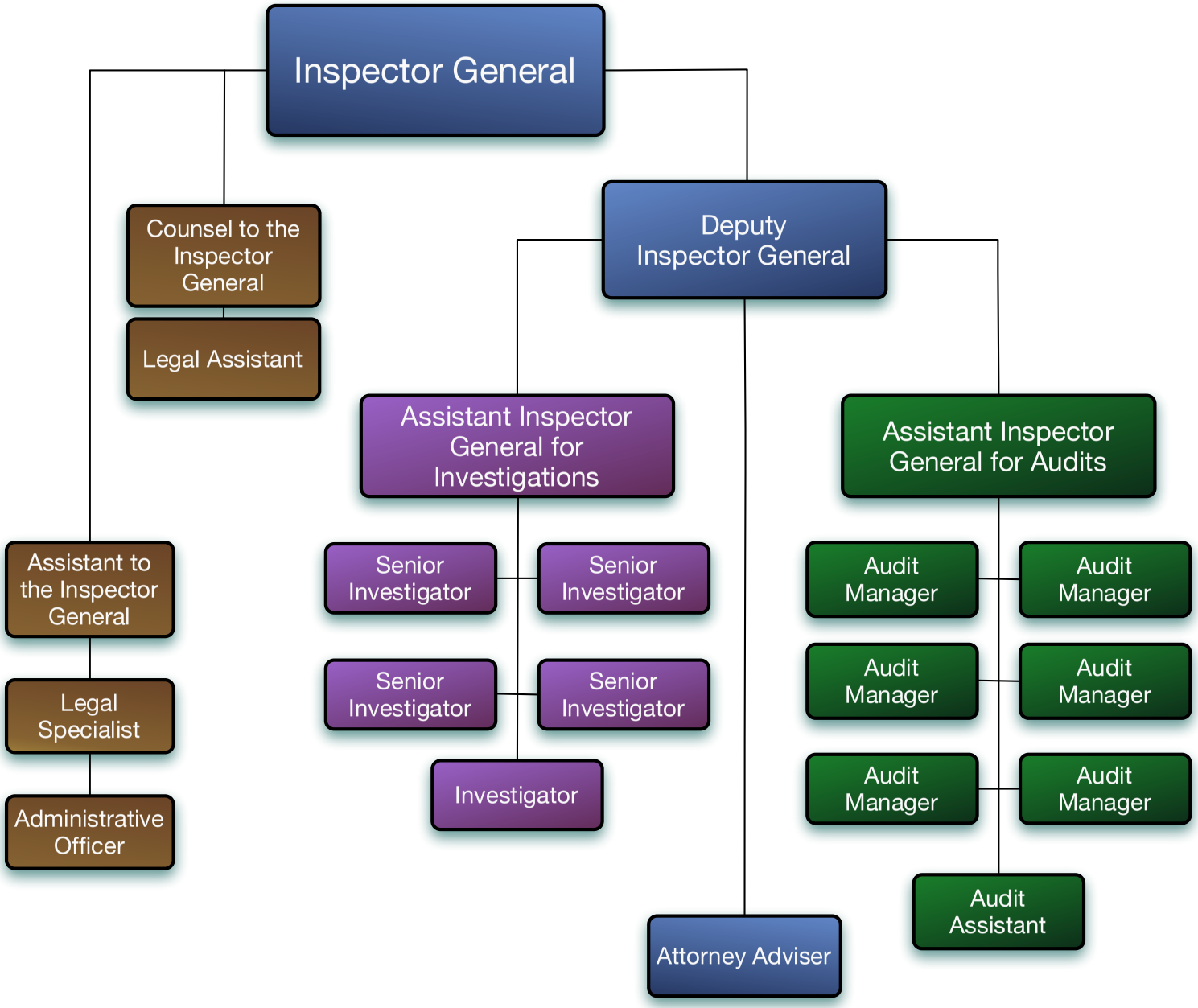
U.S. Securities and Exchange Commission
Office of the Inspector General

Semiannual Report to Congress
April 1, 2010 - September 30, 2010

Organizational Chart

Office of Inspector General



April 1, 2010 - September 30, 2010

U.S. Securities and Exchange Commission

OFFICE OF INSPECTOR GENERAL SEMIANNUAL REPORT TO CONGRESS

MISSION

The mission of the Office of Inspector General (OIG) is to promote the integrity, efficiency, and effectiveness of the critical programs and operations of the U.S. Securities and Exchange Commission (SEC). This mission is best achieved by having an effective, vigorous and independent office of seasoned and talented professionals who perform the following functions:

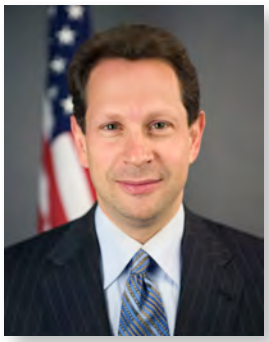
- Conducting independent and objective audits, evaluations, investigations, and other reviews of SEC programs and operations;
- Preventing and detecting fraud, waste, abuse, and mismanagement in SEC programs and operations;
- Identifying vulnerabilities in SEC systems and operations and recommending constructive solutions;
- Offering expert assistance to improve SEC programs and operations;
- Communicating timely and useful information that facilitates management decision making and the achievement of measurable gains; and
- Keeping the Commission and the Congress fully and currently informed of significant issues and developments.

U.S. Securities and Exchange Commission

Office of Inspector General

SEMIANNUAL REPORT TO CONGRESS

CONTENTS



Message from the
Inspector General

I am pleased to present the United States (U.S.) Securities and Exchange Commission (SEC or Commission) Office of Inspector General's (OIG's) Semiannual Report to Congress for the period of April 1, 2010 through September 30, 2010. This report is required by the Inspector General Act of 1978, as amended, and covers the work performed by the OIG during the period indicated.

The reporting period was another busy and productive one for the OIG. We issued numerous significant audit and investigative reports on matters critical to the SEC's programs and operations. During this reporting period, we issued six reports on audits or reviews of a wide variety of areas and matters. We conducted an audit of the SEC's Division of Corporation Finance's confidential treatment processes and procedures and made several recommendations to improve the SEC's policies to ensure there is a robust and substantive review and examination of confidential treatment requests in accordance with the applicable regulatory requirements. We also conducted a review of the reporting requirements under Section 13(f) of the Securities Exchange Act of 1934, which was enacted to increase the public availability of information regarding the securities holdings of institutional investors. Our review found that significant improvements can be made to the SEC's review and monitoring of the information reported under Section 13(f), and we made numerous specific and concrete recommendations to assist the SEC's efforts in this area. We also conducted an assessment of the SEC's privacy program, identifying vulnerabilities in SEC information technology (IT) systems that could have led to the disclosure of valuable and sensitive data. Finally, we conducted audits of the SEC's electronic travel service program and its real property leasing procurement process, as well as a review of a multi-million dollar contract about which anonymous complainants had expressed significant concerns. In all of our audits and reviews, we strove to identify cost savings and to make recommendations to improve the SEC's programs and operations. I am pleased to report that management has concurred with nearly every recommendation we made in these audits and reviews and is beginning to implement corrective action.

On the investigative side, we completed ten investigative reports on a myriad of complex and critical issues. We concluded a year-long investigation of the circumstances surrounding the SEC's proposed settlements with a leading financial institution, which included an analysis of the impact of the financial institution's status as a recipient of funds under the Troubled Asset Relief Program (TARP) on the SEC enforcement action. We also conducted a thorough and comprehensive investigation of allegations we received from several members of the House of Representatives that the SEC improperly coordinated with the White House, Members of Congress or Democratic political committees concerning the bringing of an enforcement action against Goldman Sachs & Co. In addition, we issued reports of investigation regarding allegations that SEC employees violated personnel rules by improperly receiving excessive federal benefits, failed to maintain active bar memberships and misrepresented their bar status, abused their telework, engaged in significant conflicts of interests, and acted unprofessionally while conducting examinations.

During the reporting period, I also had the opportunity to testify before the U.S. Congress or related entities on two occasions. In May 2010, I testified before the Financial Crisis Inquiry Com-

mission (FCIC) on the subject of the implementation of the SEC's Consolidated Supervised Entities (CSE) program and the adequacy of the SEC's oversight of Bear Stearns and other CSE program participants. In my testimony, I described the audit reports my Office issued in September 2008, analyzing the SEC's oversight of the CSE program, in which Bear Stearns, Goldman Sachs, Morgan Stanley, Merrill Lynch and Lehman Brothers participated. I was pleased to hear from the FCIC that the OIG's audits had been invaluable to its work in understanding the roots of the financial crisis.

In September 2009, I testified before the U.S. Senate Committee on Banking, Housing and Urban Affairs about an investigation my Office conducted relating to the SEC's failure to uncover the alleged $8 billion Robert Allen Stanford Ponzi scheme. In that testimony, I summarized the report of the investigation we conducted and provided suggestions about how to reform SEC operations.

I am also pleased to report that during this reporting period, we established an OIG SEC Employee Suggestion Hotline in accordance with Section 966 of the recently-enacted Dodd-Frank Wall Street Reform and Consumer Protection Act. Through this new hotline, we are receiving suggestions from Commission employees for improvements in work efficiency, effectiveness, and productivity and the use of Commission resources, as well as allegations by Commission employees of waste, abuse, misconduct, or mismanagement within the Commission. I believe that the reports received through this new hotline will result in significant improvements in the SEC's programs and operations and costs savings.

I am very proud of the exceptional accomplishments of this Office during the past six months and believe that, particularly during these turbulent financial times, the work of the OIG has been critical in providing the SEC, the U.S. Congress, and the public with valuable information about the regulatory climate. These accomplishments have been enhanced by the support of the SEC Chairman and Commissioners, as well as the SEC's management team and employees. I look forward to continuing this productive and professional working relationship as we continue to help the SEC meet its important challenges.

H. David Kotz
Inspector General

Office of Inspector General

SEMIANNUAL REPORT TO CONGRESS

MANAGEMENT AND ADMINISTRATION

AGENCY OVERVIEW

The SEC's mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public's trust and characterized by transparency and integrity. The SEC's core values consist of integrity, accountability, effectiveness, teamwork, fairness and commitment to excellence. The SEC's goals are to foster and enforce compliance with the federal securities laws; establish an effective regulatory environment; facilitate access to the information investors need to make informed investment decisions; and enhance the Commission's performance through effective alignment and management of human resources, information, and financial capital.

SEC staff monitor and regulate a securities industry that includes more than 35,000 registrants, including over 10,000 public companies, about 11,500 investment advisers, about 7,800 mutual funds, and about 5,400 broker-dealers, as well as national securities exchanges and self-regulatory organizations, 600 transfer agents, the Municipal Securities Rulemaking Board, the Public Company Accounting Oversight Board, alternate trading systems, and credit rating agencies.

In order to accomplish its mission most effectively and efficiently, the SEC is organized into five main divisions (Corporation Finance; Enforcement; Investment Management; Trading and Markets; and Risk, Strategy, and Financial Innovation), and 16 functional offices. The Commission's Headquarters is located in Washington, D.C., and there are 11 Regional Offices located throughout the country. As of September 30, 2010, the SEC employed had 3,748 full-time equivalents (FTEs), consisting of 3,664 permanent and 84 temporary FTEs.

New OIG SEC Employee Suggestion Hotline

Section 966 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Public Law 111-203, which was enacted on July 21, 2010, required the OIG to establish a new suggestion hotline program for SEC employees. We are pleased to report that effective September 27, 2010, the OIG, in accordance with the requirements of the Dodd-Frank Act, established both a new hotline telephone number and electronic mailbox. Through either of these mechanisms, the OIG

welcomes suggestions by all SEC employees for improvements in work efficiency, effectiveness, and productivity and the use of the resources of the Commission, as well as allegations by SEC employees of waste, abuse, misconduct or mismanagement within the Commission.

The OIG will carefully review and give serious consideration to all suggestions or reports received through the new hotline. Consistent with the requirements of Section 966 of the Dodd-Frank Act, the OIG will maintain as confidential the identity of individuals who provide information to the new hotline, unless the individual requests otherwise in writing. The OIG will also keep confidential any specific information provided to the hotline, at the request of the individual making the suggestion or report.

At the end of the semiannual reporting period, the OIG had already received four reports through the new hotline. The OIG immediately began to review and assess these suggestions. During the next reporting period, the OIG plans to implement a program, in accordance with Section 966 of the Dodd-Frank Act, to provide non-monetary recognition to SEC employees who make suggestions that increase the work efficiency, effectiveness, or productivity of the Commission, or reduce waste, abuse, misconduct, or mismanagement within the Commission.

OIG Five Year Strategic Plan

During the reporting period, the OIG finalized and issued its Strategic Plan (Plan) for Fiscal Years 2010 to 2015, which describes the OIG's goals and objectives and presents measures that the OIG will use to gauge its performance. In the course of finalizing the Plan, the Deputy Inspector General oversaw efforts to review the OIG's previous strategic plan and to make necessary changes and improvements. One focus of those efforts was to make certain that the OIG's internal processes and procedures are designed to ensure that our audits and investigations are conducted in a fair and impartial manner. The OIG considered any issues or concerns that had been raised during audits and investigations conducted during the past several years to ensure they were appropriately addressed in the Plan. The OIG then developed the performance indicators described in the Plan to include not only output measures, but also outcome measures.

The Plan set forth the following OIG vision: To increase the likelihood that Commission objectives are achieved as a trusted contributor to investor protection, the maintenance of fair, orderly and efficient markets, and the facilitation of capital formation in conducting audits and investigations and the achievement of its statutory purpose. The Plan also identified several core values that are fundamental to the OIG accomplishing its mission and conducting its daily operations, which include: integrity, fairness, relevancy, communication, and competency. Further, the Plan discussed the significant expansion anticipated in the Commission's staff and resources as the agency continues to reform and improve the manner in which it operates in an environment of increased scrutiny, and how the OIG plans to adjust its activities in light of this expansion.

In addition, the Plan set forth three specific goals the OIG has adopted in order to accomplish its vision, as well as specific objectives enumerated under each goal. The three goals are:

Goal 1: Improve the Economy, Efficiency and Effectiveness of SEC Programs and Operations

Goal 2: Enhance the Efficiency and Effectiveness of the SEC OIG's Operations and Communications

Goal 3: Promote the Integrity, Efficiency and Effectiveness of the SEC by Keeping Congress and the Public Informed

Finally, the Plan noted that, consistent with the requirements of the Government Performance and Results Act, the OIG has established performance indicators to help measure how well the OIG is achieving the aforementioned goals. These performance indicators include both (1) output measures, such as the number, quality and complexity of the audit, evaluation and investigative reports issued, and the number of recommendations implemented by the agency; and (2) outcome measures, such as the extent to which the OIG effects positive change in the agency and stakeholder needs are met in a timely manner.

OIG Staffing

During the reporting period, the OIG added two auditors, an attorney-advisor and a legal assistant, thereby further increasing its capacity to conduct its oversight responsibilities.

In April 2010, Andrea Holmes joined the OIG as an Audit Manager. Ms. Holmes comes to us from the Department of Housing and Urban Development (HUD), where she spent 20 years in various staff positions at the headquarters and field office level. While at HUD, Ms. Holmes served as an Operating Accountant, Systems Accountant, and Management Analyst. She performed management reviews of agency field offices to assess the effectiveness of internal controls, made recommendations to improve financial accounting systems, and reconciled obligation, disbursement, and accrual transactions for a major housing loan program. Ms. Holmes is a Certified Public Accountant and member of the American Institute of Certified Public Accountants.

In April 2010, Raphael Kozolchyk joined the OIG as an attorney-advisor. Prior to joining the OIG, Mr. Kozolchyk was General Counsel to the Personal Watercraft Industry Association, a division of the National Marine Manufacturers Association, where he managed the legislative and legal affairs of the trade association. Before working for the association, Mr. Kozolchyk clerked for a senior judge on the U.S. Court of Appeals for the Third Circuit. He also has extensive experience on Capitol Hill, having worked for the U.S. House of Representatives Committee on the Judiciary, and the personal staff of both a Member of the House of Representatives and a U.S. Senator. Mr. Kozolchyk is a 1998 graduate of the University of Arizona, where he received Bachelor of Arts degrees in Political Science and Philosophy. He received his Juris Doctor degree from University of Maryland, Baltimore School of Law in 2006.

In July 2010, Kelli Brown-Barnes joined the OIG as an Audit Manager. Ms. Brown-Barnes comes to us from the SEC's Division of Trading and Markets, where she served as an Automated Review Policy Specialist and spent nine years conducting inspections of Self-Regulatory and Clearing Organizations. Ms. Brown-Barnes is a graduate of Bowie State University, where she received both her Bachelor's degree in Business Administration and Master's degree in Administrative Management.

In August 2010, Suh-Young Lauren Hong joined the OIG as a legal assistant. Ms. Hong worked most recently as the Director of Contracts for a professional IT services provider, where she provided advice on numerous contracts and compliance issues concerning labor and employment law. Ms. Hong received a Bachelor of Arts degree from the Ewha Woman's University in Seoul, Korea in 1998, and a Master's degree from the Sogang Graduate School of International Studies in Seoul, Korea, in 2001, graduating with 4.00 GPA. In 2009, she obtained her Juris Doctor degree from the American University Washington College of Law.

Finally, one of our audit managers, Renee Stroud, left the OIG during the reporting period for another position within the SEC. In addition, two contractors, who worked for the OIG in temporary positions, Verngina Smith and Natasha Dandridge, left for other opportunities.

Office of Inspector General

SEMIANNUAL REPORT TO CONGRESS

CONGRESSIONAL AND OTHER RELATED TESTIMONY, REQUESTS, AND BRIEFINGS

During the reporting period, the OIG continued to keep the Congress fully and currently informed of the OIG's investigations, audits and other activities, as well as proposals for legislative improvements, through testimony and numerous meetings and written and telephonic communications. Many of these communications related to the OIG's investigation pertaining to the SEC's response to concerns regarding Robert Allen Stanford's alleged Ponzi scheme, which was completed during the previous reporting period, as well as requests related to other previously-completed investigations and requests for additional investigative work. The Inspector General (IG) also had extensive communications with Members of Congress concerning specific legislative provisions that would impact the SEC, the SEC OIG and other IGs, including the sweeping financial reform legislation that was debated and enacted during the reporting period. Further, the SEC IG briefed the staff of, and testified before, the Financial Crisis Inquiry Commission (FCIC), which was established pursuant to Public Law No. 111-21, the Fraud Enforcement and Recovery Act of 2009, to examine the causes, both domestic and global, of the current financial and economic crisis in the U.S. The IG's testimony and certain other requests and briefings are discussed in detail below.

Inspector General Testimony

The IG testified before both the U.S. Senate Committee on Banking, Housing and Urban Affairs (Senate Banking Committee) and the FCIC during the reporting period.

On September 22, 2010, the IG testified before the U.S. Senate Committee on Banking, Housing and Urban Affairs (Senate Banking Committee) on the subject of "Oversight of the SEC's Inspector General's Report on the 'Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme' and Improving SEC Performance." The OIG's Report of Investigation (OIG-526) was is-

sued on March 31, 2010, and was discussed in detail in the OIG's Semiannual Report to Congress for the period ending March 31, 2010. In his testimony before the Senate Banking Committee, the IG provided a briefing on the comprehensive investigation the OIG conducted, at the request of the Committee's Ranking Member, the Honorable Richard Shelby (R-Alabama), and the Honorable David Vitter (R-Louisiana), into the handling of the SEC's investigation into Robert Allen Stanford (Stanford) and his various companies, including the history of all the SEC's investigations and examinations regarding Stanford.

The IG provided a synopsis of the extensive work performed during the course of the investigation, including: (1) requests for and search of approximately 2.7 million e-mails; (2) review and analysis of documents produced in response to the OIG's comprehensive document requests to the Division of Enforcement (Enforcement) and the Office of Compliance, Inspections and Examinations (OCIE), as well as outside entities, pertaining to the SEC's examinations, inquires and investigations of Stanford and his firms between 1997 and 2009; and (3) 51 testimonies and interviews of 48 individuals with knowledge of facts or circumstances surrounding the SEC's examinations and/or investigations of Stanford and his firms.

The IG then briefed the Senate Banking Committee on the results of the OIG's investigation, as contained in a report of investigation that included over 150 pages of analysis and 200 exhibits, which was issued to the SEC Chairman on March 31, 2010. The IG informed the Senate Banking Committee that the OIG's investigation determined that the SEC's Fort Worth Regional Office was aware since 1997 that Stanford was likely operating a Ponzi scheme, having come to that conclusion a mere two years after Stanford's investment adviser registered with the SEC in 1995. The IG also testified that over the next eight years, the SEC's Fort Worth Examination group conducted four examinations of Stanford's operations, finding in each examination that the certificates of deposit (CDs) Stanford was promoting could not have been legitimate, and that it was highly unlikely the returns Stanford claimed to generate could have been achieved with the purported conservative investment approach utilized. The IG provided detailed information regarding each of the four examinations conducted in 1997, 1998, 2002 and 2004, which concluded in each instance that Stanford's CDs were likely a Ponzi or similar fraudulent scheme, with the only difference being that the potential fraud continued to grow exponentially, from $250 million to $1.5 billion.

The IG's testimony also discussed in detail multiple complaints received by the SEC from outside entities that reinforced and bolstered the examiners' suspicions about Stanford's operations, and the SEC's failure to follow up on these complaints or to take any action to investigate them. The IG described the multiple efforts made by the Fort Worth Examination group after each examination of Stanford's operations to convince the Enforcement group to open and conduct an investigation of Stanford, and the failure of the Enforcement group to make any meaningful effort to investigate the potential fraud until late 2005. In addition, the IG observed that even after the Enforcement group agreed in late 2005 to seek a formal order from the Commission to investigate Stanford, they missed an opportunity to have the SEC bring an action based upon the admitted failure to conduct any due diligence regarding Stanford's investment portfolio.

The IG further briefed the Senate Banking Committee on the OIG's overall finding that SEC-wide institutional influence had factored into the Enforcement group's repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. In particular, the IG mentioned the perception of senior Fort Worth officials that they were being judged on the numbers of cases brought, so-called "stats," which resulted in cases like Stanford, which were not considered "quick-hit" or "slam-dunk" cases, not being encouraged. The

IG also discussed the evidence obtained during the OIG's investigation showing that a former head of Enforcement in Fort Worth, who played a significant role in multiple decisions over the years to quash investigations of Stanford, sought to represent Stanford on three separate occasions after he left the Commission and, in fact, represented Stanford briefly in 2006 before the SEC Ethics Office informed him that such representation was improper.

In addition to describing the findings of the OIG investigation, the IG briefed the Senate Banking Committee on the recommendations the OIG made in its report of investigation. These recommendations included that the SEC Chairman carefully review the report's findings and share with Enforcement management the portions of the report that related to the performance failures by those employees who still work at the SEC, so appropriate action would be taken, on an employee-by-employee basis, to ensure that future decisions about when to open an investigation and when to recommend the Commission take action are made in a more appropriate and timely manner. The IG also advised the Senate Banking Committee of nine specific recommendations from the OIG's investigative findings designed to improve the operations of several SEC divisions and offices, as well as the improvements the SEC had begun to make in order to implement these recommendations. The IG apprised the Committee that the OIG provided the report to the SEC's Ethics Counsel for referral to the bars of the two states in which the former head of Enforcement in Forth Worth was admitted to practice law. Finally, the IG identified some parallels between the SEC's handling of the Stanford matter and its failure to uncover Bernard Madoff's Ponzi scheme. The full text of the IG's written testimony is contained in Appendix B to this Semiannual Report.

On May 5, 2010, the IG testified before the FCIC on the implementation of the SEC's Consolidated Supervised Entities (CSE) program and the adequacy of the SEC's oversight of the Bear Stearns Companies, Inc. (Bear Stearns) and other CSE program participants. The CSE program had been created in 2004 to allow the SEC to supervise certain broker-dealer holding companies on a consolidated basis. In response to a request from the Honorable Charles E. Grassley (R-Iowa), Ranking Member of the U.S. Senate Committee on Finance, the OIG conducted two audits that analyzed the CSE program as it related to Bear Stearns and the SEC Division of Trading and Markets' (TM's) broker-dealer risk assessment program. Both of these audits were completed on September 25, 2008, and were discussed in detail in the OIG's Semiannual Report to Congress for the period ending September 30, 2008.

The IG's testimony before the FCIC focused particularly on the audit the OIG conducted pertaining to the CSE program as it related to Bear Stearns (Report No. 446-A). The IG briefed the FCIC on the audit objectives and the work performed during the audit, including the assistance provided by OIG expert Albert S. (Pete) Kyle, a faculty member at the University of Maryland and a renowned expert on many aspects of capital markets.

The IG then discussed the audit's findings which included the identification of significant deficiencies in the CSE program that warranted improvement. The IG described the audit's overall finding that there were significant questions about the adequacy of a number of the CSE program requirements, given that Bear Stearns was compliant with several of these requirements but nonetheless collapsed. He also noted the audit's findings that prior to Bear Stearns' collapse, TM became aware of numerous potential red flags relating to Bear Stearns, but did not take actions to limit these risk factors, and that internal SEC procedures and processes were not strictly followed. The IG informed the FCIC of 11 separate specific concerns with the Commission's oversight of the CSE program that were identified during the audit.

Additionally, the IG described for the FCIC 26 recommendations made by the OIG to im-

prove the Commission's oversight of the CSE firms. The IG reported that on September 26, 2008, one day after the OIG issued its final audit report, former SEC Chairman Christopher Cox announced that TM would end the CSE program. However, the IG noted that, notwithstanding the closure of the program, the SEC has made efforts to implement the OIG's recommendations in order to improve its operations. The IG informed the FCIC that, as of March 31, 2010, management had completed implementation of 23 of the OIG's 26 recommendations. The full text of the IG's written testimony is contained in Appendix C to this Semiannual Report.

Other Requests and Briefings

During the reporting period, the IG received correspondence from Members of Congress, requesting that the OIG undertake investigations into particular matters. For example, on April 23, 2010, the IG received a letter from the Honorable Darrell Issa (R-California), Ranking Member of the U.S. House of Representatives Committee on Oversight and Government Reform, requesting that the OIG conduct a thorough and independent investigation into the filing of the SEC's civil securities fraud action against Goldman Sachs & Co. (Goldman) in the Southern District of New York on April 16, 2010. On April 25, 2010, the IG replied to Congressman Issa's letter and informed him that the OIG had opened an investigation into the allegations described in his April 23, 2010 letter.

