEC's Exemption 3 litigation theory is at odds with its own Form 1662, in which the agency explicitly warns witnesses that their testimony could be released to many different types of organizations." The court also determined that the SEC's "novel and overly expansive interpretation" of Exemption 3 would result in the agency having "unbridled discretion regarding all information obtained by a subpoena"[37]—a concern that could very well be applied to the Exemption 3 provisions contained in Section 929I.

In a letter to Chairman Frank and Senator Dodd, Aguirre explains how he relied heavily on information obtained through his FOIA case to make an argument before the DOJ, Federal Bureau of Investigation, congressional committees, and the SEC that insider trading charges should be filed against Pequot and Samberg. He eventually succeeded in pushing the SEC to reopen the case, and in June 2010 the agency filed charges against Pequot and Samberg resulting in a $28 million settlement.[38] Aguirre was further vindicated a few months ago when he received a settlement for wrongful termination.[39] However, he states that the court would have likely denied access to the information in his FOIA case if Section 929I had been in effect.[40]

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[36] Minority staff of the Senate Committee on Finance and the Senate Committee on the Judiciary Committee, *The Firing of an SEC Attorney and the Investigation of Pequot Capital Management*, August 2007. http://finance.senate.gov/library/prints/download/?id=f9d94204-7602-49f7-8bab-cb932c05310e (Downloaded September 9, 2010)

[37] Aguirre v. SEC, 551 F. Supp. 2d (D.D.C. 2008)

[38] Securities and Exchange Commission, "SEC Charges Pequot Capital Management and CEO Arthur Samberg With Insider Trading," May 27, 2010. http://sec.gov/news/press/2010/2010-88.htm (Downloaded September 13, 2010)

[39] Zachary Goldfarb, "SEC settles with Gary Aguirre over firing during Pequot Capital Management probe," *The Washington Post*, June 30, 2010. http://www.washingtonpost.com/wp-dyn/content/article/2010/06/29/AR2010062904955.html (Downloaded September 13, 2010)

[40] Letter from Gary Aguirre to Senator Christopher Dodd and Representative Barney Frank, August 4, 2010. http://pogoarchives.org/m/er/aguirre-letter-20100804.pdf (Downloaded September 13, 2010); and Gary Aguirre, "The Dodd-Frank Act: A FOIA Exemption for SEC Misconduct?" *Wall Street Lawyer*, September 2010, Vol. 14, Issue 9, pp. 18-25.

In Section 929I, Congress has provided the SEC with the type of broad withholding authority it had attempted to invoke in the *Aguirre* case in Section 929I, and so has made it more difficult for whistleblowers such as Aguirre to both expose serious flaws and offer recommendations for improving the agency's investigations.

Nearly Universal Evidentiary Privilege

The Commission also has asserted that it must shield the information provided by financial institutions from non-FOIA litigation.[41] Section 929I allows the SEC to claim blanket privilege in third party lawsuits and in suits brought *against* the SEC not related to FOIA appeals. We strongly urge the Committee to reexamine whether it intended for Section 929I to protect against the release of information in non-FOIA litigation.

Did Congress intend to block information requested by subpoena in suits brought *against* the SEC? This could allow the SEC to refuse to provide the court with evidence in cases brought by a whistleblower attempting to prove retaliation or a registered entity seeking review of a penalty or fine. This accountability shield is a recipe for corruption and cover-ups.

We also do not believe that it is in the public interest, or in the service of the SEC's core mission to protect investors, for the SEC to be given the authority to outright refuse nearly every document subpoena from a civil litigant. The harm caused by such vast authority to refuse to provide evidence to the potentially harmed or shield registered entities from being held accountable far outweighs any benefit that might be derived in incentivizing compliance by registered entities. Should defrauded investors, whistleblowers who suffered retaliation, the media seeking to uncover corruption, or any other party be denied access to documents that might make the difference in real justice simply because the SEC does not wish to comply with subpoenas or because registered entities fear disclosure of sensitive information?

Though the SEC is hardly the first agency to argue for immunity from subpoenas in civil litigation, and the question has been tried many times, the U.S. Court of Appeals for the D.C. Circuit found that U.S. government agencies are not immune in *Yousuf v. Samantar*.[42] Even so, whether or not a civil litigant will actually be able to enforce a subpoena on a federal agency is never certain, and can in fact be very difficult. Federal Rule of Civil Procedure 45 expressly provides that the government or other parties can quash a subpoena seeking privileged or trade secret material or claiming the subpoena as unduly burdensome.[43] In addition, agencies have a number of other tools at their disposal to resist subpoenas.[44] The decision about whether or not a