Subsequent to the commencement of the OIG's investigation in the Goldman matter, Congressman Issa again wrote to the IG on July 22, 2010. In that letter, Congressman Issa raised questions regarding the timing of the settlement of the SEC's suit against Goldman, which came within two hours after the U.S. Senate passed financial reform legislation. Congressman Issa requested that the OIG broaden its existing investigation into the SEC's suit against Goldman to include the circumstances surrounding the Commission's negotiations with Goldman and subsequent settlement. The IG wrote to Congressman Issa on July 22, 2010, indicating that the OIG would broaden its current investigation as requested. The OIG completed its investigation entitled, *Allegations of Improper Coordination Between the SEC and Other Governmental Entities Concerning the SEC's Enforcement Action Against Goldman Sachs & Co.*, on September 30, 2010, and that investigation is described in detail in the Investigations and Inquiries Conducted Section of this Report.

On April 23, 2010, the IG also received a letter from Senator Grassley, which enclosed an anonymous complaint concerning an SEC supervisor who, during a previous reporting period, was found by the OIG to have engaged in inappropriate use of SEC computer resources. Senator Grassley requested that the IG take appropriate action to review and evaluate the merits of the allegations and to report the results to Congress. The IG responded to Senator Grassley on April 23, 2010, informing him that the OIG had received the same anonymous complaint and had already begun to investigate the matter. The OIG's investigation into the complaint about the supervisor is ongoing and is discussed in the Pending Investigations Section of this Report.

On June 14, 2010, Senator Grassley wrote to the IG, noting that in recent reports the OIG had highlighted problems associated with the revolving door between working at the SEC and working in the securities industry, which the SEC is charged with regulating. Senator Grassley stated that the *Wall Street Journal* had reported that "the speed at which the door revolves can be swift," and quoted various examples from the *Wall Street Journal* article. Senator Grassley's letter further noted a recent situation when an SEC senior official left the SEC to work for a firm that is regulated by the SEC. Senator Grassley requested a summary of the matters the OIG had reviewed that raised revolving door issues and asked the OIG to conduct a review of the circumstances surrounding

the senior official's departure and disclose the results of that review.

On June 15, 2010, the IG replied to Senator Grassley's June 14, 2010 letter. In his response, the IG described in detail previous OIG investigations, in addition to the ones identified in Senator Grassley's letter, that had found concerns associated with SEC employees who represented individuals or entities in matters pending before the SEC after leaving government work. The IG also discussed the OIG's ongoing work in this area and notified Senator Grassley that the OIG had already commenced an investigation into the circumstances surrounding the departure of the senior official to work for the regulated entity. This investigation is ongoing and is discussed in the Pending Investigations Section of this Report.

On August 23, 2010, Senator Grassley and Congressman Issa provided a letter to the IG, noting that recent press reports had revealed a "new layer of political review" in one federal department's processes for responding to Freedom of Information Act (FOIA) requests. Specifically, Senator Grassley and Congressman Issa requested that the SEC IG conduct an inquiry to determine whether, and if so, the extent to which, political appointees as the SEC are made aware of information requests and have a role in request reviews and decision-making.

On September 14, 2010, the IG wrote to Senator Grassley and Congressman Issa, informing them that the OIG had opened an investigation into the impact, if any, of political appointees on the FOIA process at the SEC. The IG stated that the OIG planned to conduct a thorough and comprehensive investigation of the matter and detailed the investigative work performed to date. The OIG's investigation is ongoing and is discussed in the Pending Investigations Section of this Report.

The IG also received correspondence from Members of Congress requesting information about previous OIG investigative work, OIG audit recommendations that remained unimplemented and other matters.

On April 22, 2010, the IG received a request from Senator Grassley for additional information pertaining to OIG investigations of SEC employees who inappropriately accessed pornographic materials from their government computers that were described in the OIG's previous semiannual reports to Congress. On April 22, 2010, the IG provided Senator Grassley with the requested summary, which reported, among other things, that during the past five years the SEC OIG had substantiated that 33 SEC employees or contractors had viewed pornographic, sexually explicit or sexually suggestive images using government computer resources and official time, and that 17 of these employees were at a grade level SK-14 or above. On April 27, 2010, the IG provided information pertinent to the disciplinary actions taken by the SEC in the 33 cases identified by the OIG in response to a request from Senator Grassley for additional information. The IG also reported to Senator Grassley regarding various measures taken by the SEC and the OIG in order to prevent future violations of this nature.

On April 14, 2010, the IG responded to a March 24, 2010 letter from Congressman Issa that requested updated information concerning the SEC OIG's open and unimplemented recommendations, as well as suggestions for legislative improvements to the Inspector General Act of 1978 (IG Act), or the Inspector General Reform Act of 2008 (Reform Act). In his response to Congressman Issa, the IG provided information on the SEC's open and unimplemented recommendations, including those with estimated cost savings, as well as those that the SEC OIG deemed to be the three most important open and unimplemented recommendations as of April 1, 2010. These included recommendations that (1) OCIE establish a protocol for identifying red flags and potential violations of securities laws based upon an evaluation of information found in news reports and relevant industry sources; (2) Enforcement put

in place policies and procedures or training mechanisms to ensure staff have an understanding of the types of information that should be validated with independent parties during investigations; and (3) Enforcement develop written in-depth triage analysis steps for complaints relating to naked short selling. In response to Congressman Issa's request for suggestions for improvements to the IG Act and the Reform Act, the IG referenced his March 25, 2009 testimony before the Subcommittee on Government Management, Organization and Procurement of the U.S. House of Representatives Committee on Oversight and Government Reform, in which he set forth certain improvements that he believed would strengthen the IGs and assist them in carrying out their critical work.

On June 1, 2010, the IG responded to an April 8, 2010 request from Senator Grassley and the Honorable Tom Coburn (R-Oklahoma), Ranking Member, Permanent Subcommittee on Investigations of the U.S. Senate Committee on Homeland Security and Governmental Affairs, requesting, among other things: (1) information on instances when the agency resisted and/or objected to oversight activities or restricted the OIG's access to information from October 1, 2008 to April 8, 2010; and (2) all closed investigations, audits and evaluations conducted by the SEC OIG that were not disclosed to the public for the period of January 1, 2009 through April 30, 2010. In his June 1, 2010 response, the IG advised the Senators that the SEC OIG had no instances to report for the period from October 1, 2008 to April 8, 2010, in which the SEC resisted and/or object to oversight activities and/or restricted the OIG's access to information. The IG also informed the Senators that the OIG places a great deal of importance on transparency and strives to keep the Congress and the public informed of the Office's significant activities. The IG stated that the OIG's semiannual reports to Congress described all investigations, audits and evaluations conducted by the Office during the reporting period, as well as all other matters of interest that occurred during the period. Finally, the IG noted that all audits and evaluation reports, investigative memoranda and management alerts are posted to the OIG's website, which also contains links to OIG investigative reports that the SEC has posted in redacted form pursuant to the FOIA.

In addition, during the reporting period, the IG conducted numerous briefings of, and had discussions with, Members of Congress and their staffs about a wide variety of issues. On April 21, 2010, the IG briefed Senator Vitter and his staff concerning the OIG's investigation in the Stanford matter and the related findings and recommendations. The IG also participated in briefings and discussions pertaining to various provisions of the financial reform legislation, including a provision that would have required Presidential appointment and Senate confirmation of the IGs of several of the financial regulatory agencies, including the SEC. Specifically, the IG met with Congressional staff on the financial regulatory reform legislation on April 7, 2010, and April 13, 2010, and also provided suggestions for various alternative provisions. Further information regarding the IG's comments on legislative proposals is contained in the Review of Legislation and Regulations Section of this Report.

Office of Inspector General

SEMIANNUAL REPORT TO CONGRESS

THE INSPECTOR GENERAL'S STATEMENT ON THE SEC'S MANAGEMENT AND PERFORMANCE CHALLENGES

As required by the Reports Consolidation Act of 2000 and Office of Management and Budget guidance, I am pleased to submit the following statement summarizing what I consider to be the most serious management challenges facing the Securities and Exchange Commission. This statement has been compiled based on OIG audits, investigations, evaluations, and general knowledge of the agency's operations.

CHALLENGE: PROCUREMENT AND CONTRACTING

The OIG first identified the SEC's procurement and contracting function as a management challenge in Fiscal Year (FY) 2008. In FY 2009, we reported that this area continued to be a management challenge, although SEC management had represented significant improvements had been made. While management reports that additional improvements were made in the procurement and contracting area during FY 2010, the SEC's efforts in this area have not been completed, and the SEC's procurement and contracting function continues to be a management challenge.

The Office of Acquisitions (OA), within the SEC's Office of Administrative Services (OAS), is in the process of fully automating its procurement and contracting function after two previous failed attempts to implement an automated procurement system. OA reports that it has successfully implemented the first phase of its new automated procurement system, which is named PRISM. However, the second phase of the PRISM project (which involves the integration of PRISM and Momentum, the SEC's financial system) has yet to be completed, and we understand that the SEC is experiencing delays with this phase of the project.

During Fiscal Year 2010, the OIG conducted work in the procurement area that identified a number of problems and need for increased management controls. Specifically, the OIG issued *Management and Oversight of Interagency Acquisition Agreements at the SEC*, Report

No. 460, in March 2010, and *Review of PRISM Automated Procurement System Support Contracts*, Report No. 486, in September 2010.

In OIG Report No. 460, an OIG audit identified numerous specific areas in which OA needed to improve its processes and procedures regarding interagency acquisition agreements (IAAs), *i.e.,* vehicles through which the SEC obtains needed goods or services from or through another federal agency, in a variety of ways. Significantly, our audit found that OA did not have a complete, accurate list of the universe of the SEC's IAAs and had no centralized method for accurately tracking the SEC's IAAs, although the agency is in the process of implementing such a system through the PRISM project. Our audit also found that OA lacked SEC-specific written internal policies and procedures for administering and overseeing IAAs. In addition, our audit identified 23 SEC IAAs for which the period of performance had expired, but that $6.9 million in funds remained obligated on these IAAs. We further found that OA lacked crucial information to review IAA cost estimates, and that the Statement of Work for a large IAA did not conform to the guidance for the underlying program. While OA has submitted proposals to implement the recommendations for improvement made in the OIG's audit report, the majority of the report's 15 recommendations remain pending. Management has, however, informed us that they have made efforts to deobligate the funds we identified, and has already deobligated over $4 million of these funds.

More recently, in OIG Report No. 468, an OIG audit identified significant contract administration issues pertaining to PRISM and related support and service contracts. The audit found that (1) the PRISM project lacked adequate Information Technology (IT) project management oversight; (2) OA improperly restricted competition without following Federal Acquisition Regulation (FAR) requirements when it solicited and awarded a contract for project support services; (3) there was an inadequate segregation of duties in the management of the support contract; and (4) a critical deliverable under the support contract did not meet quality standards.

In addition, several recommendations made in an OIG audit report issued in September 2009, *Audit of the Office of Acquisitions Procurement and Contract Management Function,* OIG Report No. 471, have yet to be completed and remain pending. These include recommendations related to determining the universe of SEC contracts, completion of the automation of the SEC's procurement and contracting function, providing adequate training to regional office staff with delegated warrant authority, and reporting regional activities in the Federal Procurement Data System.

Therefore, while the SEC continues to make improvements in the procurement and contracting area, further progress is needed to ensure that the SEC has a well-designed and fully functioning system in place for the proper oversight of all SEC contracts and interagency acquisitions.

CHALLENGE: INFORMATION TECHNOLOGY MANAGEMENT

IT management remains a management challenge for the SEC. In connection with its audit of the SEC's financial statements for FY 2009, the Government Accountability Office (GAO) reported that information security control weaknesses continued to jeopardize the confidentiality, integrity, and availability of information processed by the SEC's key IT financial reporting systems. The GAO identified inadequate controls for segregating computer-related duties and functions; restricting user privileges; implementing patches and current software versions; using approved, secure means to transmit data; implementing configuration management; and certifying and accrediting the SEC's general ledger and supporting processes.

In FY 2010, the OIG conducted work that confirmed that the SEC continues to require improvements in several IT-related areas identified by GAO. These areas include: restricting user privileges, implementing patches and current software versions, ensuring the use of approved means to transmit data, and configuration management. These findings are based on our reviews of three specific areas of IT management. The OIG issued one report on the SEC's encryption program, *Evaluation of the SEC Encryption Program*, Report No. 476, in March 2010; two reports pertaining to privacy, *Evaluation of the SEC Privacy Program*, Report No. 475, in March 2010 and *Assessment of the SEC's Privacy Program*, Report No. 485, in September 2010; and one report on the IT investment process, *Assessment of the SEC Information Technology Investment Process*, Report No. 466, in March 2010.

The OIG's *Evaluation of the SEC Encryption Program*, Report No. 476, found that while the SEC has a comprehensive encryption program, mobile devices and portable media have not been properly encrypted. The OIG report also found that the SEC's Office of Information Technology (OIT) has not implemented a policy for encrypting portable media throughout SEC headquarters and regional offices.

The OIG's *Evaluation of the SEC Privacy Program*, Report No. 475, found that the SEC's privacy-related policies and procedures need to be finalized and that an in-depth assessment of the SEC's privacy program was required. In accordance with the findings of Report No. 475, the OIG conducted an in-depth assessment of the SEC's privacy program and recently issued its report, *Assessment of the SEC's Privacy Program*, Report No. 485. This report identified significant concerns with the manner in which the SEC handles personally identifiable information. Specifically, the OIG found that OIT has not adequately implemented controls to restrict user access privileges to sensitive data; patches and current software versions were not current; sensitive data was transmitted to unapproved resources; and newly-deployed desktops/laptops were not adequately configured to meet Federal Desktop Core Configuration requirements. The Office of Information Technology and Office of the Chief Operating Officer have indicated that they concur with the majority of the report's recommendations and fully support the obligation of the SEC to protect the privacy of individuals.

The OIG's audit, entitled *Assessment of the SEC Information Technology Investment Process*, Report No. 466, found that the Chief Information Officer (CIO) continues to lack necessary authority to manage the SEC's Capital Planning and Investment Control (CPIC) process adequately, CPIC policies and procedures were not being followed, and IT projects were improperly managed due to the lack of effective project management. The SEC Chairman and OIT concurred with all of the report's recommendations, and the Chairman reported that the charters for the agency's three distinct bodies that review and approve proposed IT investments have been revised as a result of an internal review of roles and responsibilities relating to the SEC's IT investments.

Finally, the OIG found that additional attention is still needed in specific key IT areas, including the administration and oversight of IT contracts, IT human capital, remote access, and operations monitoring. These key initiatives remain challenges as deficiencies that were identified in these areas in the past have not been completely mitigated. During the past FY, the SEC filled two essential senior management positions: Chief Security Officer (CISO) and Chief Operating Officer (COO). Nonetheless, the critical CIO position is currently vacant. This position is essential to the SEC's IT program and should be filled expeditiously. The OIG plans to continue its oversight of IT management and monitoring progress in key areas noted above.

CHALLENGE: FINANCIAL MANAGEMENT

The GAO's FY 2009 audit of the Commission's financial statements found that they were fairly presented in all material respects. However, the GAO found that the SEC did not maintain effective internal controls over financial reporting and, thus, did not have reasonable assurance that misstatements would be prevented or detected on a timely basis. This determination was based on the GAO's identification of six significant internal control deficiencies in the Commission's financial reporting process that, taken collectively, constituted a material weakness in the SEC's internal controls for financial reporting.

The GAO defines a material weakness as a significant deficiency or combination of significant deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will be not be prevented or detected. A significant deficiency is a control deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by management. The significant control deficiencies that cumulatively resulted in the GAO's finding of a material weakness concerned the Commission's controls over: (1) information security; (2) financial reporting process; (3) fund balance with the Department of the Treasury; (4) registrant deposits; (5) budgetary resources; and (6) risk assessment and monitoring process.

In addition, the GAO identified other deficiencies in internal controls that although not considered material weaknesses or significant deficiencies, could adversely affect the Commission's ability to meet financial reporting and other internal control objectives. These deficiencies concerned the Commission's (1) security over sensitive employee information; (2) policies and procedures related to or affecting financial reporting; (3) documentation of payroll controls; (4) prior period corrections; (5) preparation of labor surveys; (6) Prompt Payment Act interest payments; (7) excessive user access rights in the SEC's time and attendance system; (8) financial statement closing schedule; (9) documentation of Contracting Officer's Technical Representative's review of contractor's invoices prior to SEC payment; and (10) notes to interim financial statements and proforma financial reporting.

In addition, the GAO reported that the SEC's ability to sustain effective internal control over financial reporting was at risk due to its continued reliance on processes and systems that were not designed to provide the accurate, complete, and timely transaction-level financial information that management needed to make well-informed decisions, or to accumulate and report reliable financial information without extensive manual workarounds and compensating controls. The GAO further reported that these deficiencies are likely to continue to exist until the SEC's general ledger system is either significantly enhanced or replaced, key accounting activity is fully integrated with the general ledger at the transaction level, information security controls are strengthened, and appropriate resources are dedicated to maintaining effective internal controls.

The SEC stated that it is committed to making resolution of the six significant deficiencies identified by the GAO a high priority, and is developing a plan to remediate the resulting aggregate material weakness to strengthen the SEC's financial reporting. The SEC Chairman indicated that remediating the material weakness in internal control over financial reporting was one of her top priorities and expressed her commitment to improving the integrity of the SEC's reporting system. The OIG, as it has done in the past, continues to plan to provide assistance to the GAO in conducting the SEC's financial statement audit and monitoring progress with respect to the indentified significant internal control deficiencies.

CHALLENGE: REAL PROPERTY LEASING

The OIG has identified the SEC's real property leasing procurement process as a management challenge.

The OIG recently completed an audit of the SEC's real property leasing process, *Real Property Leasing Procurement Process*, Report No. 484, issued in September 2010. The audit determined that the Real Property and Leasing Branch (Leasing Branch) within the SEC's OAS does not have adequate policies and procedures in place and, until very recently, had no final policy for the SEC's real property leasing program, which includes leased properties in 13 different locations nationwide and an annual expenditure of over $83 million in lease payments. The audit identified several specific deficiencies in OAS's draft leasing policies and procedures, including (1) an incomplete listing of the applicable legal requirements and guidelines; (2) an insufficient asset management plan; (3) insufficient procedures for managing and tracking leases; and (4) the absence of goals or performance measures that specifically addressed real property leasing.

The audit also determined that the absence of adequate leasing policies and procedures led to certain situations in which the SEC was required to make payments that could have been avoided if appropriate policies and procedures had existed and been followed consistently. These situations included (1) the failure to timely execute a new lease or obtain a lease extension at the time the existing lease for the San Francisco Regional Office expired, resulting in the payment of higher holdover rent; (2) making millions of dollars in simultaneous payments for two office buildings in New York that will continue for a total of seven years, even though the SEC no longer occupied one of these buildings; and (3) paying an off duty police officer $200,000 per year to patrol a leased facility in a high-crime area, even though the SEC only occupies one of four floors of the facility.

The OIG has made several specific recommendations designed to remedy the deficiencies identified in the SEC's real property leasing function. We are pleased that management has concurred with all of these recommendations.

CHALLENGE: PERFORMANCE MANAGEMENT

The OIG identified performance management as a management challenge in both FY 2008 and 2009. In February 2007, the OIG had issued an audit report, *Enforcement Performance Management*, Report No. 423, which found that the Commission did not consistently perform all parts of the performance appraisal process and did not have adequate policies and procedures for, among other things, managing performance problems and implementing all the phases of the performance review cycle. The OIG audit also found that the performance cycle was not aligned with the fiscal year and did not timely reward employees for significant, performance-based contributions.

In FY 2009, the OIG reported that the SEC had begun to undertake numerous steps to remedy this challenge, and that the agency had begun transitioning to a new five-level performance rating system in FY 2008.

During FY 2010, the SEC continued its effort to migrate employees to the new performance-based management system in a phased approach. Employees in the Division of Enforcement and the Office of Compliance Inspections and Examinations were scheduled to move new system on or about June 30, 2010. At the end of FY 2010, however, not all SEC employees had transitioned to the new system. Management has indicated that the phased approach will continue during FY 2011 and that it expects every employee to have a new performance work plan by the end of FY 2011. Thereafter, according to management, the new system will be used to re-link pay to performance.

Management has further indicated that it is providing web-based training to managers and non-managers as part of the implementation of the new performance management system and has created a SharePoint site dedicated to performance management to apprise employees of important information regarding the new system. As the transition to the new system continues, the SEC needs to continue its efforts to ensure that agency has a fair, transparent and credible method for measuring performance and awarding merit-pay increases.

SEMIANNUAL REPORT TO CONGRESS

ADVICE AND ASSISTANCE PROVIDED TO THE AGENCY AND THE GOVERNMENT ACCOUNTABILITY OFFICE

During this semiannual reporting period, the OIG provided advice and assistance to SEC management on various issues that were brought to the OIG's attention during the course of audits and investigations conducted by the Office and otherwise. This advice was conveyed through written communications, as well as in meetings and conversations with agency officials. The advice provided included comments on draft policies and procedures and suggestions for improvements in existing policies and procedures. The OIG also collaborated with and provided assistance to the Government Accountability Office (GAO) on matters of mutual interest to GAO and the OIG.

Specifically, during the reporting period, the IG met with several officials who joined the agency during the reporting period in an effort to coordinate the OIG's activities with those of these new offices. For example, the IG met with the SEC's Chief Compliance Officer, a new position at the agency, to discuss coordination between the OIG and the compliance function, particularly with respect to the SEC's system for monitoring employee securities trading that was implemented in response to an OIG investigation conducted during a previous reporting period. Subsequently, the IG and OIG staff met with the SEC's new Ethics Counsel to discuss issues of mutual interest and ways in which the OIG and the SEC Ethics Office can continue to cooperate and work together to achieve their respective missions. The IG also met with the SEC's first-ever Chief Operating Officer (COO) for information technology, financial reporting, and records management to discuss the challenges the IG believed the new COO would face.

In addition, the IG and OIG staff met with the Director of the SEC's Office of Equal Employment Opportunity (OEEO) and OEEO staff to discuss protocols and procedures to be followed when the OIG and the OEEO are simultaneously conducting investigations that have overlapping issues. Further, the OIG provided advice and assistance to the Office of Human Resources (OHR) in connection with an investigation completed during this reporting period into allegations that certain supervisors in the

Office of Compliance Inspections and Examinations (OCIE) were working part-time schedules but regularly using leave without pay in order to receive full-time benefits. In particular, the OIG provided OHR officials with information concerning and citations to U.S. Office of Personnel Management guidance on benefits affected by reducing a full-time employee to part-time status and the proper use of leave without pay. The IG and OIG staff also met with Enforcement officials and the SEC Chairman's Office to discuss the appropriate implementation of the SEC's new Tips, Complaints, and Referrals Intake Policy, which was issued on March 10, 2010.

Further, the OIG reviewed a draft of an updated version of the SEC OIT "Rules of the Road," SECR 24-04.A01, which are intended to ensure that agency computing and network resources are used responsibly, safely and efficiently, thereby maximizing the availability of these resources. Based upon its review of the draft document, the OIG provided written comments to OIT that made suggestions for improvements to and clarification of the draft. In its written comments, the OIG suggested (1) the addition of a reference to a recently-issued administrative regulation on the Management and Protection of Privacy Act Records and Other Personally Identifiable Information; (2) revision of the draft to reflect the Privacy Act exception for disclosure of information to officers and employees of the agency who have a need for the record in the performance of their official duties; (3) clarification of whether the term "personal information" referred to personally identifiable information or something broader; (4) inclusion of a reference to Executive Order 13513, Federal Leadership on Reducing Text Messaging While Driving, October 1, 2009; and (5) clarification that SEC policy prohibits using a government-supplied electronic device to send e-mails, as well as to text.

After the OIG submitted its comments on the draft updated Rules of the Road document, OIT provided a revised draft that reflected changes made in response to the comments submitted by the OIG, as well as by other SEC divisions and offices. The OIG reviewed the revised draft and noted that all of its comments had been incorporated into the revised draft. In addition, the OIG provided two additional comments that suggested clarification of provisions pertaining to exceptions for disclosing Privacy Act records and the prohibition on intentionally viewing or modifying agency data without the explicit authorization of the owner of the data or an authorized exception. OIT incorporated the OIG's comments into the final version of the Rules of the Road that was posted to the SEC's Intranet site.

Also during the reporting period, the OIG coordinated with and provided assistance to GAO in connection with an engagement it commenced involving the "revolving door" at the SEC (*i.e.*, SEC staff leaving the agency and then working for or representing firms regulated by the SEC). The IG and OIG staff met with representatives of GAO to share insight and knowledge acquired in this area as a result of prior and ongoing OIG audit and investigative and work. In connection with that meeting, the IG reviewed and provided responses to various questions GAO had concerning, among other things, the nature of the revolving door issues the OIG has encountered, and measures the SEC has taken or could take to address problems presented by the revolving door and to minimize risk to the Commission in terms of influence by former staff members. The IG also provided GAO with information regarding previous OIG audit and investigative reports that made recommendations designed to ensure that Commission employees exercised impartiality in performing their official duties and were not unduly influenced by the presence of former employees in examinations or investigations, and the status of management's implementation of these recommendations.

SEMIANNUAL REPORT TO CONGRESS

COORDINATION WITH OTHER OFFICES OF INSPECTOR GENERAL

During this reporting period, the SEC OIG coordinated its activities in a variety of ways with those of other OIGs, as is required by Section 4(a)(4) of the Inspector General Act of 1978, as amended. Specifically, the SEC IG, or a senior OIG staff member, attended the monthly meetings of the Council of the Inspectors General on Integrity and Efficiency (CIGIE). During one of these monthly meetings, the SEC IG briefed the CIGIE members on challenges faced in conducting the SEC OIG's investigation into the SEC's failure to uncover Bernard Madoff's Ponzi scheme, which was completed on August 31, 2009. The SEC IG also met with outside consultants performing an organizational assessment of another OIG to identify areas of strength and opportunities for improvement, and shared his experiences, as well processes and practices followed within the SEC OIG.

The SEC IG is also a member of the CIGIE's Professional Development Committee, the purpose of which is to provide educational opportunities for members of the CIGIE community and to assist in ensuring the development of competent personnel. The IG or a senior OIG staff member attended the Professional Development Committee's monthly meetings.

The Counsel to the SEC IG is currently the Chair of the Council of Counsels to the Inspector General (CCIG), which is an informal organization of IG attorneys throughout the federal government who meet monthly and coordinate and share information. In the reporting period, the Counsel to the SEC IG chaired the group's monthly meetings and otherwise provided leadership to the CCIG members.

The SEC IG also participated in activities designed to coordinate efforts among the federal financial regulatory IGs and strengthen the oversight of the federal financial regulatory structure as a whole. For example, the SEC IG met monthly with the IGs for the Department of Treasury, Federal Deposit Insurance Corporation (FDIC), Federal Housing Finance Agency (FHFA), Commodity Futures Trading Corporation (CFTC), National Credit Union Administration (NCUA), Pen-

sion Benefit Guaranty Corporation (PBGC), Board of Governors of the Federal Reserve System Federal Reserve (Federal Reserve Board), Troubled Asset Relief Program (TARP), Department of Housing and Urban Development (HUD), U.S. Export-Import Bank and Farm Credit Administration to discuss coordinated oversight efforts among the financial regulatory IGs. The SEC IG also served on the TARP Inspector General Council, along with the Special IG for the TARP, and IGs from the Department of Treasury, Federal Reserve Board, FDIC, FHFA, HUD, Treasury Inspector General for Tax Administration and the Small Business Administration, and the U.S. Comptroller General.

In addition, Section 989E of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Public Law 111-203, which was enacted on July 21, 2010, established a new Council of Inspectors General on Financial Oversight (CIGFO), chaired by the IG of the Department of Treasury and also composed of the IGs of the Federal Reserve Board, CFTC, FDIC, FHFA, NCUA, SEC and TARP. Under the Dodd-Frank Act, this Council is required to meet at least quarterly to facilitate the sharing of information with a focus on the concerns that may apply to the broader financial sector and ways to improve financial oversight. The CIGFO is also required to submit an annual report to the newly-established Financial Stability Oversight Council and the Congress, which must include a section that highlights the concerns and recommendations of each IG who is a member of the CIGFO General and a summary of the general observations of the CIGFO. The SEC IG will actively participate in the CIGFO's important activities and responsibilities.

Office of Inspector General

SEMIANNUAL REPORT TO CONGRESS

AUDITS AND EVALUATIONS

OVERVIEW

The OIG is required by the Inspector General Act of 1978, as amended, to conduct audits and evaluations of agency programs, operations and activities. The OIG's Office of Audits focuses its efforts on conducting and supervising independent audits and evaluations of the programs and operations of the various SEC divisions and offices. The Office of Audits also hires independent contractors and subject matter experts to conduct work on its behalf. Specifically, the Office of Audits conducts audits and evaluations to determine whether:

- There is compliance with governing laws, regulations and policies;
- Resources are safeguarded and appropriately managed;
- Funds are expended properly;
- Desired program results are achieved; and
- Information provided by the agency to the public and others is reliable.

Each year the Office of Audits prepares an annual audit plan. The plan includes work that is selected for audit or evaluation based on risk and materiality, known or perceived vulnerabilities and inefficiencies, resource availability, and complaints that are received from Congress, internal SEC staff, the Government Accountability Office, and the public.

Audits

Audits examine operations and financial transactions to ensure that proper management practices are being followed and resources are adequately protected in accordance with governing laws and regulations. Audits are systematic, independent, and documented processes for obtaining evidence. In general, audits are conducted when firm criteria or data exist, sample data is measurable, and testing internal controls are a major objective. Auditors collect and analyze data and verify agency records by obtaining supporting documentation, issuing questionnaires, and through physical inspection.

The OIG's audit activities include performance audits that are conducted of SEC programs and operations relating to areas such as the oversight and examination of regulated entities, the protection of investor interests, and the evaluation of administrative activities. The Office of Audits conducts its

audits in accordance with the generally accepted government auditing standards (Yellow Book) issued by the U.S. Comptroller General, OIG policy, and guidance issued by the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

Evaluations

The Office of Audits also conducts evaluations of the SEC's programs and activities. Evaluations consist of reviews that often cover broad areas and are typically designed to produce timely and useful information associated with current or anticipated problems. Evaluations are generally conducted when a project's objectives are based on specialty and highly technical areas, criteria or data are not firm, or needed information must be reported in a short period of time. The Office of Audits' evaluations are conducted in accordance with OIG policy, Yellow Book non-audit service standards and guidance issued by the CIGIE.

Audit Follow-up and Resolution

During this semiannual reporting period, the SEC offices and divisions made significant efforts to reduce the backlog of open recommendations, while ensuring that the most recent recommendations were fully implemented. Based on the appropriate evidence and documentation that management provided to the OIG to support its intent to implement the OIG's recommendations, the OIG closed 109 recommendations related to 21 different Office of Audits reports.

AUDITS AND EVALUATIONS CONDUCTED

Assessment of Corporation Finance's Confidential Treatment Processes and Procedures (Report No. 479)

Background

The federal securities laws generally require any company that is publicly held or is registering its securities for public sale to disclose a broad range of financial and non-financial information in registration statements, annual reports, and other filings made with the SEC. Companies that are registered with the SEC are required to comply with the reporting requirements of the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act). Specific disclosure requirements for financial and non-financial information are primarily found in Regulation S-K, 17 C.F.R. § 229.10, and Regulation S-X, 17 C.F.R. § 210.1-01 *et. seq.*, sets forth the financial statement disclosure requirements.

The SEC's Division of Corporation Finance (CF) assists the Commission in executing its responsibility to oversee corporate disclosure of important information to the investing public, and manages the confidential treatment request process pursuant to delegated authority from the Commission. CF has a number of statutory requirements and review priorities that it must meet to pursue its core investor protection responsibilities. In addition to processing requests for confidential treatment, CF reviews registrants' Exchange Act reports and the financial statements of every registrant at least once every three years, as mandated by the Sarbanes-Oxley Act of 2002.

Sometimes the public disclosure of information required by the SEC's disclosure rules (*e.g.*, Regulation S-K) can adversely affect a company's business and financial condition because of the competitive harm that could result from the disclosure. This issue frequently arises in connection with the requirement that a registrant file publicly all contracts material to its business other than those it enters into in the ordinary course of business. Typical examples of the information that raises this concern include pricing terms, technical specifications and milestone payments. To address the potential disclosure hardship, the Commission has adopted a system that allows companies to request confi-

dential treatment of information filed under the Securities Act and the Exchange Act.

Specifically, Commission Rules 406, 17 C.F.R. § 230.406, and 24b-2, 17 C.F.R. § 240.24b-2, set forth the exclusive means for obtaining confidential treatment of information contained in documents filed under the Securities Act and the Exchange Act, respectively, that would be exempt from disclosure under the FOIA. Rule 24b-2 requires an applicant to include the following items, among other things, in an application to the Commission for confidential treatment:

- Identification of the confidential portion of the filing;
- A statement of the grounds of objection to disclosure, including an analysis of how the confidential portion meets an applicable FOIA exemption(s); and
- A justification of the time period for which confidential treatment is requested.

Rule 406 requires that an applicant include similar information in its request for confidential treatment. In their confidential treatment applications, most applicants rely on the exemption for "trade secrets and commercial or financial information obtained from a person [that is] privileged or confidential," which is commonly referred to as "the (b)(4) exemption."

The objectives of the OIG's audit were to:

- Assess the adequacy of CF's internal policies that governed the intake, processing, and decision-making associated with confidential treatment requests;
- Assess if registrants that were provided confidential treatment by CF adhered to the SEC rules that govern confidential treatment requests;
- Test whether CF followed its internal policies and procedures for processing confidential treatment requests; and
- Determine whether improvements and best practices could be implemented for the CF confidential treatment process.

Results

The OIG found that CF is not performing a robust review and examination of many confidential treatment requests. Specifically, out of 3,381 confidential treatment requests submitted to CF from January 2008 to March 2010, 2,298, approximately 68 percent, were processed without review as a result of an initial screening process. A total of 789 out of 3,381 requests, or approximately 23 percent, were monitored for one or more particular matters (*e.g.*, duration, materiality, etc.), while 286 out of 3,381 requests, or approximately 8.5 percent, were selected for a full review of the confidential treatment application, which includes a review of the application itself and the initial screening form, and completion of an examination report. As a result, over 90 percent of the confidential treatment requests submitted to CF did not receive a thorough review and examination for compliance with all aspects of the applicable rules. Therefore, the OIG believes there is an increased risk that information that is material to investors may not be disclosed. Additionally, the OIG determined that the denial of a confidential treatment request is a rare occurrence, because we only found one confidential treatment request that CF did not grant during the scope of our review.

In addition, the OIG found the widespread use of conclusory statements in applicants' analyses of the applicable FOIA exemptions, as well as in arguments regarding the potential competitive harm that could result if the subject matters for which confidential treatment was requested were disclosed.

The OIG also identified instances when the scope of confidential treatment requests appeared to be overly broad. Further, we found that documentation explaining why the subject matter of the confidential treatment request was not necessary for the protection of investors did not always include a robust assessment of both qualitative and quantitative factors that should be considered in assessing materiality.

During the audit, the OIG also identified numerous instances when confidential treatment requests were assigned for review to CF staff in Assistant Director Offices that do not normally review the SEC filings of the confidential treatment applicants or companies in the confidential treatment applicants' industry groups. For example, only 27 percent (247 out of 924) of the confidential treatment requests received from companies in the healthcare and insurance industries from January 2008 to December 2009 were assigned to the Assistant Director Office that processes confidential treatment requests submitted by companies in the healthcare and insurance industries. Staff members who are not assigned to a confidential treatment request applicant's industry group may not be as knowledgeable of the subject matter of certain confidential treatment requests, thus increasing the risk that confidential treatment may be improperly granted for information that would be material to investors.

Lastly, the OIG determined that CF needs to implement additional controls in its confidential treatment request tracking database to ensure data is captured correctly. The OIG identified some data discrepancies in the CF confidential treatment request database, and found that the confidential treatment request tracking database lacks certain functionality, such as the ability to track confidential treatment requests that are modified after the initial submission. The CF confidential treatment request tracking database is used by management as a medium to generate performance reports. As such, the OIG determined that the reliability, accuracy, and completeness of information contained in the confidential treatment request tracking database is necessary to assist those charged with oversight of and decision-making for the confidential treatment request process.

Recommendations

On September 28, 2010, the OIG issued its final report on the results of the audit. The report included eight recommendations that were designed to improve CF's policies and procedures for processing, screening, and examining confidential treatment requests. Specifically, the OIG recommended that CF:

(1) Recommend to the Commission that the substantive requirements for confidential treatment requests that are currently described in Staff Legal Bulletin No. 1, as well as any additional substantive requirements deemed appropriate, be codified as formal guidance for confidential treatment applicants;

(2) Revise its internal procedures for processing confidential treatment requests to require additional documentation of the substantive review of the materiality and competitive harm application-specific requirements, including a description of the specific qualitative and/or quantitative factors considered in assessing the materiality and competitive harm pertinent to the subject matter of the confidential treatment request;

(3) Revise its internal procedures to require additional documentation of the Assistant Director Offices' review of the Office of Disclosure Support's recommendations of "No Review" to document factors considered in making the determination that no review is required;

(4) Perform periodic internal audits of the confidential treatment process to provide for continuous monitoring of the confidential treatment program and, as part of these periodic internal audits, verify on a periodic basis that the information for which confidential treatment was granted has not been publicly disclosed and, if such information has been publicly disclosed, take steps, as appropriate, to revoke the grant of confidential treatment;

(5) Revise its internal procedures for handling the initial screening of confidential treatment requests to ensure that the materiality and competitive harm criteria are not met by simply making conclusory statements or including boilerplate language in the applications by requiring additional documentation of how the screening and review process identified specific and concrete representations to support each criteria;

(6) Ensure that the Assistant Director Offices with the highest percentage of confidential treatment requests provide training to staff in the other Assistant Director offices in order to share knowledge about specific industry matters with staff who will be performing reviews of confidential treatment requests for companies in industries outside of their assigned industry group;

(7) Implement controls in the confidential treatment request database to perform validity checks for fields and to ensure that all information for each record has been completely populated; and

(8) Add functionality to the confidential treatment request tracking database to identify confidential treatment requests that were modified from their initial state.

Management fully concurred with four recommendations, partially concurred with three recommendations, and did not concur with one recommendation. We expressed concern that CF did not concur with our recommendation to codify the substantive requirements listed in Staff Legal Bulletin No. 1 as formal guidance for confidential treatment requests, because we believe that codification of these requirements would be beneficial to both companies and CF.

Additionally, we expressed concern that CF partially concurred with our recommendations that CF enhance its documentation reflecting its assessment of the materiality and competitive harm arguments presented in confidential treatment requests to detail the specific qualitative and/or quantitative factors considered in making these assessments; that CF verify on a periodic basis that information that has been granted confidential treatment has not been publicly disclosed; and that CF document how the screening and review process identified specific, concrete representations to support each criteria needed for confidential treatment to be granted. We remain convinced that CF should fully implement all of the OIG's recommendations in order to improve CF's internal policies and procedures for processing confidential treatment requests and enhance CF's review of such requests.

The OIG's report, *Assessment of Corporation Finance's Confidential Treatment Processes and Procedures*, is available on our website at http://www.sec-oig.gov/Reports/AuditsInspections/2010/479.pdf.

Review of the SEC's Section 13(f) Reporting Requirements (Report No. 480)

Background

In 1975, Congress enacted Section 13(f) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78m(f), to increase the public availability of information regarding the securities holdings of institutional investors. According to the legislative history for Section 13(f), Congress intended to create in the SEC a centralized repository of historical and current data regarding the activities of institutional investment managers in order to improve the body of publicly available factual data and thereby increase investor confidence in the integrity of the U.S. securities markets. This legislative history also reflects that Congress anticipated that government agencies, including the SEC, would be expected to make extensive use of the institutional disclosure data in fulfilling their responsibilities to protect the public interest within a consistent and coordinated regulatory framework.

Section 13(f) and the Commission's implementing regulation requires that institutional investment managers that exercise investment discretion with respect to accounts holding certain equity securities having an aggregate fair market value of $100 million or more on the last trading day in a calendar year to file quarterly reports of their holdings with the SEC on Form 13F electronically through the Commission's Electronic Database Gathering and Retrieval (EDGAR) system. Section 13(f)(3) mandates that the Commission tabulate the information contained in the Form 13F reports and disseminate that information to the public.

The institutional investment managers that are required to file Form 13F typically include investment advisers, banks, insurance companies, broker-dealers, pension funds and corporations. The securities that must be reported under Section 13(f) generally include equity securities that are traded on an exchange or quoted on National Association of Securities Dealers Automated Quotations (NASDAQ), equity options and warrants, shares of closed-end investment companies, and some convertible debt securities. Under Section 13 (f)(3), the Commission is responsible for publishing an official list of the securities that must be reported pursuant to Section 13(f)(1). Form 13F requires disclosure of the name and address of the institutional investment manager filing the report and, for each security being reported, specific information, including the name of the issuer, the class, the Committee on Uniform Securities Identification Procedures (CUSIP) number, the number of shares or principal amount, and the aggregate fair market value.

Pursuant to Commission Rule 24b-2, 17 C.F.R. § 240.24b-2, an institutional investment manager may request confidential treatment of information required to be reported on Form 13F. Section 13(f)(3) provides that the Commission may prevent or delay the public disclosure of the information reported under Section 13(f)(1) in accordance with the FOIA. Section 13(f)(3) further provides that information identifying securities held by the account of a natural person or an estate or trust (other than a business trust or investment company) shall not be publicly disclosed. The Commission has delegated authority to the SEC's Division of Investment Management (IM) to grant or deny applications for confidential treatment pursuant to Section 13(f), and to revoke any grants of confidential treatment for such applications.

The overall objectives of the review were to:

- Examine whether the Commission's implementation of and current practices under Section 13(f) meet Congress's intent in establishing Section 13(f);
- Examine the sufficiency of the Commission's existing policies and

procedures that implement Section 13(f);

- Determine whether the reporting of entities covered under Section 13(f) is appropriately designed to comply with the statutory requirements;
- Examine whether the Commission's policies and procedures for reviewing and processing requests for the confidential treatment of information required to be reported under Section 13(f) are adequate and appropriate; and
- Determine whether the oversight over the Section 13(f) process is sufficient.

Results

Overall, our review found that significant improvements can be made with respect to the SEC's review and monitoring of information reported under Section 13(f). Significantly, our review found that despite Congress' intent that the SEC would be expected to make extensive use of the Section 13(f) information for regulatory and oversight purposes, no SEC division or office conducts any regular or systematic review of the data that is filed on Form 13F. Specifically, the OIG found that while IM has been delegated authority to grant or deny confidential treatment pursuant to Section 13(f), no division or office has been delegated the authority to review and analyze the Form 13F reports, and no division or office considers this task as part of its official responsibility. Further, the OIG found that the information filed on Form 13F can be useful and should be reviewed in a routine and systematic manner.

The OIG's review also disclosed that no SEC division or office monitors the Form 13F filings for accuracy and completeness. As a result, many Forms 13F are filed containing errors or problems, which may not be detected or corrected in a timely manner because no routine monitoring is conducted. As a consequence, errors or problems with the Form 13F filings are typically detected only in connection with IM's processing of Section 13(f) confidential treatment requests, or when a member of the public notifies IM of an error or problem with a Form 13F. Additionally, we found that there are no checks built into the EDGAR system (through which Forms 13F are filed) to scan for obvious errors in the forms, and that the current text file format of Form 13F limits the facility to extract, organize and analyze the data being reported.

Further, the OIG's review revealed that a third party prepares the official list of Section 13(f) securities that the Commission is required to provide to the public, and has been doing so since 1981, based upon specifications received from the SEC in 1979. The official list prepared by the third party is posted to the Commission's website each quarter; however, no SEC division or office conducts any review of the list for accuracy and completeness before it is posted. We believe that such a review is important, given that institutional investment managers rely on the official list in preparing their Form 13F reports in accordance with Commission Rule 13f-1, 17 C.F.R. § 240.13f-1. We also found that the SEC has no contract or agreement with the third party with respect to the preparation of the official list of Section 13(f) securities. This lack of a formal contract or agreement poses a risk to the SEC that the third party could stop preparing the list at any time, and this informal arrangement appears to violate the voluntary services prohibition of the Antideficiency Act, 31 U.S.C. § 1342.

The OIG's testing of a sample selection of 25 confidential treatment requests that were processed by IM revealed that files and supporting documentation could not be located for approximately one-half of the items selected in our initial sample. When we selected an additional 12 CTRs to review, files for two-thirds of these additional items also could not be located. These missing files raised concerns that confidential information reported

on Form 13F could inadvertently be disclosed. Our testing also revealed that the SEC is not complying with its records retention schedule for CTRs. In addition, our review found that with respect to several CTRs, IM has not rendered a final decision on a timely basis, thus affording certain filers *de facto* confidential treatment of their 13F reports.

Finally, our review disclosed that the current Section 13(f) reporting requirements are outdated and do not currently require disclosure of all significant activities of institutional investment managers, thus rendering the data less useful than it could be to investors and regulators.

Recommendations

The OIG issued a final report containing the results of our review on September 27, 2010. The report included 12 recommendations that were designed to improve the Section 13(f) reporting process to ensure that useful and reliable data is provided to the public and government regulators, consistent with Congress' intent in enacting Section 13(f). The recommendations made in the report were as follows:

(1) The Chairman's Office should delegate primary responsibility for reviewing and analyzing Form 13F information to the appropriate division or office;

(2) The Chairman's Office should assign to the appropriate divisions or offices responsibility for monitoring Section 13(f) filings for accuracy and completeness in order to limit the errors in or problems with the filings, thereby enhancing the usefulness and reliability of the data;

(3) IM and OIT should renew efforts that were begun in 2005 and implement checks in the EDGAR system to detect and/or correct obvious errors in Forms 13F;

(4) IM, in consultation with the Chairman's Office, should work with OIT to pursue updating Form 13F to a more structured format that will make the data easier to extract and analyze;

(5) The Chairman's Office should assign to an appropriate division and/or office responsibility for reviewing the official list of Section 13(f) securities that is prepared quarterly by a third party and test it on a sample basis;

(6) IM, in consultation with OAS and the Chairman's Office, should ensure that the SEC enters into a formal contract or agreement with the third party that prepares the official list of Section 13(f) securities;

(7) IM and the SEC's Records Management Branch should modify their respective policies and procedures to ensure that files for processing CTRs are properly maintained and retained in accordance with the SEC's record retention schedule;

(8) IM, in consultation with the Chairman's Office, should take appropriate steps to improve its policies and procedures to ensure that written requests for confidential treatment (particularly certain novel requests) under Section 13(f) are granted or denied within an appropriate time frame so that filers are not afforded *de facto* confidential treatment as a result of IM not issuing a written response;

(9) IM, in consultation with the Office of the General Counsel (OGC), the Office of International Affairs and the Chairman's Office, should take appropriate steps to improve its poli-

cies and procedures to ensure that requests for relief under Section 13(f) made by certain large foreign institutional investment managers are addressed in a timely and appropriate manner;

(10) IM, in consultation with the Division of Risk, Strategy, and Financial Innovation (Risk Fin), OGC and the Chairman's Office, should determine whether legislative changes to Section 13(f) should be pursued;

(11) IM, in consultation with the Chairman's Office, should request that Risk Fin update its previous analysis of the impact of increasing the Section 13(f) reporting threshold of $100 million; and

(12) IM, in consultation with Risk Fin and the Chairman's Office, should determine whether to recommend that the Commission adopt a rule requiring institutional investment managers to report aggregate purchases and aggregate sales of securities under Section 13(f).

Management fully concurred with all of the OIG's recommendations. The OIG's report, *Review of the SEC's Section 13(f) Reporting Requirements*, is available on our website at http://www.sec-oig.gov/Reports/AuditsInspections/2010/480.pdf.

Real Property Leasing Procurement Process (Report No. 484)

Background

In 1990, Congress provided the SEC with independent leasing authority and, at the same time, exempted the SEC from General Services Administration (GSA) space management's regulations or directives. In doing so, Congress intended that the SEC would exercise this independent leasing authority vigorously in order to achieve cost savings and increase the SEC's productivity and efficiency. Pursuant to its independent leasing authority, the SEC enters into commercial leases for all of the agency's office space.

The SEC's real estate leasing function is managed primarily by OAS's Real Property and Leasing Branch (Leasing Branch), which was established in April 2009. Other OAS components that have responsibilities that impact the SEC's real estate leasing program include OAS' Security and Construction Branches, as well as the Office of Acquisitions. Other SEC offices, such as the Office of Financial Management (OFM) and OIT, have significant interaction with the leasing program.

At the time of the OIG's audit, SEC maintained 2,482,576 square feet of leasehold interests. These include leases for SEC headquarters facilities located in Washington, D.C., as well as leases for all of the SEC's regional offices located throughout the country. The SEC made total lease payments of approximately $83.8 million in both FYs 2008 and 2009, representing approximately nine percent of the SEC's total budget authority for these years. It is anticipated that the SEC's leasing program and leasing costs will increase over the next few years as the agency expands to meet new responsibilities.

The objectives of the OIG's audit were to determine whether OAS had established real property leasing policies and procedures and to examine whether these policies and procedures were consistently followed and in compliance with applicable federal laws, rules, and regulations. The audit was also performed to ascertain how the Leasing Branch maintains and tracks the SEC's real property leases. Lastly, the audit sought to identify the SEC's current leases and assess whether the lease requirements were appropriate and whether the SEC received the best value for its leasing investments.

Results

Overall, the audit found that the SEC's Leasing Branch does not have adequate policies in place and, until very recently, had no final leasing policies and procedures. The audit also determined that the absence of adequate leasing policies and procedures led to certain situations in which the SEC was required to make lease payments that could have been avoided if appropriate policies and procedures had existed and been followed consistently.

Significantly, the audit determined that the primary leasing policy document, SECR 11-03, "SEC Leasing Program," which was finalized after our audit fieldwork was completed, is incomplete and inadequate. Further, the SEC's Leasing Program Operating Procedures (OP 11-03), which supplement SECR 11-03, are also inadequate and remain in draft form.

The audit noted several specific deficiencies in the SEC's leasing policies and procedures. First, we found that SECR 11-03 is incomplete, as it does not list or describe all of the legal requirements and guidelines relevant to real property leasing, fails to enumerate the specific objections of the SEC's leasing program and provides no instructions or guidance to facilitate compliance with relevant authorities. While the SEC is exempted from strict adherence to GSA space management regulations or directives, the OIG found that the SEC could benefit significantly by looking to GSA regulations on leasing and management of real property as a guide, and evaluating, assessing and implementing these regulations, as deemed appropriate.

Second, while OGC has indentified SECR 11-03 as the SEC's asset management plan required by Executive Order 13327, "Federal Real Property Asset Management," the OIG's review of that document revealed that it falls well short of being an adequate asset management plan. The audit noted that SECR 11-03 does not include the required components of an asset management plan that are set forth in guidance issued by the Federal Real Property Council (FRPC).

Third, the audit found that OAS did not have sufficient procedures for how leases should be management and tracked. Although the Leasing Branch had a document that described the rent payment process and staff manually tracked monthly lease payments on a spreadsheet, the Leasing Branch did not separately track amounts paid for operating expenses, property taxes or repairs. The audit concluded that the lack of such detailed payment data hinders the SEC's ability to monitor expenses incurred during the operational phase of a lease, and that such information would be useful in making future leasing decisions and formulating the annual budget for leased properties.

Fourth, the audit determined that although the SEC's five-year draft strategic plan included a strategic goal that encompassed enhancement of the Commission's performance through the effective alignment and management of financial capital, the SEC had no specific goals or performance measures for real property leasing, even though the SEC expends approximately $83.8 million per year on real property leases. The audit noted that without such goals and performance measures, OAS is unable to employ a continuous monitoring and feedback mechanism, which is a required component of a sufficient asset management plan.

The audit revealed certain specific instances in which the failure to have adequate leasing policies and procedures resulted in additional costs to the agency. In the case of the San Francisco Regional Office lease that was expiring at the end of October 2009, we found that OAS changed its initial plan to negotiate a lease with the current landlord due to market information showing a dramatic drop in rental rates in the San Francisco office market. As a consequence, OAS decided to conduct a full and open competition and prepared a sole source justification to extend the existing lease for one year, at an expected rate of

$42.24 per rentable square foot, to allow sufficient time to negotiate a long-term solution. However, the one-year extension was never executed, and the SEC paid higher "holdover" rent of over $60 per rentable square foot until it executed a new lease with the existing building landlord in April 2010. At that time, the SEC was able to obtain a credit for the difference between the higher "holdover" rent rate and the rent rate in effect as of October 31, 2009, of $53.34 per rentable square foot.

Notwithstanding the credit obtained, the OIG found that the failure to extend the previous lease prior to its expiration or to enter into a new one on a timely basis resulted in the SEC, during a time of declining market rental rates, paying rent at rates substantially higher than the rate it would have paid had it executed the one-year lease extension. Specifically, the OIG calculated that even with the credit obtained after the new lease was signed, the SEC paid excess rent totaling $203,000 between November 2009 and March 2010. While OAS indicated that it performed acquisition planning, the OIG audit found that the SEC's written leasing policies and procedures did not adequately address timely acquisition planning and did not require the preparation of adequate project plans.