[41] In her letter to Representative Issa, Chairman Schapiro notes that "Section 929I also provides important protections in non-FOIA litigation, where FOIA exemptions do not apply. The Commission cannot, for example, rely on FOIA exemptions when responding to a subpoena served on it in private litigation." Letter from SEC Chairman Mary Schapiro to Representative Darrell Issa, August 24, 2010, p. 2. http://pogoarchives.org/m/er/schapiro-letter-20100824.pdf (Downloaded September 13, 2010)
[42] Robert R. Vieth and Tara M. Lee, "Can a Third Party Subpoena the Feds?" *Legal Times*, Vol. XXIX, No. 34, August 21, 2006. http://www.cooley.com/files/tbl_s5SiteRepository/FileUpload21/1096/Article%20%20-%20Aug%2006%20-%20Legal%20Times%20-%20ViethLee.pdf (Downloaded September 9, 2010)
[43] United States Courts, *Federal Rules of Civil Procedure*, December 1, 2009. http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/CV2009.pdf (Downloaded September 14, 2010)
[44] Andrew J. Morris and Sharan E. Lieberman, "Contending With Agency Touhy Regulations: Compelling Federal Agencies to Comply With Federal-Court Subpoenas," *Securities Regulations & Law Report*, Vol. 40, No. 16, April 21, 2008.

subpoena should be enforced should be made by the courts on a case-by-case basis, as is the norm.

Also of concern is the use of Section 929I in the administrative law setting. In fact, the SEC has already attempted to invoke Section 929I in an administrative proceeding that had nothing to do with FOIA or the agency's expanded authorities under the Dodd-Frank Act. The case involves a suit filed by the SEC against broker-dealer Morgan Keenan and two of its top employees. A few months ago, the defendants subpoenaed the SEC's Office of Compliance Inspections and Examinations (OCIE) seeking examination records dating back to 2000.

Once the Dodd-Frank Act passed, the OCIE attempted to invoke Section 929I to prevent the release of these records. But in a ruling last month, an administrative law judge found that OCIE "may not claim the protection of Section 929I to resist production of documents in response to an administrative subpoena issued before July 22, 2010."[45] Furthermore, the judge ruled that "OCIE may not assert 'blanket claims' of privilege" in resisting production of the documents.

In rejecting OCIE's claims of privilege, the judge cited a previous case (*Gavin v. SEC*, 2006) in which a district court ruled that the SEC cannot "circumvent its statutory obligations by ping-ponging from one [FOIA] exemption to another"[46]—a concern that could very well apply to the new exemptions contained in Section 929I.

Given its jump to utilize Section 929I, there is reason to believe that the SEC will continue to invoke Section 929I to make dubious claims of evidentiary privilege in non-FOIA litigation, raising additional concerns about leaving this provision in place. POGO believes the SEC should have to argue on a case-by-case basis why certain information is privileged, rather than hiding behind a blanket withholding statute, whether in administrative law proceedings or in federal court.

In addition, the SEC's potential use of Section 929I to claim evidentiary privilege might also prevent state attorneys general (AGs) from accessing key information in order to take action against regulated entities under their jurisdiction. Section 929I states that the SEC cannot withhold any information from other *federal* agencies and departments, but does not specifically disallow withholding from AGs and regulators at the *state* level. It would be a mistake to allow the SEC to withhold information from state regulators, especially since many state regulators have been leading the charge in bringing tough enforcement actions against regulated entities. Just a few months ago, for instance, New York AG Andrew Cuomo sued a Bank of New York Mellon unit for deliberately misleading clients about Madoff-related investments.[47] Prior to that, the top securities regulator in Massachusetts was the first to file charges against one of the Madoff "feeder funds."[48]

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[45] *Administrative Proceeding in the Matter of Morgan Asset Management, Inc., Morgan Keenan & Company, Inc., James C. Kelsoe, Jr., and Joseph Thompson Weller, CPA*, Release No. 659, August 3, 2010. http://www.sec.gov/alj/aljorders/2010/ap659jtk.pdf (Downloaded September 9, 2010)

[46] *Gavin v. SEC*, 2006 U.S. Dist. LEXIS 75,227, at *23 (D. Minn. Oct. 13, 2006)

[47] New York Office of the Attorney General, "Attorney General Cuomo Sues Bank of New York Mellon Unit for Deceiving Clients in Connection with Madoff-Related Investments," May 11, 2010. http://www.ag.ny.gov/media_center/2010/may/may11a_10.html (Downloaded September 9, 2010)

[48] Svea Herbst-Baylis, "Massachusetts regulator sues Madoff feeder fund," *Reuters*, April 1, 2009. http://www.reuters.com/article/idUSTRE5304HS20090401 (Downloaded September 9, 2010)

SEC's Request for Exemptions Has Expanded

This is not the SEC's first proposal for a blanket exemption—as Chairman Schapiro has pointed out, the SEC first proposed language similar to what is contained in Section 929I as early as 2006.