In another situation involving the lease of office space in New York City, the OIG found that the SEC, for several past years and continuing into the future, was obligated to make simultaneous payments for two office properties, one of which it no longer occupied. Specifically, the OIG found that after asbestos was discovered in the office location it had leased since late September 2001, the SEC had a dispute with the landlord and decided to relocate its New York Regional Office (NYRO) and enter into a lease at another site. However, the SEC was still responsible for payments under the initial lease, as it did not believe it could demonstrate that the landlord had breached the lease terms. In April 2004, SEC officials executed and approved a justification for other than full and open competition to obtain a new NYRO lease on the basis of unusual and compelling urgency, which was conditioned on the provision that the successor landlord assume the SEC's remaining obligations at the existing lease site.

While the SEC entered into a lease for a new NYRO location in March 2005, it remained responsible for payments under the initial lease. The new landlord did not assume any of the SEC's remaining obligation at the previous site (although the landlord did agree that the SEC would be responsible only for operating expenses during the first year of the lease). The SEC contacted GSA, which found a tenant for the SEC's former office location. The SEC, also in March 2005, entered into a wrap around lease and surrender agreement (similar to a sublease), which terminated the SEC's previous lease provided that the SEC made certain payments to the landlord, and the landlord and GSA executed a lease for the premises (which they did).

The OIG found that, as a consequence of the circumstances described above, the SEC has made since May 2005, and continues to make, simultaneous payments for office space at two locations in New York City. The OIG calculated that the SEC paid over $15 million between May 31, 2005 and March 31, 2010 for property that no SEC employees have occupied since June 2005. During this same period, the SEC made payments of over $35 million to lease its current NYRO facility. Under the terms of the wrap around lease and surrender agreement, the SEC will continue to make simultaneous payments until March 2012. The OIG audit determined that the lack of SEC guidance for evaluating options prior to vacating leased space, or for including a termination for convenience clause or a broader, more inclusive default clause in a lease, or using flexible lease terms, contributed to the SEC paying millions of dollars for space it did not occupy.

A final situation where insufficient policies and procedures contributed to increased costs pertained to the evaluation of security requirements at a site in Alexandria, Virginia,

where the SEC entered into a short-term lease for temporary office space, occupying a single floor of a four-floor building. While the audit found that the Leasing and Security Branches have been working to coordinate their efforts since the chiefs of those branches arrived at the SEC in 2008, improved coordination between these branches is needed. Further, although the Security Branch has developed two documents to be used in connection with proposed SEC office locations – a Building Security Survey and a Security and Safety Assessment, the OIG identified additional important information that should have been included in the Security and Safety Assessment.

In addition, the OIG audit found that neither the Building Security Survey nor the Security and Safety Assessment were used in connection with the Alexandria, Virginia short-term lease. Based on the SEC's analysis of the area crime rate, it explored options for appropriately securing the facility. As a result, OAS determined that the cost of developing computerized access for the building was too high. OAS decided that the most cost-effective option was to place unarmed guards on the floor occupied by the Commission, at the SEC's expense, and for the SEC to pay the landlord, pursuant to a lease amendment, to hire an off-duty police officer to patrol the area at a cost of $200,000 per year. Thus, the SEC is paying for an armed, off-duty police officer to be stationed at a facility where it occupies only one of four floors. Our audit found that if the appropriate security documents had been used in connection with this lease, the Leasing Branch would have been better equipped to negotiate for adequate security of the facility to be provided as part of the initial lease document.

Recommendations

The OIG issued a final report reflecting the results its audit on September 30, 2010. The audit determined that several improvements in the real property leasing process are needed to ensure that the SEC exercises its independent leasing authority vigorously and achieves cost savings and increased productivity and efficiency, as Congress intended. Specifically, we recommended that OAS:

(1) Revise SECR 11-03 and draft OP 11-03 to ensure that they are adequate and complete and include the information identified in the report, finalize OP 11-03, and ensure that the revised documents are posted to the Commission's Intranet site and circulated to staff with leasing responsibilities;

(2) Amend SECR 11-03 to include a complete list of relevant authorities that apply to real property leasing and finalize detailed guidance for ensuring compliance with those authorities;

(3) Measure the SEC's real property leasing policies and procedures against pertinent provisions of GSA regulations, as appropriate;

(4) Ensure that the Leasing Branch's policies and procedures, including OP 11-03 and the attached checklists, provide comprehensive guidance for SEC leasing officials regarding the leasing process;

(5) Utilize the "Required Components" Section of the FRPC's Guidance for Improved Asset Management to develop and finalize the SEC's real property leasing asset management plan, as appropriate;

(6) Amend its leasing policies and procedures to require the tracking and monitoring or all leasing expenses (*i.e.*, rent, operating costs and taxes) for informational and budget formulation purposes;

(7) Develop performance goals for the SEC's real property leasing activities, including both lease acquisition and

the monitoring and administration of existing leases, identify key external factors that could significantly affect the achievement of these goals, and periodically evaluate whether these goals are met;

(8) Develop performance measures to assist in evaluating the effectiveness of the major functions of real property acquisitions and operations and periodically evaluate performance based on these measures;

(9) Revise SECR 11-03 and draft OP 11-03 to include complete written policies for timely acquisition planning pertinent to real property leases, including the preparation of project plans and schedules with projected dates for achieving milestones well in advance of the scheduled commencement of a lease;

(10) Adopt evaluation procedures that involve scoring and ranking various options prior to deciding to vacate leased premises or to terminate a lease, and develop a transparent methodology for formulating scores and rankings;

(11) In consultation with OGC, ensure the SEC's real property leases provide appropriate protections in the event the SEC needs to terminate a lease before its expiration date;

(12) Revise the Security and Safety Assessment document to include more specific information, such as the number of recent incidents in the vicinity, the likelihood that future incidents will occur or vulnerabilities will be exploited, recommended countermeasures and the cost estimates for such countermeasures;

(13) Implement final policies and procedures to ensure the Leasing Branch consistently includes the Building Security Survey document in all solicitations for leased space; and

(14) Implement policies and procedures to ensure the Security Branch performs a physical review of prospective building locations and determines the threat within the immediate area prior to entering into a lease for any facility.

Management fully concurred with all of the OIG's recommendations. The OIG's report, *Real Property Leasing Procurement Process*, is available on our website at http://www.sec-oig.gov/Reports/AuditsInspections/2010/484.pdf.

Assessment of the SEC's Privacy Program (Report No. 485)

Background

The OIG contracted the services of C5i Federal, Inc. (C5i) to perform an assessment of the SEC's privacy policies and procedures and the proper handling of personally identifiable information (PII) in its Headquarters (Station Place), Operations Center (OPC), and regional offices. The SEC's Los Angeles Regional Office (LARO) was selected as the regional office to be evaluated based on its size and the fact that OIT last assessed this Office in 2008, and planned no further evaluation until 2011.

The privacy program assessment was conducted in two phases. First, in June 2010, the OIG assessed the LARO's handling of PII data by conducting a physical inspection, interviews, and a Network Vulnerability Assessment (NVA) of the SEC's computer network (which included performing scans of a sample of 66 deployed workstations or laptops, and two newly-imaged laptops that had not yet been deployed). Second, in July 2010, the OIG performed an NVA of Station Place and the OPC to evaluate their respective network

security postures, and conducted a "re-scan" of seven of the eight servers previously assessed at the LARO. The purpose of the "re-scan" was to determine if vulnerabilities identified during the June 2010 scans were remediated by OIT. In addition, the OIG conducted an application vulnerability assessment on the Enforcement's case-tracking application to determine how the Commission retained and secured its PII data within this application.

The primary objectives of the review were to:

- Evaluate the adequacy of the SEC Privacy Office's policies and procedures, as well as its interaction and involvement with Commission offices and divisions to ensure SEC employees' privacy;
- Perform an in-depth analysis of privacy requirements and identify the SEC processes and procedures that are used to conduct privacy reviews;
- Assess whether the Privacy Office responds to privacy issues in accordance with governing SEC, National Institute of Standards and Technology (NIST), Office of Management and Budget (OMB), and other governmental guidance and regulations to determine whether improvements were needed;
- Determine if the SEC has developed and implemented technical, managerial, or operational privacy-related controls to effectively mitigate known risks that are inherent to Privacy Act systems of records;
- Determine if the SEC has established procedures and automated mechanisms to verify privacy control effectiveness;
- Review governing Commission policy and guidance, and follow up on prior OIG recommendations;
- Perform an assessment of an SEC regional office (*i.e.*, LARO) for proper handling of PII and adherence to SEC privacy policies and procedures;
- Perform an NVA at the LARO, Station Place, and the OPC to evaluate the security posture of the SEC network in protecting PII data; and
- Perform an application assessment to ensure PII data is protected.

Results

Overall, the assessments conducted identified significant concerns about the manner in which the SEC handles PII data. Specifically, the review of systems at the LARO, OPC, and HQ identified high-level vulnerabilities affecting SEC computer systems that may be subject to exploitation and infiltration. The review further found that while software vendors provide patches and updates to remediate security vulnerabilities identified in their software, the SEC has not applied these critical patches and updates, in some cases dating back as far as 2006. The review also found that the SEC has not regularly reviewed the application of patches on a consistent basis, which leaves the Commission vulnerable to attack.

Further, assessments performed during the review yielded additional areas of concern. The review found that:

- OIT's categorization of network vulnerabilities did not accurately reflect the actual risk to the environment;
- Base images deployed on laptops were not compliant with Federal Desktop Core Configuration (FDCC) requirements and all deviations were not disclosed as required by OMB;
- SEC laptops could connect to the SEC network via a local area network port, while simultaneously being connected to an external wireless network, thus

exposing the SEC network to potential compromise by a malicious attacker;

- Design flaws existed in the development of the Enforcement case-tracking application;
- PII at LARO was contained on shared drives that did not have access controls; and
- LARO employees violated SEC policy by sending documents containing PII data to personal e-mail accounts and by using portable media that was not encrypted or adequately secured.

Additionally, interviews conducted of OIT staff and a physical assessment of office space and storage areas at the LARO, HQ and OPC revealed that documents containing PII data were insecurely left on work tables, fax machines, and desks; file rooms, file cabinets, and offices containing very sensitive information were unsecured; the SEC had no finalized policies or procedures for the destruction of portable media storage devices; and secured storage bins were not accessible to all Commission staff.

The review's findings indicated the existence of a significant risk to the SEC network and the security of the data and documents handled by the agency. While OIT has already begun taking steps to mitigate and remediate risks by progressively applying certain critical patches, significant additional work remains to be done.

During the course of its audit, the OIG briefed GAO on its findings, including the security vulnerabilities associated with the failures to apply critical patches and updates. As a result, GAO expanded the scope of its financial statement audit and eventually identified the SEC's inconsistent patch management program as a new security control deficiency and reported information security as a material weakness in internal control.

Recommendations

The OIG issued a final report containing the result of its review on September 29, 2010. The report included 20 recommendations designed to address the vulnerabilities identified during the review, which included 15 recommendations to OIT or the Chief Operating Officer (COO), four to LARO, and one to OAS. Specifically, the report's recommendations were as follows:

(1) OIT should apply patches and updates to the Commission's networks, workstations and laptops on a timely basis;

(2) OIT should implement procedures to regularly review whether a newly-released patch should or should not be applied to the environment;

(3) OIT should evaluate its risk assessment process for scoring risk;

(4) OIT should define a standard recognized character set for every response containing content in Hypertext Markup Language (the predominant markup language for web pages);

(5) OIT must ensure FDCC compliance for all base images deployed on desktops and laptops;

(6) OIT must submit a complete list of common security standard deviations to the NIST per OMB requirements;

(7) OIT should ensure that wireless cards installed on laptops are turned off when connected to the SEC's local area network;

(8) OIT should implement an agency-wide policy regarding shared folder structure and access rights;

(9) OIT should ensure personal storage tab (PST) files are saved to a protected folder;

(10) LARO should reemphasize the SEC Rules of the Road to LARO staff through training and awareness programs;

(11) LARO should enforce its encryption policy to protect sensitive data the SEC receives;

(12) The COO should implement a policy that all portable media must be fully secured (*i.e.,* locked in file cabinets) when not in use;

(13) The COO should appoint a privacy point of contact at each regional office to ensure compliance with Commission policies and procedures;

(14) LARO should ensure all file rooms and file cabinets are secured;

(15) LARO should ensure that boxes of files stored in hallways are moved to secured areas;

(16) The COO should either implement a clean desk policy to ensure sensitive information is properly secured, or require that all offices be locked when not occupied;

(17) The COO should conduct additional training to ensure that staff fully understand the rules and policies concerning the handling of PII and sensitive data and their responsibilities in protecting the SEC's information;

(18) OIT should finalize, approve and implement its operating procedures for "Hard Drive Wiping and Media Destruction," and make staff aware of the procedures and their roles and responsibilities for the disposal of portable media storage devices;

(19) OIT should provide Commission staff with training on the handling, disposal, and storage of portable media storage devices; and

(20) OAS should provide secured bins for the disposal of portable media storage devices that are easily accessible to all SEC employees, and the use and locations of these bins should be clearly communicated to all employees.

LARO and OAS fully concurred with the recommendations addressed to those Offices. The COO/Acting Chief Information Officer (CIO) concurred with 12 of the 15 recommendations that pertained to the COO and OIT, partially concurred with one recommendation, and did not concur with two recommendations. We expressed concern that the COO/Acting CIO did not fully concur with all of our recommendations. We urged the COO/Acting CIO to reconsider the opposition to turning off office wireless cards installed on laptops and to requiring that PST files be saved to a protected folder, as we believe the recommended solutions would remove vulnerabilities and protect the SEC's information. We also encouraged the COO/Acting CIO to reconsider the objection to putting network "Least Privilege" access in place to ensure that only employees involved in a particular case have access to data pertaining to the case. We are pleased that the COO/Acting CIO plans to research other solutions to identify potential courses of action for the recommendations in which the COO/Acting CIO did not fully concur. However, we remain convinced that OIT should implement our recommendations to ensure that it reduces the likelihood of these vulnerabilities being exploited.

The OIG's report, *Assessment of the SEC's Privacy Program*, is available on our website at

http://www.sec-oig.gov/Reports/AuditsInspections/2010/485.pdf.

Review of PRISM Automated Procurement System Support Contracts (Report No. 486)

Background

The OIG contracted with Regis and Associates, PC (Regis), Independent Public Accountants, to conduct a review of support contracts related to the SEC's automated procurement system known as "PRISM." The Office of Acquisitions (OA) within OAS is responsible for the agency's contract and procurement activities and processes. Over the past several years, OA had unsuccessfully attempted to automate its procurement function. OA had procured two different automated procurement systems (APSs) to manage acquisitions, both of which were discontinued. In September 2008, the SEC acquired an APS named "PRISM," which was intended to enable OA to accurately track and reconcile the SEC's contracts and agreements and was implemented on April 21, 2009.

Prior to the implementation of PRISM, OA awarded two additional contracts related to PRISM. These included a contract awarded in August 2008 to provide project support for the implementation of PRISM, and a task order awarded under another contract to perform system coding and technical services related to the integration of PRISM and the SEC's financial accounting system. The OIG had received anonymous complaints regarding the procurements relating to the management and integration of PRISM and initiated its review as a result of those complaints.

Regis conducted its review of the PRISM support contracts from June to August 2010. The overall objectives of the review were to assess the adequacy of the PRISM award and contract administration activities, and of the management and implementation of the PRISM project and integration services. The specific objectives of the review included:

- Identifying and reviewing all procurement documentation related to the project management and integration support for PRISM;
- Determining whether procurements were properly awarded, in accordance with the Federal Acquisition Regulation (FAR) and SEC policies and procedures;
- Determining the validity of complaints received by the OIG related to the award of the procurements for the management and integration of PRISM;
- Determining whether there was adequate oversight of PRISM; and
- Reviewing governing Commission policies and guidance and following up on prior OIG recommendations to ensure they have been closed and corrective actions were completed.

Results

The review identified several deficiencies related to PRISM contract administration activities that raised concerns about the future success of the PRISM project. Specifically, the review found that repeated requests were made to OIT for management support for the project. The Associate Executive Director for OAS advised OIT that the currently-assigned project manager was unable to give the upcoming APS project adequate time and attention and that the existing level of support was insufficient for the project to be successful. We found that OIT responded that it simply did not have enough resources to provide the needed project management support. Notwithstanding the negative experiences with APSs in the past and the complexity of the current project, the PRISM project continued for over a year without an active OIT project manager.

Moreover, the review found that OAS improperly restricted competition without following proper FAR requirements when it solicited and awarded a contract for PRISM project support by inserting a clause that required that a vendor's employees have a current SEC clearance or had one within the last 30 days. The review found that this requirement effectively precluded outside contractors from bidding on the work. Additionally, e-mail correspondence between the OAS Contracting Officer (CO) and an OFM employee indicated that OAS had already pre-selected a contractor approximately a week before the solicitation was publicized. The contractor identified in the CO's e-mail was ultimately awarded the contract.

In addition, the review found that there was inadequate segregation of duties in the management of the PRISM support contract. Specifically, neither a project manager nor a Contracting Officer's Technical Representative (COTR) was appointed for the support contract for at least one year. As a result, the CO was required to assume these roles and responsibilities during that period. Further, we noted that a critical deliverable under the PRISM support contract did not meet quality standards. The reconciliation tool developed by the vendor did not appear to accurately classify data between PRISM and Momentum, which led to reconciliation errors and the expenditure of additional resources to remedy these errors.

Lastly, after we conducted follow-up on the status of prior recommendations in OIG Report No. 471, *Audit of the Office of Acquisitions' Procurement and Contract Management Functions*, issued on September 25, 2009, relating to strengthening management controls over the contracting and procurement function, we found that eight of the ten recommendations contained in that report remain open.

Recommendations

The OIG issued a final report reflecting the results of the review on September 30, 2010. The report included five recommendations to help strengthen the Commission's procurement and contract management functions, as well as project management of major information technology investments. The report contained the following specific recommendations:

(1) OIT should review the adequacy of trained project officers who are available to manage all current and anticipated projects and, if it determines that sufficient qualified project officers are not available, it should either provide an adequate number of qualified personnel or implement an alternative process for ensuring proper oversight of projects;

(2) OAS should issue guidance to staff on the proper use of restrictive clauses in solicitations and the prohibition on pre-selection, and require that applicable FAR requirements are followed;

(3) OAS should implement internal procedures to limit COs from also assuming project management and COTR responsibilities on the same project, in order to ensure duties are appropriately segregated;

(4) OAS should review existing contracts to ensure that COTRs are assigned for each contract as appropriate; and

(5) OAS, in conjunction with OFM, should evaluate the reconciliation tool that did not meet quality standards to determine, on a cost-benefit basis, whether it would be feasible to correct the deficiencies identified.

Management concurred with four of the five recommendations. The OIG expressed its disappointment in OAS's opposition to implementing procedures to limit contracting officers from also assuming certain project management duties, as we believe this is a

prudent and appropriate step to ensure Commission projects are managed more efficiently in the future. While the OIG was pleased that management had agreed to implement four of the report's five recommendations, we reiterated our belief that full implementation of all of the report's recommendations will lead to significant improvement in the Commission's contract and procurement oversight.

The OIG's report, *Review of PRISM Automated Procurement System Support Contracts*, is available on our website at http://www.sec-oig.gov/Reports/AuditsInspections/2010/486.pdf.

Additionally, based upon evidence of improper pre-selection of a contractor obtained during this review, the OIG issued an investigative memorandum report, which is discussed in the Investigations and Inquiries Conducted Section of this Report.

Audit of the FedTraveler Travel Service (Report No. 483)

Background

The OIG conducted an audit of the FedTraveler Travel Service (FedTraveler), which is used to arrange the official travel of SEC staff. The Federal Travel Regulation (FTR) mandated that federal agencies fully deploy an E-Gov Travel Service (ETS) by September 30, 2006. On March 31, 2005, after extensive evaluation of the three available ETS vendors, the SEC issued a task order to procure FedTraveler, which is a comprehensive, end-to-end service used to plan, book, track, approve and request reimbursement for travel services for managing federal employees' official travel. Although mandated to be deployed by September 2006, FedTraveler was not fully deployed at the SEC until June 2008.

The OIG conducted this audit partially because of the numerous complaints it had received from SEC employees about FedTraveler since the program's inception. These complaints included concerns about the imposition of numerous administrative charges for a variety of unexplained reasons. The audit was conducted from May to August 2010.

The overall objective of the audit was to assess the adequacy of the service provided by FedTraveler and identify areas of improvement to reduce or eliminate fraud, waste, and abuse. Specific audit objectives included:

- Surveying SEC employees to determine the level of actual concern on the part of SEC employees with FedTraveler;
- Determining the source of administrative fees charged by FedTraveler and assessing the bases for the fees and whether the SEC and its employees are being unnecessarily overcharged by FedTraveler;
- Determining whether FedTraveler has effective controls over hotel accommodations and requires compliance with applicable rules and regulations and avoidance of waste, fraud, and abuse; and
- Determining if there are areas where the SEC can reduce unnecessary costs.

Results

Through a survey of SEC employees launched to assist us in conducting the audit, the OIG found that SEC employees are significantly dissatisfied with FedTraveler. The largest percentage of respondents to a survey question about costs responded that they "strongly disagreed" that the FedTraveler system had lowered costs, even though one of the stated goals of the E-Gov initiative was "to significantly reduce the cost of Federal travel

management and to achieve dramatic cost savings." SEC employees who completed the survey also generally responded that they did not believe that the hotel booking process had been simplified, with one traveler commenting, "Booking a hotel is one of the most frustrating aspects of FedTraveler." Further, respondents indicated that the FedTraveler system did not reduce the amount of time required to make travel arrangements (the largest percentage of respondents, 19.1 percent, "strongly disagreed" that the amount of time had been reduced), even though another stated E-Gov objective was to simply the travel process. In addition, a majority of survey respondents did not believe the FedTraveler system was user friendly, although their satisfaction level had increased over the past year, and they reported being satisfied with Fed Traveler support services within the Commission.

An area of the FedTraveler system that has been particularly troubling to SEC travelers (according to both the complaints we received and the survey results) is the "excessive" FedTraveler transaction fees. Our audit confirmed that the transaction fee structure (which includes three levels of transaction fees) is confusing and often excessive. We also found that no proper explanation of these transaction fees is provided to SEC travelers. During our audit, we reviewed sample itineraries and found specific and numerous instances of excessive fees. Fees for some trips totaled over $100 and, in several instances, travelers were charged transaction fees that represented a large percentage of the total cost of their trips (one traveler was charged over $43 in transaction fees for a trip costing less than $125). In all, we found that FedTraveler charged SEC employees or contractors nearly $190,000 in transaction fees for travel over a seven-month period.

The audit further found that the fees being charged by FedTraveler for trips reviewed in our sample were not in accordance with the fee schedule contained in the FedTraveler task order signed by the SEC in March 2005, and that there was significant confusion about what fees should be properly charged. In fact, during the course of the audit we were provided conflicting opinions from the CO and the COTR as to whether the pricing details in the SEC's task order or those found in the GSA master contract applied to the FedTraveler contract. We concluded that this confusion over the FedTraveler fee structure raised significant concerns about the level of the SEC's monitoring of the FedTraveler contract.

The audit also identified several ways in which the SEC could reduce transportation expenses by, among other things, educating travelers on utilizing the allowable exceptions to the use of contract fares, and we made suggestions to reduce the significant funds currently being expended for customer support, which included five full-time on-site contractor representatives at an annual cost of over $1 million (excluding transaction costs). We found that requests for actual expenses for lodging needed to be more closely scrutinized and that increased controls were necessary for travel involving the use of a privately-owned vehicle. The audit further found that a noteworthy number of travelers were not receiving their reimbursements within a timely manner, causing them to pay travel expenses out of their own pocket. Finally, the audit determined that FedTraveler is not providing the SEC the reporting capabilities that had been promised and, as a result, OFM is unable to thoroughly analyze the cost effectiveness of the system and any anticipated changes.

Recommendations

The OIG issued a final report containing the results of the audit on September 22, 2010. The report included 20 recommendations to help alleviate concerns expressed by Commission staff about FedTraveler and reduce transportation expenses. Specifically, the OIG recommended that OFM:

(1) Establish a working group to independently analyze the OIG survey results, comments, and suggestions and recommend improvements to the Associate Executive Director for Financial Management;

(2) Develop regular means of communication with Commission staff regarding common FedTraveler issues and solutions;

(3) Consult with FedTraveler and its travel management center, CI Travel, to publish a guide for employees that clearly explains the transaction fee structure;

(4) Educate Commission staff on alternatives to using CI Travel in order to minimize non-self service transaction fees;

(5) Work with FedTraveler to require that travelers be notified when non-self service transaction fees are charged by CI Travel;

(6) Determine the feasibility and cost effectiveness of capturing transaction fee costs in a distinct Budget Object Class code;

(7) Issue guidance to travelers regarding available exceptions to using the contract fare and tips for confirming that no contract flights exist prior to requesting a non-contract flight;

(8) Remind travelers of the FTR exceptions for claiming actual expenses and require that travelers provide clear justifications when claiming actual expenses;

(9) Determine how the requirement that travelers call three hotels prior to requesting actual expenses be enforced, or provide travelers and approving officials with alternative guidance;

(10) Require approving officials to review and approve requests for actual expenses for lodging prior to the routing of such requests to OFM;

(11) Work with FedTraveler to implement additional system controls to ensure travel using privately owned vehicles is in accordance with the FTR;

(12) Request that FedTraveler institute a system control that notifies travelers when their expense reports have not been submitted within the permitted time period;

(13) Request that FedTraveler provide the needed reporting capability to enable OFM to effectively monitor the receipt and processing of expense reports in accordance with the FTR;

(14) Publish on its travel website best practices with regard to preparation of expense reports so travelers can avoid the most common mistakes that lead to returned expense reports;

(15) Determine the feasibility and cost effectiveness of implementing a split disbursement method for payment of travel expenses;

(16) Identify and request from FedTraveler additional reporting capabilities needed to successfully perform its travel responsibilities and analyze the cost effectiveness of implementing such changes;

(17) Examine the activity level of the current customer serve representatives to determine if the number of representatives is appropriate; and

(18) Establish agency-specific performance measures or other means to monitor the service provided by the customer service representatives.

The OIG also recommended that OAS request a legal opinion from OGC regarding the amount and frequency of fees charged by FedTraveler to ensure the charges are appro-

priate and in accordance with the GSA master contract and the SEC's task order, and request access to the master contract through GSA's digital contract library and provide access to the COTR to assist in contract monitoring.

Management concurred with all of the report's recommendations. The OIG's report, *Audit of the FedTraveler Travel Service*, is available on our website at http://www.sec-oig.gov/Reports/AuditsInspections/2010/483.pdf.

PENDING AUDITS AND EVALUATIONS

Assessment of Compliance with Terms and Conditions of Exemptive Orders and No-Action Letters

The SEC has authority to provide firms with exemptions to the requirements of the federal securities laws through the issuance of exemptive orders. Firms request exemptions from the SEC for proposed transactions, products or services that might not comply with current securities law requirements. If the SEC grants an application for an exemption, the requestor must adhere to the terms and conditions of the exemptive order issued by the Commission. Additionally, the SEC staff may provide relief to firms in the form of a "no-action" letter. A staff no-action letter includes the specific terms and conditions of a firm's request, and advises the firm that if it proceeds as described in the request for no-action relief, the SEC staff will not recommend an enforcement action against the firm. Exemptive orders and no-action letters provide the industry with the flexibility to introduce new and novel products and services to the security markets without risking an SEC enforcement action for violating the securities laws.

The OIG is performing an audit to evaluate the SEC's processes for ensuring adherence to the conditions under which exemptive orders are granted and no-action letters are issued to applicants. In this audit, the OIG will assess the applicable SEC policies, procedures and processes and make recommendations for improvement, as warranted. The OIG will also interview SEC managers and staff involved in the exemptive order and no-action letter processes, which primarily include staff in the Divisions of Investment Management, Corporation Finance the Trading and Markets. In addition, the OIG will conduct a review of relevant documents and analyze pertinent data in order to determine whether applicants are complying with the terms and conditions of the exemptive orders and no-action letters that have been granted or issued.

Audit of Time-And-Materials and Labor-Hour Contracts

A time-and-materials contract provides for acquiring supplies or services on the basis of (1) direct labor hours at specified fixed hourly rates, including wages, overhead, general and administrative expenses, and profit; and (2) materials at cost, including material handling costs if appropriate. A labor-hour contract is a variation of a time-and-materials contract, differing only in that materials are not supplied by the contractor. The GAO has recognized the risks inherent in these types of contracts because the government bears the risk of cost overruns. The FAR provides that such contracts may only be used when it is not possible to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence. In addition, the FAR requires appropriate government surveillance of contractor performance on time-and-materials and labor-hour contracts in order to provide reasonable assurance that the contractor uses efficient methods and cost controls.

The OIG has contracted with an independent public accounting firm to conduct an audit of the SEC's procurement activities related to time-and-materials and labor-hour contracts. The objectives of the audit are to

assess whether the SEC's contract monitoring procedures for these types of contracts are adequate and comply with applicable regulations, to analyze whether contractor performance is in accordance with the contract terms and conditions, and whether contract costs incurred are allowable, allocable, reasonable and adequately supported. Specifically, the audit will determine whether (1) the qualifications of employees billed in each labor category meet the contractual qualification requirements for their positions; (2) the SEC properly reviews contractor invoices, the corresponding timesheets and other necessary supporting documentation to ensure that costs are allowable, reasonable, and allocable to the contract, and that billed rates do not exceed the contract ceiling; and (3) the SEC adequately monitors all aspects of current and past contractor performance. The audit will include a review of the applicable regulations, policies and procedures, and an analysis of information included in the contract files, as well as interviews of appropriate contracting and program staff.

Assessment of the SEC's Budget Execution Process

The OIG has contracted with an outside consulting firm to perform an assessment of the SEC's budget execution process. During this assessment, the consultant will review the sufficiency of management controls over the SEC's budget execution process and the efficiency of its operations. In addition, the consultant will examine the lines of authority and responsibility with regard to Commission budget decisions. The assessment will also include an examination of policies and procedures designed to ensure appropriate spending of approved budgets. Further, the consultant will review and assess the SEC's policies and procedures for monitoring incurred obligations to ensure the apportionments and allotments limits are not exceeded.

2010 Federal Information Security Management Act Assessments

The OIG has contracted the services of an outside consultant to perform an independent review of the SEC's IT systems, in accordance with the Federal Information Security Management Act. The consultant will independently evaluate and report on how the SEC has implemented its mandated IT security requirements regarding the following components:

- Certification and Accreditation;
- Configuration Management;
- Security Incident Management;
- Security Training;
- Remediation/Plans of Actions and Milestones;
- Remote Access;
- Identity Management;
- Continuous Monitoring;
- Contractor Oversight; and
- Contingency Planning.

The consultant will also conduct an assessment of two major SEC IT security components. Specifically, assessments will be conducted of the SEC's (1) continuous monitoring efforts for IT operations; and (2) oversight of contractors' handling of SEC data. Further, the consultant will determine whether the SEC's IT security components meet OMB and NIST requirements.

Implementation and Compliance with Homeland Security Presidential Directive 12 (HSPD-12)

The OIG has commenced an audit of the SEC's implementation and compliance with HSPD-12, "Policy for a Common Identification Standard for Federal Employees and Contractors." Specifically, the audit will

evaluate whether the Commission has fully implemented HSPD-12 as required. In addition, the audit will evaluate the adequacy of the controls, processes, and procedures that the Commission uses to perform background investigations, adjudicate results, and issue credentials. Further, the audit will evaluate the roles and responsibilities of the various offices and divisions that are involved in implementation of the HSPD-12 initiative. Finally, the OIG will determine whether the HSPD-12 processes and procedures are consistently applied throughout the agency's headquarters and regional offices.

Office of Inspector General

SEMIANNUAL REPORT TO CONGRESS

INVESTIGATIONS

OVERVIEW

The OIG's Office of Investigations responds to allegations of violations of statutes, rules and regulations, and other misconduct by SEC staff and contractors. The misconduct investigated ranges from criminal wrongdoing and fraud to violations of SEC rules and policies and the Government-wide standards of conduct. The OIG receives complaints through the OIG Hotline, an office electronic mailbox or by mail, facsimile or telephone. In addition, as discussed under the Management and Administration Section of this Report, the OIG now also receives allegations from SEC employees of waste, abuse, misconduct, or mismanagement within the Commission through the new OIG SEC Employee Suggestion Hotline, which was established pursuant to Section 966 of the Dodd-Frank Act.

The most common way complaints were received during this reporting period continued to be through the OIG Hotline, which consists of both telephone and web-based complaint mechanisms. Complaints may be made anonymously by calling the Hotline, which is staffed and answered 24 hours a day, seven days a week. Complaints may also be made to the Hotline through an online complaint form, which is accessible through the OIG's website. In addition to a mechanism for the receipt of complaints, the OIG's website also provides the public with an overview of the work of the Office of Investigations, as well as links to some investigative memoranda and reports issued by the Office.

The Office of Investigations conducts thorough and independent investigations into allegations received in accordance with the Quality Standards for Investigations of the CIGIE. In instances where it is determined that something less than a full investigation is appropriate, the Office of Investigations conducts a preliminary inquiry into the allegation. If the information obtained during the inquiry indicates that a full investigation is warranted, the Office of Investigations will commence an investigation of the allegation.

Upon the opening of an investigation, the primary OIG investigator assigned to the case prepares a comprehensive plan of investigation that describes the focus and scope of the investigation, as well as the specific investigative steps to be performed during the investigation. In all investigations, the OIG investigator interviews the complainant whenever feasible and conducts significant interviews under oath and on-the-record. Where there is any reason to believe a witness will not provide truthful testimony, the OIG investigator provides an appropriate perjury warning. In ad-

dition, the OIG investigator gives assurances of confidentiality to potential witnesses who have expressed a reluctance to come forward.

Where allegations of criminal conduct are involved, the Office of Investigations notifies and works with the U.S. Department of Justice (DOJ) and the Federal Bureau of Investigation (FBI), as appropriate. The OIG also obtains necessary investigative assistance from the SEC's OIT, including the prompt retrieval of employee e-mail accounts as requested by the OIG investigators and forensic analysis of computer hard drives. The OIG investigative staff meets with the Inspector General frequently to review the progress of ongoing investigations. The OIG investigative unit also meets periodically with the Commission's Ethics Counsel to coordinate activities.

Upon completion of an investigation, the OIG investigator prepares a comprehensive report of investigation that sets forth in detail the evidence obtained during the investigation. Investigative matters are referred to the DOJ and SEC management as appropriate. In many investigative reports provided to SEC management, the OIG makes specific findings and recommendations, including whether the OIG believes disciplinary or other action should be taken. The OIG requests that management report back on the disciplinary action taken in response to an OIG investigative report within 45 days of the issuance of the report. The OIG follows up as appropriate with management to determine the status of disciplinary action taken in matters referred by the OIG.

INVESTIGATIONS AND INQUIRIES CONDUCTED

Allegations of Improper Coordination Between the SEC and Other Governmental Entities Concerning the SEC's Enforcement Action Against Goldman Sachs & Co. (Report No. OIG-534)

Opening of the Investigation

On April 23, 2010, the SEC OIG, in response to a written request from the Honorable Darrell Issa (R-California), Ranking Member of the U.S. House of Representatives Committee on Oversight and Government Reform, and other members of the House of Representatives, opened an investigation into allegations that SEC employees communicated or coordinated with the White House, Members of Congress, or Democratic political committees concerning the bringing, or the timing of bringing, an action against Goldman Sachs & Co. (Goldman), in order to affect debate of the financial regulatory reform legislation pending before the U.S. Senate. Congressman Issa and other Members of Congress also alleged that SEC employees may have had communications with the *New York Times* concerning the SEC's complaint against Goldman prior to the filing of that complaint.

On July 22, 2010, Congressman Issa requested that the OIG broaden its investigation to examine whether the timing of the Commission's proposed settlement with Goldman related to either the financial regulatory reform legislation passed by the U.S. Senate the same day, or was an effort to avoid further criticism in the press concerning the proposed settlement. The OIG expanded its investigation to examine these additional issues.

Scope of the Investigation

On April 26, 2010, the OIG issued an agency-wide document retention notice, instructing employees to preserve all documents related to the complaint filed against Goldman on April 16, 2010, and the Division of Enforcement's related investigation of Goldman.

The OIG made numerous requests to the SEC's OIT for the e-mails of current and former SEC employees for various periods of time pertinent to the investigation. The e-mails were received, loaded onto computers with specialized search tools and searched on a continuous basis throughout the course of the investigation. In all, the OIG reviewed e-mails for a total of 64 current or former SEC employees for the time period pertinent to the investigation. The OIG estimates that it obtained and searched over 3.4 million e-mails during the course of its investigation.

In addition, the OIG reviewed various internal SEC memoranda, databases, and closed Commission meeting records, as well as numerous publicly available documents such as court filings and newspaper articles. The OIG also requested information from The New York Times Company and Bloomberg Media concerning whether, when, and how these organizations first learned about the SEC's action against Goldman.

Finally, the OIG took the sworn testimony of 32 witnesses and interviewed five other individuals with knowledge of facts or circumstances surrounding the SEC's investigation of Goldman, the SEC's filing of its complaint against Goldman, and/or the SEC's settlement with Goldman.

Summary of the Results of the Investigation

Overall, the OIG investigation did not find evidence indicating that the SEC's investigation of, or its action against, Goldman was intended to influence, or was influenced by, financial regulatory reform legislation. The OIG found that the investigation's procedural path and timing was governed primarily by decisions relating to the case itself, as well as concerns about: (1) the facts surrounding the investigation's subject matter being publicized prior to the SEC's filing of its action; (2) maintaining a relationship with the New York State Attorney General (NYAG); and (3) maximizing and shaping positive press coverage.

The OIG analyzed in great detail the information found relating to each major decision made by the staff in connection with the Goldman investigation, the Goldman civil action, and the timing of that action. The OIG did not find that financial regulatory reform legislation played a role in any of these decisions. In addition, we found no evidence that anyone at the SEC ever mentioned the financial reform legislation in connection with the Goldman investigation or the filing of the action against Goldman prior to the April 16, 2010 filing.

Further, many SEC witnesses in this investigation, including SEC Chairman Mary Schapiro, testified that they were surprised or "shocked" at the extent of the media attention given to the Goldman action. The belief held by the SEC staff, which is corroborated by e-mails, that the Goldman action might not have significant public impact, much less the impact it ultimately had, is another factor that argues against the idea that the SEC or its staff were attempting to influence financial regulatory reform legislation.

The OIG did not find evidence indicating that the SEC coordinated its investigation of, or its action against, Goldman with the Executive Office of the President, the White House, any White House employees, any Member of Congress, any Congressional employee, the Democratic National Committee, the Democratic Senate Campaign Committee, the Democratic Congressional Campaign Committee, or any of their employees. The OIG reviewed the e-mails of all of the SEC staff who played any role in the Goldman action, including the Chairman, Chief of Staff, Deputy Chief of Staff, Commissioners and their counsel, Enforcement staff, and the staff of the Office of Legislative and Intergovernmental Affairs. The documents reviewed and testimony taken indicated no information about the SEC's investigation of Goldman

was shared with any outside entities or individuals prior to the SEC's April 16, 2010 action against Goldman.

The OIG investigation also found no evidence indicating that the SEC coordinated the settlement of its action against Goldman with the Executive Office of the President, the White House, any White House employees, any Member of Congress, any Congressional employee, the Democratic National Committee, the Democratic Senate Campaign Committee, the Democratic Congressional Campaign Committee, or any of their employees. The OIG found that settlement negotiations and approval proceeded independently of any other governmental entities, any legislation, or any political entities. The documents reviewed and testimony taken by the OIG yielded no indication of coordination or communications between the SEC and other governmental entities concerning the settlement before its public announcement.

An April 20, 2010 letter sent by several Members of Congress serving on the U.S. House of Representatives Committee on Oversight and Government Reform to Chairman Schapiro specifically inquired whether the SEC Chief of Staff or Deputy Chief of Staff engaged in any communication with the Executive Office of the President, any Members of or employees of Congress, or any Democratic political committees. Our investigation found no evidence indicating that either the SEC Chief of Staff or Deputy Chief of Staff communicated with anybody outside the SEC concerning the Goldman investigation or the Goldman action prior to the SEC's complaint being filed on April 16, 2010. Our investigation also found no evidence indicating that either of these individuals played any significant role in the SEC's investigation of Goldman or the authorization of the action against Goldman.

Further, after conducting an extensive search of the e-mails of dozens of SEC employees who may have played a role in, or known about, the Goldman action, and taking the sworn testimony of these employees, the OIG did not find evidence demonstrating that anyone at the SEC shared information about its Goldman investigation with the media prior to the filing of its action against Goldman on April 16, 2010.

The OIG investigation made the following specific findings with respect to Enforcement's investigation of Goldman, the SEC's action against Goldman and the settlement of that action. On August 25, 2008, the Headquarters Enforcement staff opened an investigation into potential misrepresentations by Goldman in connection with the structuring and marketing of a particular collateralized debt obligation. On September 2, 2009, a senior Enforcement official assigned to the investigation wrote in an e-mail to others in Enforcement that "the very quickest" he expected the Goldman investigation to be on the Commission Calendar was November 2009, and suggested that the target date for bringing an action against Goldman and one individual be moved from September 2009 to December 2009.

On November 13, 2009, Enforcement reserved a spot on the Commission Calendar for December 17, 2009, for the Commission to consider the Enforcement staff's recommendation to sue Goldman and one of its vice presidents. On November 24, 2009, Enforcement circulated the Action Memorandum for this recommendation to other SEC offices and divisions for comment and confirmed that the Goldman matter would be on the Commission Calendar for December 17, 2009.

On December 8, 2009, Enforcement decided to withdraw the Goldman matter from the calendar. The OIG found that the decision to withdraw the Goldman case from the Commission Calendar was based upon a determination by the Enforcement staff working on the investigation that they should take tes-

timony from an additional Goldman witness. After the testimony of the Goldman witness was taken, on January 4, 2010, Enforcement wrote to the Office of the Secretary, "We will be re-sending this recommendation up to the Commission on Friday, January 8. ENF's Front Office has asked that the matter be calendared for the second or third week in January." Enforcement also wrote in this e-mail, "This is a high-profile enforcement case that recently became time sensitive."

The OIG investigation found that the Goldman case had become time-sensitive because SEC staff had learned that the Senate Permanent Subcommittee on Investigations (PSI) was considering holding a hearing about Goldman in late January 2010, and SEC staff members were concerned that public information would be aired relating to the Goldman investigation. There was also evidence that the SEC preferred that the facts about Goldman's conduct be publicly aired first by the SEC in a press release announcing the action, after it completed its investigation.

The OIG investigation also found that on March 15, 2010, a Counsel to the Director and Deputy Director of Enforcement began a detail at PSI. Prior to beginning that detail, this official sought advice from the SEC Ethics Counsel regarding the detail and was instructed, "To the extent you have any non-public info about SEC investigations, I would think you would not be permitted to share that with them." Later in the detail, the Enforcement Counsel e-mailed SEC staff that she would like to disclose the SEC's Goldman investigation to PSI. She was again instructed that all non-public information she obtained while at the SEC must remain non-public and that she could not disclose the fact of the SEC's Goldman investigation. We did not find evidence that this individual disclosed any information about the Goldman investigation to PSI.

On January 19, 2010, Enforcement wrote to the Office of the Secretary, "We met again this afternoon with the Front Office to discuss [the Goldman investigation]. We would like to have our recommendation against Goldman and [the vice president] considered at the January 28 closed [C]ommission meeting and will get you a final action memo within the next day. . . ." On January 22, 2010, an Enforcement manager suggested in an e-mail to senior Enforcement staff that the SEC file its complaint against Goldman on Friday, January 29, 2010, arguing that the "24-7 news cycle" makes irrelevant the SEC's traditional approach of avoiding filing significant Enforcement matters on Fridays. Others disagreed with this argument, noting the historical practice in Enforcement not to file cases on Fridays because it was assumed that the Saturday newspapers were not going to be as widely read.

On January 24, 2010, Chairman Schapiro conveyed her interest in "get[ting] the [Goldman] case out" to her Enforcement liaison in the Chairman's office. On January 26, 2010, members of the Enforcement staff met with Commissioner Troy Paredes to discuss the Goldman matter. On January 27, 2010, the day before the Commission meeting in which the Goldman recommendation was to be heard, the decision was made to pull the recommendation from the Commission Calendar.

The OIG investigation found that the Goldman case was pulled a second time from the Commission Calendar for two reasons: (1) concerns expressed by Commissioners and further analysis of the case by Enforcement staff regarding whether or not to charge an additional individual; and (2) a decision by Enforcement staff to obtain more evidence from purchasers of the collateralized debt obligation to strengthen the SEC's case against Goldman.

The Enforcement staff took further investigatory steps in the Goldman case over the next several months and marshaled additional evidence. On April 1, 2010, the Enforcement

staff submitted another Action Memorandum to the Commission recommending that the Commission file a civil action against Goldman and the vice president. On April 8, 2010, in an e-mail circulating a draft complaint against Goldman, Enforcement wrote that it planned to send the Goldman complaint to New York to be filed "either the afternoon of Wednesday April 14 or morning of Thursday April 15."

The OIG investigation found that the Commission approved the filing of the Goldman action on Wednesday afternoon, April 14, 2010. On April 12, 2010, the SEC had learned that the NYAG planned to announce on April 15, 2010, a $7 million settlement with Quadrangle Group LLC (Quadrangle) for its alleged involvement in kickbacks relating to pension fund investments. The SEC was in a position to file its own proposed settlement with Quadrangle for similar alleged violations on the same day that the NYAG would announce its settlement. Later on April 12, 2010, the SEC learned that the NYAG intended to announce its settlement with Quadrangle on Wednesday, April 14, instead of Thursday, April 15.

The Enforcement Director informed Chairman Schapiro that the SEC staff planned to file its settlement with Quadrangle on Wednesday, April 14, 2010, at the same time that the NYAG announced its settlement with Quadrangle. Chairman Schapiro responded, "Let's make sure we don't announce Goldman same day," and testified that the Quadrangle case was an important case for the NYAG, and an important case for the SEC as well. She stated that she did not want to detract from the announcement of the Quadrangle case by announcing the Goldman case at the same time, explaining, "I was a little worried that the Attorney General would be very upset if we announced multiple cases the same day."

Another reason advanced by SEC staff why it would not be advisable to announce the Goldman action on the same day as the Quadrangle settlement was that the SEC's "goal is always to get our enforcement message out widely," and bringing two cases on the same day would lessen that objective and confuse the media's focus. The Enforcement Director also noted that the SEC did not want both Goldman and Quadrangle announced on the same day because of the overwhelming amount of briefing and other work involved for each matter. He added that the SEC's Office of Public Affairs did not want the SEC to announce two significant cases on the same day because the press would be diluted, as well as the logistics involved in coordinating the publicity of the SEC's actions.

In the Enforcement Director's response to Chairman Schapiro's April 12, 2010 e-mail about making sure that the SEC did not announce the Goldman action on the same day as Quadrangle, he wrote that the SEC would announce the Quadrangle settlement on Wednesday and file the Goldman action "likely" on Thursday. On the afternoon of Tuesday, April 13, 2010, the SEC learned that the NYAG had changed its schedule again, and that it now planned to announce the Quadrangle settlement on Thursday, April 15. We obtained testimony that once the NYAG moved the Quadrangle announcement date to Thursday, April 15, 2010, the SEC decided to delay the Goldman action until Friday, April 16.

On the morning of Wednesday, April 14, 2010, the SEC's Director of Communications wrote in an e-mail to the Director of the SEC's Office of Public Affairs, that the Goldman action would be filed on Friday, April 16. On the morning of Thursday, April 15, at 2:38 a.m., the Director of Communications e-mailed to a variety of senior SEC officials in Enforcement, Public Affairs and the Chairman's Office a detailed timeline of the anticipated events for the remainder of that week. Events on this timeline included the SEC's announcement of the Quadrangle settlement Thursday morning, filing of the Goldman complaint Friday morning at 9:30 a.m., announcement of the Goldman filing at 9:45 a.m., and public release of

the OIG's Report on its Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Ponzi Scheme (OIG Stanford Report) on Friday afternoon. The Enforcement staff continued to review and edit the complaint against Goldman on Thursday, April 15, 2010.

The SEC filed the Goldman complaint with the U.S. District Court for the Southern District of New York at 10:29 a.m. on Friday, April 16, 2010. At 10:33 a.m. on April 16, the SEC issued a press release concerning its filing of the complaint against Goldman. At 1:57 p.m. on April 16, 2010, a few hours after the SEC filed its action against Goldman, the SEC publicly released a redacted version of the OIG Stanford Report, which contained criticisms of the SEC's response to concerns and allegations that Robert Allen Stanford's companies were conducting a fraudulent scheme. In part because of coverage of the SEC's Goldman action, press coverage of the OIG Stanford Report was limited.

Individuals both within and outside the SEC noted the suspicious timing of the SEC's announcement of the Goldman action and release of the OIG Stanford Report on the same day. A senior Enforcement official wrote in an April 19, 2010 e-mail:

> I'm hearing that the Chairman's office is denying that there was any connection between the decision to file the case on Friday and the decision to release the Stanford IG report the same day. They had better be careful, because they may get asked for e-mail, etc. from Congress or pursuant to a FOIA request.

This senior official testified that he "assumed that it was not coincidental" that the OIG Stanford Report and the Goldman action were made public on the same day, but that he was not involved in decisions for either matter, and did not have knowledge that the timing of the two events on the same day was intentional.

In addition, an OGC attorney sent an e-mail to a personal friend on the day that the Goldman action was announced and the OIG Stanford Report was released, stating, "What a coincidence that those two stories came out today. ;-)." He testified that his e-mail about the timing of the two being a "coincidence" was based on purely his own speculation that the timing of the two releases "would be positive damage control for the Commission" in that the Goldman action and Stanford report were put out on the same day in order for the Goldman action to drown out media coverage of the Stanford report.

These suspicions were likely fueled by the recent history of the SEC releasing OIG reports that criticized the agency on "slow" news days. The SEC released the OIG's 457-page report of investigation (ROI) concerning the failure of the SEC to uncover Bernard Madoff's Ponzi Scheme after 5:00 p.m. on September 4, 2009, the Friday before a three-day holiday weekend. The SEC then released the hundreds of exhibits supporting the OIG's ROI concerning Madoff late on Friday, October 30, 2009. In addition, the OIG ROI concerning the SEC's failure to vigorously pursue an enforcement action against W. Holding Company, Inc., and Bear Stearns & Co., Inc., was made public on Friday, October 10, 2008. Consistent with this pattern, on April 16, 2010, the same Friday that the OIG Stanford Report was publicly released and the Goldman action was announced, the SEC also publicly released the OIG's ROI concerning the SEC's failure to timely investigate allegations of financial fraud at Metromedia International Group, Inc., which had been submitted to the SEC by the OIG almost two months earlier.

Although, as noted above, we found that the decision on the timing of the release of the Goldman report was based at least par-

tially on maximizing press coverage, and that ensuring positive press coverage was a consideration in deciding when to file and announce cases, the OIG did not locate any concrete and tangible evidence in e-mails or testimony that the filing of the Goldman report was specifically delayed to coincide with the issuance of the OIG Stanford Report. After the OIG Stanford Report was submitted to the Chairman on April 1, 2010, the SEC staff undertook the process of redacting portions of the report before its public release, a task that appeared to proceed independently of the timing of the SEC's Goldman action.

On April 9, 2010, the OGC sent an e-mail to the counsels to the Commissioners, informing them that it planned to circulate a seriatim Action Memorandum on Monday, April 12, seeking Commission authority by April 14 to release the OIG Stanford Report. On that Monday, however, the OGC notified the counsels to the Commissioners via e-mail that, due to further consideration of certain redactions, the Action Memorandum would not be ready to circulate until Tuesday, April 13.

There was testimony that, by April 13, 2010, a decision had been made to postpone release of the OIG Stanford Report from April 14 to April 16 due to issues concerning the redaction of the report and, thereafter, the date of release for the OIG Stanford Report was "fixed" for Friday, April 16. The Action Memorandum seeking Commission authority to release the OIG Stanford Report was ultimately circulated to the Commissioners' counsels on April 14, and was not signed by all five Commissioners until the morning of Friday, April 16.

Accordingly, the OIG concluded that the SEC's decision to file the action against Goldman on April 16, 2010 was driven primarily by its desire to avoid filing the action on the same day that it announced the Quadrangle settlement.