However, it appears the proposal has expanded in scope over time. For instance, language was added to protect "records or information *based upon or derived from*" records obtained from registered entities, and information used in furtherance of the SEC's "other regulatory and oversight activities." We urge the Committee to request further clarification on the SEC's justification for the expanded proposal.

A History of Secrecy and FOIA Abuse

The SEC's track record with FOIA raises additional concerns about giving the agency even more authority to withhold information from the public. The courts have strongly censured the agency for non-disclosure,[49] and last year, an audit conducted by the SEC OIG uncovered a wide range of problems related to the SEC's FOIA operations.

We were particularly troubled by the OIG's finding that the SEC Chief FOIA Officer was not operating in compliance with Executive Order 13392, the Presidential Memorandum of January 21, 2009, or the OPEN Government Act, but rather was operating with a presumption in favor of withholding information. Among other things, the OIG found few FOIA liaisons had written policies and procedures for processing FOIA requests, and there were many cases in which no effort was made to segregate portions of records for disclosure purposes. Alarmingly, there also was a conflict of interest in the Office of the General Counsel (OGC) both consulting on the initial FOIA response and making the appeal determination—in many cases it was the same individual.

The OIG also determined that the SEC's FOIA release rate was "significantly lower when compared to all other federal agencies." Specifically, the OIG found that the SEC made "full grants" and "partial grants" 10.5 and 2.9 percent of the time, respectively. In contrast, all federal agencies made "full grants" and "partial grants" 41.8 and 18.7 percent of the time. Also, the SEC reported "no information found" 56 percent of the time, compared to 13 percent of the time for all federal agencies.[50]

The OIG put forth a number of recommendations for correcting the glaring deficiencies in the SEC's FOIA operations. According to the OIG's most recent semiannual report to Congress for the period leading up to March 2010, the SEC still hadn't taken final action on many of these recommendations, which had been open for more than 180 days.[51] However, Chairman

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[49] *Gavin v. SEC*, 2006 U.S. Dist. LEXIS 75,227 (D. Minn. Oct. 13, 2006) and Aguirre v. SEC, 551 F. Supp. 2d (D.D.C. 2008).

[50] Securities and Exchange Commission, Office of Inspector General, *Review of the SEC's Compliance with the Freedom of Information Act* (Report No. 465), September 25, 2009. http://www.sec-oig.gov/Reports/AuditsInspections/2009/465.pdf (Downloaded September 8, 2010)

[51] Securities and Exchange Commission, Office of Inspector General, Semiannual Report to Congress: October 1, 2009 – March 31, 2010, pp. 98-99. http://www.sec-oig.gov/Reports/Semiannual/2010/semiapr10.pdf (Downloaded August 2, 2010)

Schapiro's response to Representative Issa lists some steps that have been taken by the SEC to implement the OIG's recommendations.[52] We've also learned from the OIG that many of the recommendations are underway. We commend Chairman Schapiro for her leadership in beginning to address the serious problems uncovered by the OIG's audit, but, independent verification by the OIG is needed to assess the extent to which the agency is fulfilling its FOIA obligations.

In addition, the regular redacting and wholesale withholding of OIG reports by the Commission's Office of General Counsel (OGC) is troubling. Determinations of FOIA exemption applicability to OIG reports, particularly regarding investigations, should be independently reviewed by the FOIA office or a FOIA officer within the OIG, not by the Chair or OGC.

We urge this Committee and other committees of jurisdiction to hold the SEC accountable for ensuring that the FOIA Office is operating with a presumption of disclosure as dictated by the Administration's guidance.

Internal Guidance on Implementation is Insufficient

In spite of its history of secrecy, Chairman Schapiro has attempted to assure Congress that the SEC will be narrowly applying the provision in accordance with the President's memorandum by issuing and publishing guidance on its website "instructing staff on when and how to assert the provision so that it is applied consistent with principles of open government and only to address issues regarding sensitive information obtained through the examination process."[53]

We do not believe that internal SEC guidance is sufficient to allay the risks to the public interest in implementation of Section 929I, nor is it an appropriate process. DOJ's FOIA Guide for Exemption 3 cites a court ruling stating that a court "must find a congressional purpose to exempt matters from disclosure in the actual words of the statute (or at least in the legislative history of FOIA)—not in the legislative history of the claimed withholding statute, **nor in an agency's interpretation of the statute**" (emphasis added).[54]

The solution for addressing the uncertainty surrounding Section 929I is not additional guidance. The solution is to repeal Section 929I, as in H.R. 6086 and S. 3717.

Another Blanket Exemption in Section 404

There is another secrecy provision in the Dodd-Frank Act that has largely been overlooked, but that requires attention. Section 404 broadly restricts the disclosure of records obtained from hedge funds and other entities that had previously been exempt from registering under the Investment Advisers Act of 1940.