The OIG investigation also found that the Enforcement staff did not notify Goldman of the impending filing of the complaint against Goldman prior to its filing. We found that a senior Enforcement staff member on the Goldman case left a message with the secretary for Goldman's counsel on Friday, April 16, 2010, to give notice that the SEC had brought charges against Goldman and the vice president. Telephone records for Goldman's counsel indicated that the first call received from the SEC on April 16 came at 10:39 a.m., ten minutes after the SEC filed its complaint against Goldman and seven minutes after the SEC issued its press release about the Goldman action.

Goldman's counsel testified that "it was unprecedented, [and] in [his] view it was contrary to decades of SEC experience that they would file without calling and giving an opportunity for the respondent to put a proposal on the table." Several senior Enforcement officials testified that it was the practice of many SEC staff to notify a defendant that the Commission had authorized the staff to file an action against the defendant in order to potentially obtain a "settlement at the 11th hour." There was also testimony that one concern in notifying Goldman of Commission authorization in advance of filing was as follows:

> Goldman is a pretty sophisticated player. … [T]hey're good at the public relations game, and that … if you know that something is coming from the SEC, you can maybe take certain actions to … precondition the reporters about the case, and maybe the coverage would not be as favorable, from the SEC's perspective.

The Enforcement Director testified that Goldman's counsel called him a day or two after the filing of the Goldman complaint and "expressed displeasure about really not having a chance to settle the case." The Enforcement

Director testified that he responded that Goldman had many opportunities to settle the case and the SEC had no reason to believe Goldman was interested in settling. He also testified that he did not necessarily think it was a good idea for it to become standard practice for the SEC to notify an entity when the Commission has authorized filing an action against the entity.

The OIG found that Section B(15)(c) of SECR 18-2, "Press Relations Policies and Procedures," stated, in part:

> Every effort should be made to avoid the possibility that defendants in an SEC enforcement action first learn of the action when they read about it in the newspapers or when they are called by a reporter for comment about the SEC's complaint. The division, regional or district office primarily responsible for the filing of a particular complaint shall take all necessary steps to see that the defendants and/or their counsel are given timely advice concerning the action.

While we found that the Office of Public Affairs circulated its press policy, including SECR 18-2, to Enforcement staff on at least an annual basis, two members of the Enforcement staff responsible for bringing the Goldman action testified that they were not aware of the provision quoted above.

Accordingly, the OIG found that the SEC staff did not fully comply with SECR 18-2 because they did not make "every effort" to notify Goldman of the SEC's action prior to filing the action. In light of the differing views expressed by Enforcement management as to whether notice should be given to a defendant in advance of an SEC enforcement action, the OIG recommended consideration of whether this regulation should be revised.

The OIG investigation also found that the SEC's decision to file its action against Goldman during trading hours with no advance notice to Goldman or the New York Stock Exchange (NYSE) resulted in market volatility, which concerned an NYSE Regulation official. However, the OIG did not find anything improper in this decision. The OIG recommended that Enforcement give further consideration to whether, under certain circumstances, filing an action after trading hours or giving advance notice of an action to NYSE Regulation or other self-regulatory organizations is appropriate.

The OIG also analyzed the circumstances surrounding the timing of the SEC's July 2010 settlement with Goldman. Settlement negotiations with Goldman began almost immediately after the SEC filed its complaint against Goldman. A few weeks prior to the July 15 settlement announcement, Goldman made it clear to the SEC staff that it wanted the matter settled, both prior to July 19, when Goldman's answer to the SEC's complaint was due, and prior to July 20, when Goldman's quarterly earnings would be announced and at which point Goldman would have to take and announce an accounting reserve if no final settlement had been reached.

The Enforcement Director testified that, at that point, "everybody was of the view that if we're going to get [the settlement] done it had to get done before those two dates." After settlement negotiations continued through June 2010, on July 1, 2010, the Enforcement staff sent draft settlement papers to Goldman's counsel and by early July, the SEC staff had set a plan to bring Goldman's settlement offer before the Commission on Thursday, July 15. The Enforcement staff circulated the Action Memorandum recommending acceptance of Goldman's settlement offer to the Commissioners on July 12, 2010. Senior Enforcement staff held meetings with each Commissioner prior to the July 15 Commission meeting to brief them on the proposed settlement with Goldman. On July 14, 2010, the Enforcement

Staff sent final versions of the settlement papers to Goldman's counsel for signature.

The OIG investigation found that the decision was made to file and announce the settlement with Goldman immediately after the Commission approved the settlement on July 15, 2010, which was also the same day that the financial regulatory reform bill passed the Senate. The Enforcement Director testified that one of the reasons for the decision to announce the settlement on July 15 was a concern about leaks to the media. A senior Enforcement official agreed that the primary reason that the SEC decided to announce the settlement quickly was "to beat leaks. … [T]he more time that went by between the Commission approving it and filing the settlement, the more likely it was going to get out there." A senior official in the Chairman's office stated that the SEC decided to announce the settlement quickly on Thursday, July 15, rather than wait until the next day because, "If you wait until Friday and it leaks, then Goldman gets to control the story." The Director of Public Affairs testified that there was "absolutely" concern at the SEC that Goldman would provide information to the media and spin the settlement in Goldman's favor.

The Enforcement Director also testified that there may have been internal discussions at the SEC that the filing of the proposed Goldman settlement on the same day that financial regulatory reform was approved by the Senate might lead to speculation that the timing of the two events was connected, even though it was not. However, the Enforcement Director testified that the SEC decided to keep to its schedule because it would have been inappropriate to delay the settlement because of this concern. Others concurred that while there was concern that the SEC would be perceived poorly by announcing the proposed Goldman settlement on the same day that financial regulatory reform legislation was passed by the Senate, it was decided to announce the settlement that day as originally planned because, if the SEC held the Goldman settlement filing and announcement another day, people would then be able to say the SEC held it because of financial regulatory reform.

The Commission approved the settlement with Goldman in a closed Executive Session on the afternoon of July 15, 2010. At 3:15 p.m., pursuant to a timeline previously circulated, a few minutes after the Commission approved the settlement, the SEC issued a press advisory announcing a press conference to be held at 4:45 p.m., without identifying the topic of the press conference. At 4:28 p.m., as the NYSE trading day was ending, the SEC released its public announcement of the settlement with Goldman.

Based upon the foregoing evidence, the OIG investigation did not find that the SEC's investigation of, or its action against, Goldman was intended to influence, or was influenced by, financial regulatory reform legislation. The OIG also did not find that the settlement between the SEC and Goldman was intended to influence, or was influenced by, financial regulatory reform legislation. We also did not find that the SEC improperly coordinated its Goldman investigation with outside entities or shared information about that investigation with any journalists or members of the media prior to the filing of its action against Goldman on April 16, 2010.

The OIG did find that the SEC staff did not fully comply with Administrative Regulation SECR 18-2 by failing to notify Goldman of the SEC's action until after it had filed the action, and that this decision, in combination with the decision not to give notice to NYSE Regulation in advance of filing the action and to file the action during market hours, resulted in an increase in volatility in the securities markets on the day of the filing.

Recommendations in the Report of Investigation

The OIG recommended that the Chairman and the Enforcement Director: (1) give consideration to, and then communicate to Enforcement staff, the circumstances, if any, under which Enforcement should give notice to NYSE Regulation or other self-regulatory organizations in advance of filing an enforcement action in which the defendant has not been given notice that an action is imminent; (2) give consideration to, and then communicate to Enforcement staff, the circumstances, if any, under which Enforcement should file an enforcement action, and issue any related press releases or advisories, after the close of trading hours for the exchange on which the securities of the defendant entity trades; and (3) give consideration to whether SECR 18-2 should be revised, and to then communicate to Enforcement staff whether and in what circumstances advance notice should be given to defendants in an enforcement action.

The OIG's report of investigation was issued just prior to the end of the semiannual reporting period. Consequently, as of the end of the period, no action had yet been taken by management with respect to the OIG's recommendations.

Investigation of the Circumstances Surrounding the SEC's Proposed Settlements with Bank of America, Including a Review of the Court's Rejection of the SEC's First Proposed Settlement and an Analysis of the Impact of Bank of America's Status as a TARP Recipient (Report No. OIG-522)

Opening of the Investigation

On August 6, 2009, the Honorable Elijah E. Cummings (D-Maryland), Member of Congress, U.S. House of Representatives, sent a letter to the SEC OIG and to the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) regarding the SEC's proposed $33 million settlement with Bank of America (BofA), for false and misleading statements made in connection with its merger with Merrill Lynch & Co. (Merrill), filed in U.S. federal court on August 3, 2009. Specifically, Congressman Cummings referenced an attached August 4, 2009 *Washington Post* article that raised the following conflict of interest issues that could potentially arise from SEC enforcement actions against entities that, like BofA, were in receipt of Troubled Asset Relief Program (TARP) funds:

(1) Whether the enforcement action may harm the firm's viability, and threaten systemic risk to the financial industry;

(2) Whether the fines levied would essentially be paid with taxpayer funds;

(3) Whether the fines would harm the shareholder investment in the firm, when the shareholder is the U.S. taxpayer; and

(4) Whether the role played by Federal Reserve or Treasury officials in the actions upon which fines were issued may have been significant to the occurrence of the violation but cannot be investigated by the SEC.

Congressman Cummings asked the SEC OIG and SIGTARP, respectively, to investigate the extent to which the issues above existed in Enforcement's first proposed settled action against BofA, as well as the potential for these conflicts to occur in future actions against TARP recipients. In response, the SEC OIG opened an official investigation on August 6, 2009.

Subsequent to opening its investigation, the OIG learned that the Honorable Jed S. Rakoff, U.S. District Judge for the Southern District of New York, rejected the Commission's proposed settlement with BofA on September 14, 2009. Shortly after Judge

Rakoff rejected the settlement, Senior Counsel from the Senate Banking Committee contacted the IG and asked if the OIG's investigation of this matter would include the circumstances surrounding Judge Rakoff's decision to reject the settlement, including analysis of whether Enforcement had vigorously and appropriately enforced the securities laws in its investigation of BofA that led to the settlement rejected by Judge Rakoff. Based upon this discussion, the OIG expanded the scope of its investigation to analyze the circumstances surrounding the settlement rejected by Judge Rakoff.

On February 4, 2010, the SEC and BofA submitted a revised proposed settlement, which Judge Rakoff ultimately approved on February 22, 2010. The second settlement included a civil monetary penalty of $150 million, specific remedial undertakings that BofA was required to implement and maintain for three years, and a Statement of Facts prepared by the Enforcement staff and agreed to by BofA describing the details behind the SEC's allegations. Pursuant to subsequent conversations with the Congressional officials, the OIG further expanded its investigation to include an analysis of the circumstances surrounding the revised settlement to determine whether the charging decisions in each instance were made appropriately.

Scope of the Investigation

In the course of its investigation of the circumstances surrounding the two BofA settlements and potential conflicts of interest, the OIG obtained and reviewed over 500,000 e-mails, and numerous supporting attachments, for over 15 employees in five different offices and divisions within the SEC. The OIG also reviewed numerous supporting materials including, but not limited to: (1) drafts and final versions of internal memoranda to the Commission recommending an enforcement action against BofA; (2) pleadings filed and judicial orders issued in the BofA litigation; (3) drafts and final versions of internal policy memoranda, including an internal policy memorandum to the Commission establishing an Enforcement policy for seeking civil penalties against TARP recipients; (4) the transcript of Judge Rakoff's August 10, 2009 hearing on whether he should approve the SEC's first proposed settlement with BofA; and (5) numerous press articles about both SEC settlements with BofA. In addition, the OIG took on-the-record, under-oath testimony of nearly 20 SEC employees, a former BofA employee, and the Special Inspector General for the Troubled Asset Relief Program. Finally, the OIG submitted written questions to the NYAG and received written responses from the law enforcement agency.

Summary of the Results of the Report of Investigation

The issues giving rise to the OIG investigation stemmed from the global financial crisis that came to the fore in 2008. Specifically, to stabilize the financial system and encourage banks to resume lending in the wake of the recent global financial crisis, Congress enacted the Emergency Economic Stabilization Act of 2008 (EESA) (Division A of Public Law 110-343, enacted October 3, 2008). EESA established the TARP, which provided the U.S. Department of the Treasury with the power to purchase hundreds of billions of dollars in illiquid assets from banks and other financial institutions and to take other measures to bolster lending and unfreeze the credit markets. EESA also established SIGTARP to conduct, supervise and coordinate audits and investigations of the purchase, management and sale of assets under TARP. BofA, itself a recipient of TARP funding, and Merrill signed a merger agreement in September 2008, and in November 2008, the companies filed a definitive joint proxy statement soliciting shareholder votes for approval of the merger.

BofA, however, did not disclose to its shareholders that it had agreed to allow Merrill to pay employees up to $5.8 billion in dis-

cretionary bonuses. BofA also did not disclose that it was aware, prior to a December 5, 2008 vote on the merger, that Merrill had net losses of $7 billion in October and November 2008. On January 16, 2009, after the merger had been approved, BofA reported that Merrill had sustained a net loss of $15.3 billion and that BofA had obtained $20 billion in TARP funds to assist in the acquisition. On the next trading day, BofA's stock price fell by nearly 30 percent.

After Merrill's losses were disclosed, several state and federal law enforcement agencies – including the SEC, the DOJ, the NYAG and SIGTARP – investigated the circumstances of the merger. On July 30, 2009, the Commission authorized Enforcement to file an action against BofA for failure to disclose the agreement authorizing Merrill to pay up to $5.8 billion in discretionary year-end bonuses. At the same time, the Commission approved the general terms of Enforcement's recommended settlement with BofA. On August 3, 2009, the SEC formally reached a proposed settlement with BofA, the terms of which were: (1) entry of a final judgment permanently enjoining the company from violating Section 14(a) of the Exchange Act; and (2) a civil monetary penalty against the company in the amount of $33 million. The proposed settlement was rejected by the Court, resulting in a second proposed settlement of $150 million with remedial undertakings rather than a permanent injunction. The Court approved the second proposed settlement in February 2010.

During its investigation, the OIG analyzed the SEC enforcement actions against BofA, including the first proposed settlement and its rejection by the Court; the second proposed settlement and its acceptance by the Court; and what role, if any, BofA's status as a TARP recipient played in the SEC's investigation, charging decisions and settlement discussions.

Overall, the OIG found that despite the Court's rejection of the SEC's first proposed settlement with BofA, the evidence did not show that SEC staff failed to diligently and zealously investigate potential securities law violations. The Enforcement attorneys who worked on both proposed settlements ably operated under considerable time constraints to investigate and bring actions against BofA for violations of the federal securities laws in connection with the Merrill merger. The OIG's investigation chronicled the decisions made by both Enforcement teams for "lessons learned" and informational purposes and described how the second Enforcement team's strategic determinations and clear understanding of the statutory basis for individual liability led to a settlement being accepted by the Court.

The OIG also did not find evidence of the improper conflicts of interest that formed the basis of the August 6, 2009 Congressional letter to the OIG and SIGTARP requesting this investigation. The OIG did find that BofA's status as a TARP recipient had an impact on the favorable settlement the staff first recommended to the Commission.

Specifically, the OIG found that in or around January 2009, the SEC NYRO Enforcement staff began its investigation of the circumstances surrounding BofA's approximately $50 billion acquisition of Merrill on January 1, 2009. The Enforcement staff began investigating allegedly false and misleading statements made by BofA in a November 3, 2008 joint proxy statement filed in connection with the merger. The initial investigation involved a disclosure schedule detailing an agreement to pay up to $5.8 billion – nearly 12 percent of the total consideration to be exchanged in the merger – in discretionary year-end bonuses to Merrill executives for 2008. The disclosure schedule was omitted from the proxy statement and its contents were not disclosed before the shareholders' vote on the merger on December 5, 2008.

The staff also began investigating an alleged failure by BofA to disclose, prior to the

December 5, 2008 shareholder meeting, extraordinary fourth quarter losses that Merrill sustained in October and November 2008. However, we found that the decision was made to bring an action solely on the issue of BofA's failure to disclose the agreement to pay the year-end bonuses to company executives, at least partially, on the staff's perceived need to bring the Enforcement case against BofA quickly. The OIG found the Enforcement staff felt pressure to bring a case against BofA promptly because of the internal interest in the case and its high-profile nature. There was also initial skepticism on the part of senior Enforcement officials with regard to the viability of an action regarding the failure to disclose the extraordinary fourth quarter losses.

On August 3, 2009, the SEC announced in a press release that it had "charged Bank of America Corporation for misleading investors about billions of dollars in bonuses that were being paid to Merrill Lynch & Co. executives at the time of its acquisition of the firm." Also according to the press release, "Bank of America agreed to settle the SEC's charges and pay a penalty of $33 million." The press release noted that "as Merrill was on the brink of bankruptcy and posting record losses, Bank of America agreed to allow Merrill to pay its executives billions of dollars in bonuses. Shareholders were not told about this agreement at the time they voted on the merger." The press release stated further that the settlement was "subject to court approval."

The OIG investigation found that as the SEC and BofA negotiated settlement terms, attorneys representing BofA raised the issue of potential collateral consequences that might arise were it to agree to a settlement that included an injunction against future violations of the antifraud provisions of the federal securities laws. The potential collateral consequences for BofA included losing its status as a Well-Known Seasoned Issuer (WKSI) and its safe harbor for forward-looking statements. WKSI status allows an issuer to use advantageous procedures in the registration and offering of securities, including allowing the issuer to file an automatic shelf registration statement with the SEC. The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act afford limited protection from liability or penalty for certain issuers who make forward-looking statements that turn out to be false, provided that certain statutory criteria are met.

The Commission has the power to waive certain collateral consequences of an antifraud injunction, including the statutory disqualification from WKSI status and from the safe harbor for forward-looking statements. Prior to entry of the first proposed settlement, BofA requested that the Commission grant it waivers from both WKSI and safe harbor disqualification. The waiver most important to BofA involved its status as a WKSI filer. However, the alleged violation of the proxy solicitation rules was directly related to BofA's own disclosures. Therefore, BofA did not meet the "traditional criteria" for granting a WKSI waiver.

Initially, Division of Corporation Finance (CF) officials took the position that under the SEC's standard criteria, BofA should not receive a WKSI waiver. CF also objected to the fact that the proposed settlement was conditioned on the granting of the WKSI waiver, noting that the previous Commission had been "strongly against being presented with contingent settlement offers." CF also explained its own opposition to conditioning settlements on granting waivers because the waiver becomes a bargaining chip that can be negotiated away and thus, the impact of the collateral consequences of the antifraud provisions may be eroded.

The OIG investigation found that up until the morning of the July 30, 2009 closed Commission meeting at which the proposed settlement was to be considered, it appeared that CF would continue to oppose BofA's request for the WKSI waiver. However, at a meeting with BofA and Enforcement that

morning, BofA officials convinced CF to alter its view of BofA's WKSI waiver request. In this meeting, BofA argued that the dire state of the financial markets made it critical that it be able to raise money quickly. CF noted that although BofA did not meet the "traditional criteria" for a WKSI waiver, it decided not to oppose the waiver because of "deference given to the fact that BofA was a TARP recipient" and because "it would not be in the interest of the market or investors to prevent [BofA] from getting to the market as quickly as [its] competitors."

Thus, the OIG found that the traditional criteria for determining WKSI waiver requests were not applied to BofA. CF agreed to recommend that BofA receive a conditional WKSI waiver based upon its TARP status, and the related concern that in the economic environment denying BofA a WKSI waiver could have had an adverse impact on BofA and the entire market. The OIG found this departure from general SEC practice noteworthy, although BofA never actually received the waiver because the Court rejected the proposed settlement.

After the SEC filed the proposed settled action in the U.S. District Court for the Southern District of New York, Judge Rakoff held a hearing during which the SEC and BofA presented arguments supporting the proposed settlement. On September 14, 2009, the Court issued a Memorandum Order rejecting the SEC's proposed settlement with BofA, and opined that the SEC's normal policy was to bring actions against individuals who are responsible for securities law violations as well as the responsible issuers. The OIG investigation found that Enforcement looked at this issue after the Court rejected the proposed settlement.

The OIG investigation found that the BofA case differed from other cases where individuals were not named – notably because there was no rule change or other intervening event that made a case against individuals more difficult. Further, the OIG found that when considering whether to name individuals in its first proposed settlement of its action against BofA, members of the Enforcement team were unaware that individuals could directly violate Exchange Act Section 14(a) and Exchange Act Rule 14a-9, and as a result, the team was left to consider whether the individuals in this case could be sued successfully under Exchange Act Section 10(b) and Exchange Act Rule 10b-5 – as either direct violators or as aiders and abettors. The team then considered whether the individuals in question possessed the requisite intent for a successful 10(b)/10b-5 case, when a 14(a)/14a-9 case potentially could have been made with a lower showing of intent (negligence as opposed to scienter).

With Section 10(b)/Rule 10b-5 being considered as the only avenue available, the team decided that the evidentiary hurdle, and resulting litigation risk, were simply too high to pursue individuals. The misperception of this higher evidentiary hurdle may have been a reason why the OIG found no evidence of any substantive or significant analysis of the question of whether to charge individuals in connection with the first proposed settlement of the BofA case until after the proposed settlement was filed with the Court.

In contrast to the approach of the first Enforcement team, the second Enforcement team considered the issue of the appropriateness of naming individuals and engaged in a very substantive and thorough analysis of whether a viable legal theory existed for pursuing individuals. The second team did not appear confused about whether individuals could be charged as direct violators of Exchange Act Section 14(a) and Exchange Act Rule 14a-9, acknowledging that the SEC has historically charged individuals for direct violations of these statutes. Even after performing this substantive analysis, however, the second Enforcement team concluded that there

were insufficient legal and factual bases to charge individuals.

In addition, after the Court rejected the SEC's first proposed settlement, the second Enforcement team conducted extensive discovery, added a new claim to strengthen its litigation position and focused at great length on developing the facts necessary to file a second case alleging a failure by Merrill to disclose the fourth quarter losses. In January 2010, the Commission filed the fourth quarter losses action as a related case to the bonuses action, charging BofA with violating Section 14(a) and Rule 14a-9 by failing to disclose, prior to the December 5 shareholder meeting, the "extraordinary losses" that Merrill sustained in October and November 2008. This additional case was critical to the second proposed settlement with BofA because it created (along with the Court's rejection of the first proposed settlement) the leverage necessary to demand a larger civil monetary penalty from BofA and enhanced the prospect for a Fair Fund distribution to injured investors.

A second issue the Court identified in rejecting the first proposed settlement was that the SEC sought the standard "obey-the-law" injunction, pursuant to which a defendant neither admits nor denies the SEC's allegations of wrongdoing. The Court found the SEC's "obey-the-law" injunction ineffective because BofA maintained that it violated no federal securities laws by issuing the joint proxy statement with Merrill. Because the company believed it engaged in lawful conduct the first time, according to Judge Rakoff, the Court would be unable to hold BofA in contempt for engaging in similar conduct in the future. The OIG investigation found that "obey-the-law" injunctions, in which a defendant neither admits nor denies wrongdoing, were often sought by Enforcement for settled actions in federal court.

The second Enforcement team worked with CF to craft remedial measures that would provide a level of prophylactic relief against future misconduct that an injunction could not. These measures, known as "undertakings," were designed to remedy the alleged underlying violations and to create safeguards in the areas in which BofA was deficient to avoid a recurrence of the problem. In addition, these undertakings had the additional effect of allowing the proposed settlement to proceed without triggering the WKSI provisions that were a source of considerable discussion during the Commission's approval of the first proposed settlement.

A third major concern was the recommended civil penalty of $33 million against only the company. According to the Court, the $33 million was a "trivial penalty for a false statement that materially infected a multi-billion-dollar merger and thus, would be imposed not on the individuals putatively responsible, but on the shareholders, thus further victimizing the victims." The OIG investigated the methodology that Enforcement used to arrive at the original $33 million figure and found that members of the first BofA investigative team relied substantially on case precedent in arriving at the $33 million civil penalty figure that the Court rejected. Similarly, the Division's own Enforcement Manual provided, "If the Division agrees to make a specific enforcement recommendation to the Commission, the staff should consider the settlement terms of other similar cases to identify prior precedent involving similar alleged misconduct." In contrast, the OIG found that the second Enforcement team was not as constrained by precedent, and used leverage provided by adding the fourth quarter losses action and the Court's rejection of the first proposed settlement to reach a substantially higher penalty figure of $150 million.

The OIG investigation also found that at the time that the SEC began investigating issues related to the merger between BofA and Merrill, several other law enforcement agencies were conducting related investigations. These law enforcement agencies included the U.S. Attorney's Offices for the Southern Dis-

trict of New York and the Western District of North Carolina, the NYAG and SIGTARP.

The U.S. Attorney's Offices and the SEC made significant efforts to coordinate their investigations. Attempts between the SEC and the NYAG to coordinate the BofA investigation were less successful. In contrast to the collaborative relationship between the SEC and the U.S. Attorney's Office for the Southern District of New York, the OIG investigation found that there has historically been tension in the relationship between the SEC and the NYAG.

Prior to investigating the merger between Merrill and BofA, the SEC and the NYAG had been coordinating an investigation involving Merrill. However, SEC lawyers expressed the view that, although the NYAG provided some cooperation with the SEC during the BofA investigation, the NYAG failed to cooperate fully. According to SEC attorneys, the NYAG refused to share information and to provide certain witness transcripts requested by the SEC prior to the SEC's first and second proposed settlements. The NYAG explained why certain transcripts were not provided to the SEC in connection with the BofA investigation, noting that they were "concerned about the impact partial disclosure could have on [the NYAG] litigation . . . [as well as] on [its] ongoing investigations of other individuals."

The NYAG's refusal to produce witness transcripts to the SEC meant that the SEC did not obtain testimony for certain witnesses. Because the Court had limited the number of depositions the SEC could take, the SEC could not always remedy the NYAG's refusal to produce transcripts by deposing the same witnesses. Consequently, in making its charging decisions, there were certain witnesses whose testimony the SEC was not able to obtain, requiring the staff to rely instead on attorney proffers that were considered "not as good as a transcript." There also were concerns expressed about the SEC not sharing information with the NYAG. The NYAG stated that the "office requested copies of certain investigative materials from the SEC," but "did not receive investigative materials from the SEC in this case."

The OIG's investigation also found that SIGTARP was closely aligned with the NYAG and, therefore, was limited in the information it could share with the SEC. Further, the OIG's investigation found that concerns over SIGTARP sharing SEC investigative findings with the NYAG also kept the SEC from coordinating more fully with SIGTARP.

In or around January 2010, the Enforcement Director and the NYRO Director communicated with the NYAG about a potential global settlement in which the SEC and the NYAG would jointly announce a settlement with BofA. However, according to an SEC trial attorney, the NYAG rejected the idea of a global settlement largely because the SEC's settlement did not include a charge against individuals.

On February 4, 2010, the SEC and BofA submitted a revised proposed settlement, which the Court ultimately approved on February 22, 2010. The second settlement included a civil monetary penalty of $150 million, specific remedial undertakings that BofA was required to maintain for three years, and a Fair Fund distribution to harmed "legacy" BofA shareholders. The SEC's settlement did not include any charges against individuals. On February 4, 2010, the NYAG and SIGTARP also announced that the NYAG had filed charges against BofA and two of its executives "for violations of the Martin Act [a New York financial fraud statute], the Executive Law and common law . . . [following] a year-long investigation."

The SEC attorneys involved in the investigation asserted that even if the NYAG had cooperated fully and produced all of the requested transcripts, the SEC still would not have charged individuals at BofA. The SEC

attorneys expressed the view that they were able to ascertain what evidence the NYAG had developed and did not believe the NYAG was in possession of facts that would have led the SEC to charge individuals. However, the OIG found that greater coordination and collaboration among law enforcement agencies would have more efficiently utilized governmental resources and sped up the investigation by reducing duplication of witness interviews and other investigative efforts.

Recommendations in the Report of Investigation

The OIG did not find that any SEC employee engaged in improper conduct during the BofA investigation and two proposed settlements. The OIG, however, made recommendations for improvements in two areas. First, with respect to the WKSI waiver process, the OIG recommended that CF: (1) create clear criteria for making waiver determinations; (2) disseminate the guidance both internally and externally; and (3) in cases where the waiver decision departs from the stated criteria, articulate in a written decision or order the rationale for the departure.

Second, to address coordination issues identified in the OIG's investigation, the OIG recommended Enforcement: (1) continue the efforts undertaken by the NYRO Regional Director to increase cooperation and coordination among law enforcement agencies; (2) as part of these efforts, review the level of coordination and cooperation on current investigations and assess where improved coordination would conserve government resources; (3) in the early planning stages of investigations, assess whether other law enforcement agencies are already participating in, or should be made aware of, the subject investigation; and (4) encourage staff, where appropriate, to establish and maintain effective communication with those who are assisting in investigations and to inform supervisory personnel when they are not receiving cooperation.

Because the OIG's report of investigation was issued just prior to the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendations.

Failure to Maintain Active Bar Membership, Lack of Candor, Conflicts of Interest, Improper Use of Non-Public Information, and Abuse of Full-Time Telework Arrangement at Headquarters (Report No. OIG-520)

On August 4, 2009, the OIG opened an investigation based on a complaint alleging that an SEC Headquarters attorney had been suspended from the practice of law, but continued to work as an SEC attorney. After the OIG commenced its investigation into the attorney's alleged failure to maintain active bar membership, the OIG uncovered evidence showing that the attorney was engaged in numerous outside activities using his SEC computer, often during work hours, and expanded the scope of its investigation to include these additional issues.

During the course of its investigation, the OIG obtained and reviewed voluminous documents related to this matter, including: (1) e-mail records; (2) official personnel files; (3) time and attendance records; (4) ethics filings; (5) State bar information; and (6) U.S. Department of State records. The OIG also conducted testimonies or interviews of 11 individuals, including the subject of the investigation.

The OIG investigation revealed that the attorney had not been a member in good standing of any state bar since 2006, when he was suspended from one bar for failure to pay his bar license fees and complete his continuing legal education (CLE) credits. We learned that the attorney had previously been suspended in 2005 from the only other bar of which he was a member, also for failing to pay bar license fees and to complete the required CLE credits. Therefore, we found that the

attorney did not meet the basic condition of his employment at the SEC, *i.e.*, that he be an active member of a state bar.

The OIG investigation found that in addition to not being an active member of a state bar, as required for his SEC job, the attorney engaged in many other forms of misconduct. Specifically, related to his lack of a bar membership, the attorney misrepresented his bar status to management officials when questioned about it, lacked candor about not having knowledge of his bar suspension, and engaged in the outside practice of law, using his SEC computer, while suspended from the practice of law.

The OIG investigation further revealed that the attorney may have violated a federal criminal conflict-of-interest statute, 18 U.S.C. § 205, when he composed documents e-mailed from his SEC computer, which were used by a foreign national to assist with her U.S. Visa application. In addition, the OIG found that the attorney took SEC equipment outside of the U.S. without obtaining permission to do so, conducted work on non-public matters in an unapproved, unsecure location outside of the U.S. in violation of SEC rules, and lacked candor regarding these matters in his testimony before the OIG.

Moreover, our investigation found that the attorney gave advice, and possibly sensitive, non-public information, about SEC filings to his friend, who was outside counsel for public companies filing with the SEC, and potentially received favors in return, including a round-trip flight. The attorney also served on the board of directors of two companies that issued securities. In addition, the attorney represented a prospective professional athlete as his attorney and agent. These outside activities gave rise to an appearance of impropriety and conflicts of interest. Further, the OIG investigation revealed that the attorney often engaged in these outside activities during his core business hours and using SEC equipment.

The evidence obtained by the OIG also showed that the attorney transmitted non-public SEC information from his SEC e-mail account to his personal e-mail account and back to his SEC account on numerous occasions, in violation of SEC rules. In addition, the investigation revealed that the attorney was approved for a full-time telework arrangement, but that the attorney was sometimes unavailable or difficult to reach during the attorney's normal business hours. Moreover, we established that the attorney was away from his telework station during core business hours without requesting or using leave, as required. The evidence also established that the attorney had a history of poor communication with his supervisors. Moreover, we found that throughout his testimony before the OIG, the attorney lacked candor regarding nearly every subject about which we questioned him.

Because of the breadth and severity of his misconduct, the OIG planned to refer this matter to the appropriate U.S. Attorney's Office for a potential violation of 18 U.S.C. § 205 and practicing law without a license. In addition, we planned to refer this matter to the applicable State Bars.

The OIG issued its report of investigation to management on September 1, 2010, recommending disciplinary action against the attorney, up to and including removal. The OIG also recommended that management implement a previous OIG recommendation that SEC attorneys be required to certify annually that they are active members in good standing of a state bar. Finally, the OIG recommended that management remind employees that non-public SEC information should never be sent to non-secure computers and that attorneys should not advise those outside the SEC on particular filings, other than their specifically assigned work.

Based on the OIG recommendations, in September 2010, all SEC attorneys were notified that they were required to submit certifications to OHR that they were members in good standing of at least one bar. As of the end of the semiannual reporting period, management had not yet proposed disciplinary action against the attorney.

Improper use of Leave Without Pay to Receive Full-Time Benefits While Working Part-Time Hours by OCIE Staff (Report No. OIG-524)

On August 3, 2009, the OIG opened an investigation after receiving an anonymous complaint received through the OIG's complaint Hotline that alleged that certain SEC OCIE supervisors were working a part-time schedule by regularly using leave without pay (LWOP) and identifying themselves in the computerized payroll system as full-time employees in order to receive full-time benefits.

After reviewing current payroll records of all OCIE employees in the particular supervisory role identified in the anonymous complaint, the OIG began to investigate those supervisors who were regularly using LWOP. The OIG conducted on-the-record testimony and interviews of the subjects and an OCIE management official, and reviewed the payroll data for each of the subjects from 2005 to 2010. The OIG determined that each of these supervisors had been authorized to work reduced hours after their return from maternity leave, yet maintained their full-time status and benefits.

The investigation revealed that OCIE had developed and implemented a policy in May 2007 for maternity leave and requests to work a part-time schedule after returning from maternity leave. Specifically, OCIE allowed Headquarters employees returning from maternity leave to take an additional six months of leave before returning to work; then, after returning to work, these employees could request part-time schedules in three-month increments. The OIG investigation determined that while these supervisors invoked the Family and Medical Leave Act of 1993 (FMLA), which allows for up to 12 administrative work weeks of LWOP in a 12-month period for certain family and medical events, and entitles employees to maintain their health benefits coverage, their use of LWOP extended far beyond that granted under the FMLA.

Moreover, the actual work schedules of the OCIE supervisors examined did not conform to the limited strictures of the OCIE policy. For example, two of the supervisors examined in the investigation continued a reduced work schedule far beyond the one-year OCIE policy limitation. In addition, the OCIE policy appeared to require a reduction in benefits and leave, yet the OCIE supervisors we investigated did not have their benefits or leave reduced. The OIG investigation concluded that at least three OCIE supervisors received numerous additional benefits afforded full-time employees, when in fact they were working part-time schedules. These additional benefits related to: (1) sick and annual leave accrued; (2) health insurance premiums paid; (3) holiday pay; (4) retirement annuity and eligibility; (5) life insurance eligibility; and (6) Thrift Savings Plan contributions.

Overall, the OIG investigation found that OCIE's policy was inconsistent with federal and agency requirements. Specifically, while the U.S. Office of Personnel Management (OPM) guidance on LWOP allows managers to grant LWOP at their discretion, allowing regular use of LWOP to create a *de facto* part-time schedule and not reducing benefits conflicts with OPM regulations or guidance. OPM requires a reduction in benefits for part-time employment and extended use of LWOP. In addition, the OCIE policy, which was not extended to employees beyond OCIE Headquarters, conflicted with provisions of the SEC's Collective Bargaining Agreement (CBA), as the CBA recognizes that employees who choose to work part-time schedules are

not entitled to full-time status or benefits. In addition, the CBA did not extend benefits granted beyond those outlined in the FMLA.

In our report of investigation, we made the following recommendations:

(1) OCIE, and any other office with a similar policy, should disband the policy (*i.e.*, not allow employees to use LWOP regularly for extended periods of time to create a *de facto* part-time schedule without reducing benefits and leave accruals) and require every SEC office to follow the CBA requirements for part-time employment;

(2) OHR should conduct a comprehensive audit of all Commission employees to determine whether other employees regularly use LWOP to create a part-time or reduced work schedule, but have not had their benefits properly reduced, and provide the audit results to the OIG and Executive Director. For the employees identified in the report and others working less than a full-time schedule who have not had their benefits and leave properly reduced, OHR should recalculate the benefits and leave and attempt to recoup those improperly given. Specifically, OHR should recalculate the following for each of these employees: (1) sick and annual leave accrued; (2) health insurance premiums paid; (3) holiday pay given when they would have normally taken LWOP; (4) retirement annuity and eligibility; (5) life insurance eligibility; and (6) TSP contributions. The OIG also recommended that those employees working a reduced schedule be promptly notified of reduced leave and benefits to be effective immediately if remaining on a reduced work schedule, and that these employees be required to sign and date OHR's "Benefits Agreement for Changing Work Schedules from Full-Time to Part-Time" to show they have been informed of the reduced leave and benefits; and

(3) The Executive Director, the Associate Executive Director for OHR and the Director of OCIE should carefully examine the report of investigation to identify improvements needed in the manner in which the SEC manages and approves reduced work hours.

The OIG issued its report of investigation to management on July 23, 2010. As of the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendations.

Misrepresentation of Identity and Lack of Active Bar Membership (Report No. OIG-541)

On August 13, 2010, we opened an investigation as a result of an August 10, 2010 e-mail complaint, alleging that a Regional Office Staff Attorney had harassed the complainant's girlfriend on the internet. The complainant specifically alleged that, on two occasions during the last two years, the Staff Attorney had misrepresented himself in online chat rooms. The complainant had determined the Staff Attorney's actual identity by conducting an online search.

In addition, during the investigation, the OIG learned that the Staff Attorney had allowed his bar memberships to lapse on several occasions and for significant periods of time. The OIG discovered that the Staff Attorney is not currently an active member of a bar and has not been an active member of a bar since 2008. The OIG found that while the Staff Attorney's bar memberships have been suspended, he signed and filed a complaint on

behalf of the Commission in federal district court. Additionally, the OIG found that the Staff Attorney applied in the past year for several positions within the SEC and certified on each of those applications that he was an active member of a bar.

The OIG interviewed the complainant and took sworn on-the-record testimony of the Staff Attorney. The OIG also interviewed several representatives of state bar organizations, and other SEC staff. In addition, the OIG reviewed records provided by the bar organizations. Finally, the OIG reviewed the Staff Attorney's e-mails, his Official Personnel Folder, and a background questionnaire provided by the Staff Attorney.

The OIG found that the allegations that the Staff Attorney had misrepresented his identity online were generally substantiated. The Staff Attorney acknowledged using an e-mail address that could be associated with the SEC on the Internet, which led to the complaint being filed with the OIG.

Further, the OIG found that the Staff Attorney had not maintained active bar membership during various periods of his employment as an SEC attorney, as he was required to do, and had not been an active bar member since 2008. The OIG also found evidence that the Staff Attorney signed a complaint in federal district court misrepresenting himself as an active member of a bar, during which time he was suspended from the practice of law. In addition, on three separate occasions when applying for various promotions, the Staff Attorney had falsely certified that he was an active member of a state bar.

The OIG issued its report of investigation to management on September 8, 2010. In its report, the OIG referred this matter to management for disciplinary action, up to and including dismissal. As of the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendation. The OIG also recommended, as it has done in the past, that OHR require that SEC attorneys certify annually that they are active members of a state bar in good standing. As mentioned above, subsequent to the issuance of this report, all SEC attorneys were notified that they were required to submit certifications to OHR that they are currently members in good standing of at least one bar.

Unprofessional Conduct by Supervisor While Conducting Examination (Report No. OIG-530)

On January 7, 2010, the OIG opened an investigation as a result of information received from the OIG's complaint Hotline. The complaint alleged, among other things, that an Examinations Branch Chief in an SEC Regional Office, during the course of an SEC examination, had entered a firm and proceeded to examine documents without properly identifying himself or showing his SEC identification on two separate occasions. The complaint also alleged that after these incidents occurred, the Branch Chief had harassed the complainant, an examiner in the Regional Office by, among other things, setting unreasonable deadlines that reflected a change in policy.

In conducting this investigation, the OIG took sworn, on-the-record testimony from or interviewed nine individuals, including the Branch Chief, the complaintant and the owner of the firm being examined. The OIG also reviewed various pertinent documents, including the Regional Office's examination procedures.

The OIG investigation found evidence that the Branch Chief engaged in unprofessional behavior by failing to identify himself properly or to produce his SEC identification to employees of the firm on two separate occasions while conducting an examination of the firm. The evidence showed that during the first incident, contrary to required practice, the Branch Chief entered the firm without identifying himself or showing identifica-

tion and went to the back office where the firm's client documents were located. The evidence showed that a second, more serious incident occurred when the Branch Chief again entered the examination site without introducing himself or producing identification. We found that during this second incident, the Branch Chief responded unprofessionally to requests that he provide his identification. The investigation, however, found insufficient evidence that the Branch Chief had harassed the complainant after the identification incidents.

The OIG issued its report of investigation to management on June 27, 2010, and recommended appropriate disciplinary action against the Branch Chief. Subsequent to issuing the report of investigation, the OIG learned that the Branch Chief had resigned from the Commission.

Allegation of Failure of a Regional Office to Conduct an Adequate Investigation (Report No. OIG-529)

On May 22, 2008, the OIG opened an investigation into an anonymous complaint alleging investigative misconduct by staff of an SEC Regional Office. Specifically, the complaint alleged that Regional Office Enforcement officials failed to vigorously and diligently investigate the officers of a publicly-traded corporation for securities fraud. The complaint further alleged that the Enforcement investigation was unduly delayed, relevant evidence was not examined and management improperly removed staff from the investigation.

In our investigation, we reviewed numerous relevant documents relating to the Enforcement investigation, and nearly 1,000 e-mails, and related attachments, of the various staff attorneys assigned to the investigation, as well as of staff from other divisions and offices who were involved in the matter. Further, we took the sworn testimony of five Regional Office staff members who worked on the enforcement action between 2004 and 2009.

The OIG issued its report of investigation to management on June 8, 2010, finding no evidence that the Regional Office Enforcement investigation into securities violations and other wrongdoing by the officers of the company was negligent, despite a pronounced delay in obtaining testimony and concluding the investigation. The OIG also did not find evidence that the decision not to pursue fraud charges was unsupportable in light of the litigation risks expressed.

Further, the OIG concluded that the penalties assessed for the ill-gotten gains derived from the company's officers' fraudulent activities were supported by an analysis obtained from the SEC's Office of Economic Analysis (now part of the Division of Risk, Strategy, and Financial Innovation). However, the OIG investigation did find that certain delays in the investigation were excessive. The OIG further determined that some potential evidence may have been unexamined, likely as a result of poor communication among the Regional Office staff. Finally, while the OIG found that there was considerable turnover in the staffing of the investigation, the OIG did not uncover evidence substantiating the claim that staff members were improperly removed from the investigation in order to negate staff efforts to conduct a more aggressive investigation.

Allegations of Failure to Conduct Adequate Enforcement Investigation and Misconduct by Enforcement Attorneys (Report No. OIG-531)

The OIG opened an investigation on January 19, 2010, into allegations that Enforcement failed to properly and vigorously enforce the federal securities laws in the course of an investigation of accounting rule and insider trading violations by a publicly-traded corporation. Specifically, the com-

plainant alleged that Enforcement had improperly dropped an accounting issue that arose during its investigation and covered this up; the SEC improperly failed to pursue valid insider trading claims against corporate insiders; SEC Commissioners may not have had all the facts before they voted to approve settlements in this matter; and the complainant should have been paid a bounty. The complainant also alleged specific acts of misconduct by Enforcement staff members during the course of the investigation.

During the investigation, the OIG took the sworn, on-the-record testimony of the complainant, and of an Enforcement Assistant Director who had been in charge of the Enforcement investigation. The OIG also reviewed numerous relevant documents, including hundreds of pages of correspondence and supporting materials sent by the complainant, including his complaints to the OIG and a series of complaints he had filed with Enforcement beginning in 2002.

The OIG issued its report of investigation to management on August 11, 2010. In this report, the OIG found that the evidence did not substantiate the allegations that Enforcement improperly dropped an accounting issue and covered this up, or that the SEC improperly failed to pursue valid insider trading claims. To the contrary, the OIG found that the SEC's case against the issuer based upon fraudulent accounting resulted in a significant settlement, which was used to establish a Fair Fund to provide restitution to investors. The OIG further found that Enforcement's recommendations to the Commission on the insider trading claims were based upon its stated attempt to balance the litigation risks, the totality of the circumstances, and available SEC resources. We did not find evidence that Enforcement's recommendations, or the Commission's decisions based upon those recommendations, were an abuse of authority or *per se* improper, as the complainant had claimed.

In addition, the OIG found that the evidence did not substantiate the allegation that the SEC Commissioners may not have had all the facts before they voted to approve the settlements. The OIG found that Enforcement provided significant written information about the proposed settlements to the Commissioners, and that the Commissioners discussed the pertinent issues prior to voting to approve the settlements. The OIG also found that the complainant was not entitled to a bounty under the law that was in effect at the time because no insider trading penalty was assessed or recovered in the matter.

Further, the OIG investigation found no evidence to support the complainant's allegations that SEC staff members may have engaged in various types of inappropriate or unethical conduct, such as a *quid pro quo* with the corporate defendant, obstruction of justice, mail and wire fraud, honest services fraud, and bestowing favors in return for future employment. The OIG investigation also found insufficient evidence to support the complainant's allegation that the Enforcement Assistant Director was belligerent towards him during a telephone conversation.

Allegation of Unauthorized Disclosure of Non-Public Information (Report No. OIG-525)

The OIG opened this investigation on October 6, 2009, after receiving a letter from a trial attorney in the Public Integrity Section of the DOJ. The attorney requested that the OIG provide assistance to a Special Agent of the FBI in connection with a criminal investigation being conducted by the Public Integrity Section.

The criminal investigation involved an alleged leak by individuals who worked for the SEC at the time of the events in question regarding a recently-proposed rule. The DOJ was investigating whether SEC staff may have disclosed non-public information regarding the rule to certain individuals outside the

Commission. Specifically, the non-public information alleged to have been leaked related to how the Chairman and Commissioners planned to vote on the rule.

DOJ had requested that the OIG obtain e-mails for certain SEC staff members. Additionally, DOJ requested that the OIG search those e-mails for any e-mail messages sent or received from certain individuals outside the Commission, and provide that information to the FBI. The OIG compiled e-mails related to the search terms identified by the DOJ, and provided the FBI with a binder of all related e-mails. The OIG also provided other assistance at the FBI's request, and the OIG and the FBI conducted a joint interview of a former SEC staff member. Additionally, OIG staff attended a joint proffer of another individual.

After reviewing the e-mails obtained during the investigation, the OIG did not find any evidence that SEC staff had provided any non-public information regarding the rule at issue to anyone outside the Commission. Further, the FBI informed the OIG that the investigation into certain former SEC staff did not produce any evidence that they leaked any non-public information. As a result, this investigation was closed on July 6, 2010.

Complaint Concerning Obstruction of Justice (Report No. OIG-513)

The OIG opened this investigation on March 10, 2009, after receiving information that an SEC employee may have offered to obstruct an SEC investigation. The OIG took the sworn, on-the-record testimony of an individual who stated that he had learned of an SEC employee who allegedly had destroyed SEC investigative documents in the past, and could do so again in return for compensation. The OIG also obtained and reviewed relevant documents, including e-mails, personnel files, time and attendance records, and Commission database records from the SEC and relevant outside entities.

Due to the potential criminal nature of the allegations, the OIG contacted the DOJ Public Integrity Section. The OIG worked closely with DOJ, as well as the FBI, in the course of investigating this matter. After being questioned by the FBI, the source of the allegation recanted his story.

On September 15, 2010, the OIG issued a report describing the results of its investigation in this matter. Based upon the work performed in conjunction with DOJ and the FBI, the OIG did not find evidence that any SEC official was willing to remove SEC files for pay.

Inquiries Conducted and Memorandum Reports Issued

During this semiannual reporting period, the OIG completed a total of 23 inquiries into complaints received by the OIG. Of these inquiries, five were converted to, or included in, investigations, six resulted in the issuance of memorandum reports recommending disciplinary action, and two made other types of recommendations. In addition, the OIG issued a memorandum report recommending disciplinary action that arose out of a review completed by the OIG Office of Audits during the reporting period. Several of the most significant of the inquiries completed and memorandum reports issued during the period are described below.

Misuse of Computer Resources and Official Time (PIs: 10-30, 10-31, 10-32, and 10-59)

During the semiannual reporting period, the OIT provided the OIG with a report of employees or contractors who had received a substantial number of access request denials for websites classified as pornography by the SEC's Internet filter. In reviewing the information provided by OIT, the OIG learned that three employees and one contractor who had received a large number of access request denials had also successfully accessed

sexually explicit or sexually suggestive websites from their government-assigned computers.

The OIG conducted inquiries into the Internet activities of the three employees, and issued memorandum reports to management in all three matters on April 30, 2010. In each matter, the OIG concluded that the employee's inappropriate use of the Internet violated Commission policy and rules, as well as the Government-wide Standards of Ethical Conduct. The OIG referred all three employees to management for disciplinary action, up to and including removal.

In one matter (PI 10-30), the OIG found that an SK-7 Headquarters employee received 295 access request denials for websites classified by the Commission's Internet filter as pornography during a seven-week period. Some of these access denials occurred during normal Commission work hours. The OIG inquiry further found that the employee successfully accessed sexually explicit photographs, sometimes doing so during normal Commission work hours. Based on the OIG's referral, management proposed a 30-day suspension of the employee.

In a second matter (PI 10-31), the OIG found that an SK-13 Headquarters employee received over 10,000 access request denials for websites classified by the Commission's Internet filter as pornography during a five-and-a-half-week period. Many of the access denials were received during normal Commission work hours. The OIG inquiry further found that the employee successfully accessed sexually explicit photographs on numerous instances, and that many of these photographs were accessed during normal Commission work hours. The employee resigned from the SEC after the agency had proposed his removal based upon the OIG's referral.

In the third matter (PI 10-32), the OIG found that an SK-9 Headquarters employee received 297 access request denials for websites classified by the Commission's Internet filter as pornography during a one-month period. Many of the access denials occurred during normal Commission work hours. The OIG inquiry further found that the employee successfully accessed sexually explicit or sexually suggestive photographs, and that many of these photographs were accessed during normal Commission work hours. Based on the OIG's referral, management proposed a 30-day suspension of the employee.

The OIG also conducted an inquiry into the computer usage of the contractor who had received a substantial number of access denials classified as pornography by the Commission's Internet filter. In this matter (PI 10-59), a Headquarters contract employee had received 1,097 access request denials for websites classified by the Commission's Internet filter as pornography during a one-month period. The OIG inquiry found that the contract employee successfully accessed sexually explicit or sexually suggestive photographs and had performed an inappropriate Internet search. On July 9, 2010, the OIG issued a memorandum report to management, recommending disciplinary action. Based on the OIG's referral, the contract employee was removed from the SEC contract.

Allegations of Preferential Treatment, Improper Gifts, and Improper Solicitation of Charitable Donations (PI 09-103)

In July 2009, the Office of Inspector General (OIG) received two anonymous complaints about a then-Regional Office Branch Chief. The first complaint alleged that a Regional Office Staff Attorney had given extravagant gifts to her Branch Chief. The complaint further stated that these gifts were a factor in the Branch Chief's approval of the Staff Attorney's reduced work schedule and the Staff Attorney's receipt of several cash and time-off awards. The second complaint alleged that the Regional Office Branch Chief had asked numerous people, many of whom reported to her, for donations for various

causes. In conducting this inquiry, the OIG took sworn, on-the-record testimony and conducted interviews of Regional Office staff members and contacted the SEC's Ethics Office. The OIG also reviewed payroll records, official personnel files and e-mails.

The OIG investigation revealed that the Branch Chief had violated the federal ethics rules by soliciting charitable contributions on one occasion and accepting gifts from subordinates on several other occasions. The OIG also found that the Staff Attorney had been allowed to work an improper schedule by regularly using leave without pay to create a *de facto* part-time or reduced schedule. Additionally, the OIG found that the Staff Attorney had inappropriately received full time benefits while working a part-time schedule. The OIG concluded in a recently-issued report of investigation, OIG-524, that allowing SEC employees to regularly use leave without pay to create a *de facto* part-time schedule without reducing benefits and leave accruals is inconsistent with federal and agency requirements.

The OIG issued its memorandum report to management on September 27, 2010, and recommended that the Regional Office cease allowing the Staff Attorney to work her current, or similar, part-time schedule and receive full time benefits; and that OHR recalculate the amount of benefits and leave that the Staff Attorney should have received based on her part-time schedule and attempt to recoup those amounts improperly given. Because the OIG's report of investigation was issued just prior to the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendations.