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[52] Letter from SEC Chairman Mary Schapiro to Representative Darrell Issa, August 24, 2010, pp. 4-5. http://pogoarchives.org/m/er/schapiro-letter-20100824.pdf (Downloaded September 13, 2010)
[53] Letter from SEC Chairman Mary Schapiro to Representative Darrell Issa, August 24, 2010, p. 2. http://pogoarchives.org/m/er/schapiro-letter-20100824.pdf (Downloaded September 13, 2010)
[54] Department of Justice, "Exemption 3," *Department of Justice Guide to the Freedom of Information Act*, p. 208. http://www.justice.gov/oip/foia_guide09/exemption3.pdf (Downloaded September 9, 2010); citing *Reporters Comm. for Freedom of the Press v. DOJ*, 816 F.2d at 735 (D.C. Cir.)

Specifically, Section 404 states that the SEC, the Financial Stability Oversight Council, and other agencies will be exempt from FOIA and other disclosures—presumably in civil litigation—with respect to any reports, documents, records, or information obtained from registered entities.

It would be helpful if the Committee could explain the purpose of Section 404, and if it could clarify how the disclosure restrictions in Section 404 relate to the blanket exemptions in Section 929I. Furthermore, the recently enacted OPEN FOIA Act states that in order for a new statute to qualify as an Exemption 3 statute, it must specifically cite to Exemption 3.[55] However, this citation appears to be missing in Section 404, which would not preclude it from being used to refuse to provide evidence in a civil suit.

Existing Exemption 3 and Privilege-Related Statutes

POGO also recommends that a comprehensive review be conducted to determine which of the other Exemption 3 and privilege-related statutes that existed prior to the passage of the Dodd-Frank Act might also allow the SEC to restrict public access to records. There are several, though most are very narrow and facially seem to meet the criteria for Exemption 3 statutes.[56] Prior to the passage of the Dodd-Frank Act, Section 31(c) of the Investment Company Act of 1940 stated that the SEC cannot be compelled to disclose any "internal compliance of audit records" provided to the SEC, which also would be repealed in H.R. 6086. It has only been invoked once in denying a FOIA request in 2009.[57] However, it is unclear when and how this has been used to block information being provided in civil suits.

The public interest demands a full review of the purpose of these Exemption 3 statutes, the number of times the SEC has withheld records from the public under these statutes, and the ongoing need for these statutes given the Administration's guidance instructing agencies to adopt a "presumption in favor of disclosure."

Recommendations

In conclusion, POGO urges Congress to repeal Section 929I by passing H.R. 6086, which also will narrowly address the SEC's concern regarding sufficient legal authority for using Exemption 8 for all entities regulated by the SEC. We also urge you to repeal the other blanket secrecy provision in the Dodd-Frank Act, Section 404. Congress should examine the use of Exemption 8 and then should supply clear standards for employing it.

Additionally, Congress should request OIG reviews of the SEC's FOIA and disclosure practices. It's time for an audit regarding the SEC's implementation of the OIG's recommendations from the September 2009 report. Also, regular periodic studies on the SEC's use of FOIA exemption

[55] Department of Justice, Office of Information Policy, "Congress Passes Amendment to Exemption 3 of the FOIA," March 10, 2010. http://www.justice.gov/oip/foiapost/2010foiapost7.htm (Downloaded September 9, 2010)
[56] Some of these statutes can be found in several sections of the Securities Exchange Act of 1934 related to the collection of records on large traders (Section 13(h)(7)), government securities brokers and dealers (Section 15C(b)(2)(F), Section 15C(d)(3)(F) and Section 15C(f)(6)), holding companies tied to brokers, dealers, municipal securities dealers, and investment banks (Section 17(h)(5) and Section 17(j)), and records obtained from foreign securities authorities (Section 24(d)).
[57] Securities and Exchange Commission, *Freedom of Information Act (FOIA) Report for Fiscal Year 2009*, p. 5. http://www.sec.gov/foia/arfoia09.pdf (Downloaded September 9, 2010)

authorities with particular emphasis on how the expanded Exemption 8 has helped SEC with its examinations and investigations are needed. The OIG should review the extent to which the SEC has used existing Exemption 3 statutes and other provisions limiting disclosure in the context of FOIA and in administrative law and federal court proceedings. Congress should examine the problem of censoring and redacting OIG reports by the Office of General Counsel at the SEC and at other agencies and establish independent FOIA review by the OIG or FOIA officer. Naturally, in the spirit of open and accountable government, all OIG audits and reports should be immediately publicly available and posted on the SEC website.

I thank you for the opportunity to testify before you today and for your consideration of this matter of critical importance to bring more accountability and transparency in the regulation of Wall Street and the financial sector in order to protect investors, consumers, and taxpayers.