Appearance of Impropriety With Respect to Acts Affecting a Personal Financial Interest (PI 09-04)

The OIG conducted an inquiry into a complaint questioning whether it was appropriate for an SEC Headquarters supervisor to serve on the investment committee of a non-profit organization at the same time that he was responsible for overseeing reviews of certain company filings. The OIG inquiry reviewed whether the supervisor's participation on the aforementioned committee violated any criminal conflict-of-interest statutes, the government-wide standards of ethical conduct, or Commission rules.

During its inquiry, the OIG conducted interviews of the subject of the inquiry and his supervisor and consulted with the SEC Ethics Counsel. The OIG also reviewed numerous relevant documents, including a list of the registrants over which the subject supervisor had responsibility, his Official Personnel Folder and his OGE Form 450 confidential disclosure reports.

The OIG inquiry found that the supervisor's service as a member of the investment committee, given his SEC position, created an appearance of impropriety and a very real risk that he would violate 18 U.S.C. § 208, although the OIG did not find an actual violation of that statute. The OIG further found that given the supervisor's access to a large amount of non-public information by virtue of his position at the SEC, there was an appearance that he might improperly use non-public information to advise the non-profit organization in violation of Commission rules and government-wide ethics standards. In particular, the evidence showed that the supervisor had strongly objected to a particular investment by the non-profit organization, which could have led to the appearance that he was using non-public information derived from his Commission employment to assist the non-profit organization.

On June 29, 2010, we issued a memorandum report and referred this matter to the management for appropriate remedial action, including requiring that the supervisor resign from his position as a member of the investment committee. Before management took

any action based on the OIG's referral, the supervisor resigned from his SEC position.

Failure to Follow Internal Policy Regarding Separation of a Probationary Employee (PI 09-60)

The OIG conducted an inquiry into a complaint alleging that the SEC improperly failed to provide two-weeks notice prior to terminating a former staff attorney who was serving a probationary period. In its inquiry, the OIG reviewed the applicable policies and procedures, obtained pertinent e-mails and interviewed OGC and OHR officials regarding these policies and procedures.

The OIG's inquiry found that SECR 6-18, "Use and Administration of Disciplinary Action Involving Attorneys and Personnel of the Excepted Service," provided that for employees who are within a probationary period, "[t]wo weeks notice, as a minimum, will be given unless otherwise directed by the Director of Personnel." The OIG found that there was no specific requirement in the policy that the direction to provide the waiver be in writing, and the evidence showed that a waiver had been provided verbally in the complainant's case. However, the OIG found that this waiver had not been granted by the "Director of Personnel," or the equivalent position, as was required by SECR 6-18, but rather had been granted by a subordinate OHR official.

Accordingly, because the waiver had not been granted in accordance with SEC written, albeit internal, policy on July 15, 2010, we issued a memorandum report to management concerning this matter. In this report, we recommended that OHR either follow the established procedures for the termination of probationary employees, or modify those procedures. In response to the OIG's recommendation, management informed the OIG that it intended to follow the existing policy in all future cases.

Enforcement Attorney Engaged in Prohibited Political Activity (PI 10-54)

This OIG inquiry was opened in response to an anonymous Hotline complaint, which alleged that an SEC Regional Office employee was running for political office and that this employee, who had been receiving workers compensation disability payments, "remain[ed] able bodied," inferring that he should not be claiming this disability.

The OIG investigation revealed that the subject Regional Office employee had submitted a disability claim to the Department of Labor's, Federal Employees' Compensation Act workers' compensation program in 2001 and, thereafter, began receiving workers' compensation payments. The employee has remained on the roles as an SEC employee for the duration of this claimed disability.

The OIG found that, during the period of his disability, the employee has been politically active, including registering and actively campaigning in a county election. The OIG noted that under the Hatch Act, 5 U.S.C. §§ 7321-7326, federal employees are expressly prohibited from running as candidates for a partisan political office. The race at issue was, in fact, a partisan political election and, although the employee was running as an independent candidate, he identified himself as a Democrat in his campaign platform material.

After speaking with a representative of the SEC OHR, the employee withdrew his candidacy during the pendency of the OIG inquiry into this matter. Notwithstanding his withdrawal from the race, the evidence clearly established that the employee had violated the Hatch Act by participating in a partisan political election. Thus, the OIG referred the matter to the U.S. Office of Special Counsel, Hatch Act Unit, for further review of the violation and appropriate disciplinary action.

Complaints Regarding Waste and Abuse in Federal Contracts (PI 09-110)

During the semiannual reporting period, the OIG reviewed several anonymous allegations primarily involving a Headquarters supervisor, including allegations that government funds were being wasted by the award of unnecessary and expensive contracts to outside contractors. The allegations included specific claims that the supervisor, as well as another individual working under the supervisor, showed favoritism in the award of certain contracts, and awarded contracts so that friends of these individuals who worked for the contracting entities would have jobs.

During its inquiry, the OIG obtained and reviewed the supervisor's e-mails for a 23-month period. Prior to the completion of the OIG's inquiry, the supervisor was transferred to a non-supervisory position and was no longer responsible for management of the contracts at issue. Therefore, the OIG focused its e-mail review on searching for evidence of misconduct on the part of the supervisor. The OIG's review of the supervisor's e-mails did not reveal an inappropriate relationship between the supervisor and any of the contractors, or any evidence of bribes, gratuities, or inappropriate favoritism towards a particular contractor.

However, the OIG's review disclosed issues regarding the management of contracts within the supervisor's former office, relating to (a) concerns on the part of staff that a particular, expensive contract was renewed despite the availability of a less expensive alternative, and (b) inadequate planning with regard to the definition of tasks and the level of funding required for contract projects. Because there is new management in the supervisor's former office, the OIG referred to the new office head the contract issues identified during its inquiry. The OIG also referred the contract issues identified in its review to its Office of Audits for consideration in connection with future audit work.

Allegation of Failure to Investigate Complaints (PI 09-39)

The OIG received a complaint from a member of the public, alleging that Enforcement failed to investigate securities law violations he had reported to the SEC in a series of e-mails. The OIG found that this complainant had filed twelve separate complaints with the SEC. The allegations included claims of insider trading, failures by an issuer to disclose material facts in its SEC filings, and the failure of a federal government official to file required disclosures of personal securities holdings.

As part of the inquiry, OIG staff obtained and reviewed copies of the underlying complaints sent from the individual to the SEC, the SEC's responses to those complaints, and relevant internal e-mails. We also interviewed one former and three current Enforcement attorneys. Further, we reviewed relevant SEC databases that identify and track complaints and investigations.

The OIG found that an Enforcement attorney had reviewed the complaints submitted by the complainant and concluded that, given the nature of the complaints, they would be more appropriately handled by the FBI (which the complainant indicated he had contacted), rather than through the SEC's Enforcement powers. The evidence showed that the Enforcement attorney, acting pursuant to existing protocols for handling complaints, determined that there was no basis to refer the complaint for further SEC analysis. We further found that an additional *de novo* review of these complaints was conducted after the complainant sent e-mails to the current and former SEC Chairmen and, as a result of that review, another set of Enforcement attorneys also determined that the matter was not appropriate to refer for SEC investigation.

While the OIG's inquiry revealed insufficient evidence of misconduct by SEC staff, the OIG determined that the complaints initially submitted to Enforcement would better

have been addressed in more detail. The OIG noted that subsequent to the time these complaints were received and processed, *i.e.,* in or about March 2010, the SEC implemented a completely new system for the intake of all tips, complaints and referrals, including those received by the Enforcement. Hence, the OIG found that any deficiencies in Enforcement's previous complaint-handling system had been addressed.

Improper Pre-Selection of Contractor

On September 30, 2010, the OIG issued a memorandum report to management based upon evidence of the improper pre-selection of a contractor that was disclosed by the OIG's report entitled, *Review of PRISM Automated Procurement System Support Contracts* (Report No. 486).

The OIG's report set forth evidence showing that a solicitation notice to vendors to procure project support services for the implementation of an automated procurement system included an extremely restrictive condition that vendors were required to meet in order to receive consideration for the contract award. Specifically, the solicitation required that the contractor's employees have a current SEC clearance, or had one within the last 30 days, thus excluding any contractors who did not have employees possessing such clearance. The SEC Contracting Officer's letter to offerors that accompanied the solicitation emphasized the restrictive clause and requested that offerors "please seriously consider not proposing if you have no one who qualified." The OIG found no justification in the contract file for the decision to include the restrictive clause. In addition, the OIG found that while there was a backlog of clearance requests at the time, interim clearances were granted for individuals to work at the SEC within seven to ten business days, and full clearances typically followed within 90 days of the initial clearance request.

While the above facts alone were suspicious, the OIG uncovered an e-mail that was sent before the issuance of the solicitation that evidenced an improper pre-selection for the project support contract. Specifically, an SEC contracting official sent an e-mail to another SEC employee that discussed the status of the procurement system, which clearly reflected that a particular contractor who had been working at the SEC and therefore met the restrictive condition of the solicitation, had been selected for the project support contract a week before the solicitation was issued and while the solicitation was still being prepared. This e-mail stated, in part, "It may be best to delay this meeting [on the status of the new procurement system] because we are hiring a project manager (i.e., [the contractor who was subsequently selected]) to assist with the acquisition and implementation. . . . Right now nothing is happening on the [automated procurement system] acquisition; I'm trying to prepare the solicitation for the [Project Management] support."

Based upon the clear evidence of preselection of a contractor for the automated procurement system project management support contract, the OIG referred the matter to management for appropriate disciplinary action for the senior level personnel who were responsible for the improper pre-selection.

PENDING INVESTIGATIONS

Complaint of Investigative Misconduct by Various Enforcement Attorneys

The OIG is continuing its investigation of a complaint received from counsel for a defendant in an SEC enforcement action, alleging numerous instances of misconduct by Enforcement attorneys during the course of the investigation. As noted in the previous Semiannual Report, the OIG investigation had been stayed pending a Court ruling on a motion in which the complainant made similar allegations to those contained in the initial complaint to the OIG. Because the Court had

direct jurisdiction over these similar claims, and was in a position to grant the relief sought by the complainant, the OIG had deferred further investigation of this matter pending a determination by the Court on these claims.

In September 2010, the Court entered an order denying without prejudice the complainant's motion that contained the pertinent allegations that were brought to the OIG's attention and did not address the merits of the claims. In light of the Court's ruling, the OIG decided to move forward with its investigation. The OIG intends to conclude its investigative work and issue its report of investigation during the next semiannual reporting period.

Complaint of Failure of an SEC Regional Office to Uncover Fraud and Inappropriate Conduct on the Part of a Senior-Level Official

In March 2010, the OIG received an anonymous complaint alleging that a senior-level official in the investment adviser examination program at an SEC Regional Office instructed examiners to not pursue certain "red flags" in an examination in which the SEC staff uncovered a massive fraud. The complaint further alleged that the senior official's apparent motive for these instructions was that he either performed, or was materially involved in directing, the most recent prior examination of the firm that did not uncover the fraud, although it existed at the time. In addition, the complaint alleged that a hostile work environment existed in the Regional Office as a result of management's failure to aggressively discipline the senior official after a previous OIG investigation revealed that the senior official had viewed pornographic images from an SEC computer.

During the reporting period, the OIG obtained and reviewed the e-mail records of 11 former and current SEC employees, and searched over 68,000 e-mails. We also obtained and reviewed thousands of pages of pertinent documents, including the examination files for three examinations conducted of the firm. The OIG also took the testimony of 17 witnesses who had knowledge of the facts and circumstances surrounding the allegations in the complaint. The OIG has nearly completed its investigatory work and intends to issue its report of investigation early within the next reporting period.

Allegation of Misconduct by an SEC Official Testifying Before Congress

During the reporting period, the OIG opened an investigation into allegations that an SEC official violated federal laws, as well as conduct and ethics rules, when the official testified before a Congressional Committee. The OIG researched and analyzed pertinent provisions of federal law, the government-wide ethics standards and the SEC's conduct rules. In addition, the OIG obtained and reviewed thousands of e-mails for approximately 18 SEC employees and prepared a detailed chronology of events. The OIG plans to conduct on-the-record testimony or interviews of individuals with knowledge of relevant facts and circumstances and complete its investigation during the next reporting period.

Complaint of Abusive and Intimidating Behavior

During the reporting period, the OIG commenced an investigation into an anonymous complaint that a staff member at SEC Headquarters had engaged in abusive and intimidating behavior toward contract staff, used profane language, and threatened their job security. The complaint further claimed that the staff member had lied to his supervisor about certain of these events and that his supervisor appeared to be unaware of the staff member's abusive and intimidating conduct. The complaint also alleged an inappropriate relationship between this staff member and a contract employee. Included with the anonymous complaint were the statements of seven witnesses that were submitted in support of

the complaint. The complainant requested that the statements be safeguarded to protect the privacy and job security of the contract staff, who feared retribution.

The OIG has taken the sworn testimony of 15 individuals, including both SEC staff members and contractor personnel. The OIG also conducted interviews of three other SEC staff members and additional follow-up interviews. In addition, the OIG has obtained and reviewed security camera recordings and numerous relevant documents. The OIG also obtained from OIT and searched the e-mails of ten individuals. The OIG plans to finalize its report of investigation in this matter during the next semiannual reporting period.

Allegation of Improper Access to SEC Facilities and Computer Systems

The OIG opened an investigation after receiving a complaint that at least one contractor employee worked at the SEC before having a background investigation conducted and being cleared. Specifically, it was alleged that this particular contractor employee, and possibly other contractor employees, entered SEC buildings and accessed SEC computer systems and applications for months before having a background investigation completed and being issued an SEC badge.

During the reporting period, the OIG met with and interviewed the complainant, obtained pertinent documents from the complainant and others, and obtained and reviewed e-mails of certain SEC contractor employees for the relevant time period. The OIG plans to take sworn, on-the-record testimony of the subjects of the investigation, complete its investigative work, and issue its report of investigation during the next semiannual reporting period.

Investigation Concerning the Role of Political Appointees in the Freedom of Information Act Process

The OIG opened an investigation in response to a written request from two Members of Congress. This written request expressed concern about a layer of political review of FOIA requests and Congressional information requests at another federal department. The letter requested that the OIG determine whether, and if so, the extent to which, political appointees at the SEC are made aware of information requests and have a role in request reviews or decision-making.

After receiving the Congressional request, the OIG obtained and reviewed relevant documents from the SEC's Office of Freedom of Information and Privacy Act Operations, including documents describing the process for responding to FOIA requests and a list of FOIA liaisons throughout the agency. The OIG also obtained and reviewed a list of all SEC political appointees from OHR. The OIG plans to take on-the-record testimony of relevant parties and to obtain and review pertinent e-mails. The OIG plans to issue its report of investigation prior to the end of the next semiannual reporting period.

Allegation of Procurement Violations

The OIG continued its investigation into allegations made by a whistleblower that a senior management official awarded contracts to a company in violation of the governing laws, rules, and/or policies pertaining to contracting procedures. In addition, it was alleged that the product purchased by the SEC in connection with these contracts failed to perform its intended functions, resulting in wasted agency resources.

During this reporting period, the OIG completed its review of relevant documents and obtained, reviewed, and searched e-mails for 16 SEC employees and one former SEC contractor for approximately a two-and-a-half

year period. The OIG also took the sworn testimony of 19 SEC employees and managers with knowledge of this matter. The OIG's investigative work has been completed and we expect to issue a report of investigation during the next semiannual reporting period.

Allegation of Negligence in the Conduct of an Enforcement Investigation

The OIG continued its investigation into a complaint received from a former Enforcement attorney, alleging that Enforcement committed acts of negligence in the conduct of an insider trading investigation. The complaint was based upon newly-discovered information that purportedly demonstrated that Enforcement had access to specific evidence showing that insider trading had occurred prior to the time Enforcement closed its investigation of the matter. Previously, the OIG had taken the sworn testimony of the complainant and reviewed documentation provided by the complainant.

During this reporting period, the OIG reviewed numerous documents related to the original Enforcement investigation that was closed without action, as well as documents related to a subsequent investigation of the same matter that resulted in the SEC filing a civil action. The OIG also took the sworn testimony of the Enforcement Branch Chief and Staff Attorneys who were assigned to the original insider trading investigation. The OIG's investigative work has been completed, and we expect to issue a report of investigation during the next semiannual reporting period.

Complaint of Unauthorized Disclosure of Non-Public Information

During the reporting period, the OIG continued its investigation into an allegation that non-public information provided to OCIE during the examination of a registrant was leaked to a major newspaper. The OIG has completed its review of over 500,000 e-mails for the relevant period obtained for over 20 employees, who may have viewed the non-public information shortly before that information was published in a newspaper article. During the reporting period, the OIG interviewed or took the testimony of potential witnesses and referred the matter to the DOJ. The OIG has been cooperating with the DOJ on a parallel investigation. We expect the OIG investigation to be completed during the next reporting period.

Allegation of Unauthorized Disclosure of Non-Public Information to the News Media

The OIG is conducting an investigation into a complaint from legal counsel, alleging that SEC staff disclosed non-public information of an investigation of its client to the news media in violation of SEC rules and regulations governing the unauthorized disclosure of non-public information. Specifically, the complainant alleged that one or more persons at the SEC disclosed to a reporter from a major newspaper that its client: (1) was the subject of a non-public investigation into possible violations of the federal securities laws; (2) had reached a proposed settlement to resolve the investigation; and (3) had agreed to pay a specific dollar amount to settle the investigation.

The OIG is obtaining documents relevant to the complainant's allegations, including numerous e-mails from the relevant current and former SEC staff members and senior officials. The OIG intends to interview individuals with knowledge of the relevant facts and circumstances and expects to issue a report of investigation in the next reporting period.

Allegation of Improper Preferential Treatment and Failure to Investigate Alleged Obstruction of SEC Investigation at Regional Office

The OIG opened an investigation after receiving a complaint that attorneys at a Regional Office failed to properly investigate a prominent law firm for alleged obstruction of an ongoing SEC case, allegedly as the result of improper preferential treatment. In addition, it was alleged that Regional Office staff improperly provided information related to that matter to the law firm.

In this reporting period, the OIG met with and interviewed the complainants and took sworn, on-the-record testimony of a relevant witness. In addition, the OIG reviewed voluminous documents provided by the complainants and obtained from other sources, and prepared a chronology of events. The OIG also obtained and reviewed e-mails of ten SEC employees for the relevant period of time. The OIG plans to take the testimony of pertinent parties, complete its investigative work, and issue its report of investigation during the next semiannual reporting period.

Complaint of Violation of Post-Employment Restrictions

The OIG opened an investigation into allegations that a former employee violated federal post-employment restrictions or SEC ethics rules when the employee left the SEC and began working at an entity regulated by the SEC, as well as broader concerns with respect to the revolving door between the SEC and outside industry.

During the reporting period, the OIG researched federal law and SEC ethics guidance regarding post-employment restrictions and interviewed a staff member of the SEC's Ethics Office. In addition, the OIG reviewed more than two years of notice of representation letters submitted to the SEC pursuant to 17 C.F.R. § 200.735-8(b). The OIG also reviewed the former employee's Official Personnel Folder, as well as comment letters submitted to the SEC by the former employee's current employer. Finally, the OIG requested and obtained thousands of e-mails related to the allegations at issue. The OIG plans to search and review these e-mails and to conduct testimony of witnesses with information relevant to the investigation during the next reporting period.

Complaint of Abuse of Compensatory Time

The OIG commenced an investigation into an anonymous complaint that requested an investigation of a Headquarters employee's use of compensatory time for travel, among other potential violations. During the reporting period, the OIG obtained and analyzed relevant travel and time and attendance records for the employee. The OIG also analyzed the regulations, policies and procedures applicable to the claiming of compensatory time for travel. The OIG plans to complete its analysis and take the testimony of the employee and his supervisor during the next semiannual reporting period.

Office of Inspector General

SEMIANNUAL REPORT TO CONGRESS

REVIEW OF LEGISLATION AND REGULATIONS

During the reporting period, the OIG reviewed legislation and proposed and final rules and regulations relating to the programs and operations of the SEC, pursuant to Section 4(a)(2) of the Inspector General Act.

Significantly, during this period, Congress enacted major financial regulatory reform with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Public Law 111-203, on July 21, 2010. Prior to the passage of this legislation, the OIG reviewed and provided comments on various provisions of the proposed legislation that would significantly impact the SEC, the SEC OIG and other Inspectors General.

Specifically, on April 22, 2010, the SEC IG provided a letter to the Honorable Paul E. Kanjorski (D-Pennsylvania), Chairman of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the U.S. House of Representatives Committee on Financial Services. In that letter, the IG provided several recommendations regarding provisions of H.R. 4173, the "Wall Street Reform and Consumer Protection Act," that would expand the SEC's bounty program beyond its existing scope that was limited to insider trading cases, particularly in light of the OIG's report entitled, *Assessment of the SEC's Bounty Program*, which was issued during the previous reporting period. The IG requested that the legislation incorporate specific deficiencies indentified in the OIG's review of the SEC bounty program and mandate their implementation as part of the legislation's significant expansion of that program. In particular, the IG recommended that H.R. 4173 require that the SEC (1) develop specific criteria for recommending the award of bounties; (2) develop and post an application form that asks whistleblowers to provide certain information; (3) establish policies regarding when to follow up with whistleblowers to clarify information provided in bounty applications and/or obtain supporting documentation; and (4) develop a tracking system for all bounty applications to ensure uniformity and consistency in the process.

The SEC IG, during the reporting period, also commented on, and suggested various alternatives to, a provision of the financial reform legislation that would have required Presidential appointment and Senate confirmation of several financial regulatory agency IGs, including the SEC IG. Additionally, on June 14, 2010, the SEC IG, together with the IGs of the CFTC, the NCUA, the PBGC and

the Federal Reserve Board provided a letter to the Honorable Charles E. Grassley (R-Iowa) and the Honorable Claire McCaskill (D-Missouri), expressing the IG's support and appreciation for their leadership in crafting Amendment 4072 to S. 3217, the "Restoring American Financial Stability Act of 2010," which contained measures designed to enhance the accountability of IGs.

Subsequent to the enactment of the Dodd-Frank Act, the OIG carefully reviewed and analyzed this legislation to identify those provisions that would impact the SEC, the SEC OIG and other Offices of Inspector General. The OIG focused its review on provisions that (1) required the OIG to establish a new suggestion hotline program for SEC employees (which was implemented on September 27, 2010); (2) provided for the funding of the OIG's suggestion hotline through the newly-established Investor Protection Fund; (3) provided that the IG reports to the Commission, rather than to the SEC Chairman; and (4) required that the SEC annually provide to Congress audited financial statements of the Investor Protection Fund (which audit will be performed by the SEC OIG for the period ended September 30, 2010).

The OIG also reviewed statutes, rules, regulations and requirements, and their impact on Commission programs and operations, within the context of audits and reviews conducted during the period. For example, in one review completed during the reporting period (Report No. 480), the OIG examined the requirements of Section 13(f) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78m(f), and Commission Rule13f-1, 17 C.F.R. § 240.13f-1 promulgated thereunder, which require periodic reporting regarding the securities holdings of institutional investment managers. As a result of its review, the OIG recommended that the Division of Investment Management (IM), in consultation with the Division of Risk, Strategy, and Financial Innovation (Risk Fin), the Office of the General Counsel and the Chairman's Office, determine whether certain legislative changes to Section 13(f) should be pursued. The OIG also recommended that IM, in consultation with Risk Fin and the Chairman's Office, consider whether to recommend that the Commission adopt a rule requiring institutional investment managers to report aggregate purchases and sales of securities. In connection with its review of Section 13(f) reporting requirements and its assessment of the Division of Corporation Finance's confidential treatment processes and procedures, the OIG reviewed and analyzed the rules governing requests for confidential treatment of information filed pursuant to the Securities Act and the Exchange Act, which are found at 17 C.F.R. § 230.406 and 17 C.F.R. § 240.24b-2, respectively.

In addition, during its audit of the SEC's real property leasing procurement process (Report No. 484), the OIG reviewed the statutory provision that provided the SEC with independent leasing authority, Section 4(b)(3) of the Exchange Act, 15 U.S.C. § 78d(b)(3), as well as the applicable legislative history, House Conference Report No. 101-924, 101st Cong., 2nd Sess. 1990. In connection with its assessment of the SEC's privacy program (Report No. 485), the OIG reviewed the requirements of various statutes, rules and regulations designed to protect the privacy of individuals and prevent the disclosure of sensitive information, including the SEC Rules of the Road, SECR 24-04.A01, and SEC Implementing Instruction 24-04.02.01 (01.0), "Sensitive Data Protection," April 6, 2006. As discussed in detail in the Section of this Report on Advice and Assistance Provided to the Agency and the Government Accountability Office, the OIG reviewed and provided comments on drafts of an updated version of the Rules of the Road, Updated Version 6.0, which was finalized and posted to the Commission's Intranet site on or about June 23, 2010.

Also during the reporting period, the OIG conducted a comprehensive review of a draft

revised Systems of Record Notice for OIG Investigative Files, SEC-43. The OIG provided extensive detailed comments on the draft revised notice to the OIT's Chief Privacy Officer. In particular, the OIG's comments sought to ensure that the routine uses contained in the notice accurately and adequately described the purposes for which OIG investigative records might be disclosed outside the Commission.

Finally, in coordination with the Legislation Committee of the CIGIE and other Inspectors General, the SEC OIG closely reviewed, tracked and provided views on various legislation of interest to the Inspector General community. In addition to the financial regulatory reform measures discussed in detail above, this legislation included S. 1508, the "Improper Payments Elimination and Recovery Act of 2010," which was enacted as Public Law 111-204 on July 22, 2010; H.R. 4983, the "Transparency in Government Act of 2010"; S. 372, the "Whistleblower Protection Enhancement Act of 2009"; and H.R. 5815, the "Inspector General Authority Improvement Act of 2010." The SEC OIG also responded to survey questions regarding the need on the part of IGs for testimonial subpoena authority and the ability of federal employees to engage in whistleblowing without fear of retaliation.

SEMIANNUAL REPORT TO CONGRESS

STATUS OF RECOMMENDATIONS WITH NO MANAGEMENT DECISIONS
Management decisions have been made on all audit reports issued before the beginning of this reporting period.

REVISED MANAGEMENT DECISIONS
No management decisions were revised during the period.

AGREEMENT WITH SIGNIFICANT MANAGEMENT DECISIONS
The Office of Inspector General agrees with all significant management decisions regarding audit recommendations.

INSTANCES WHERE INFORMATION WAS REFUSED
During this reporting period, there were no instances where information was refused.

Table 1
List of Reports: Audits and Evaluations

Audit / Evaluation Number	Title	Date Issued
479	Assessment of Corporation Finance's Confidential Treatment Processes and Procedures	Sep 29, 2010
480	Review of the SEC's Section 13(f) Reporting Requirements	Sep 27, 2010
483	Audit of the FedTraveler Travel Service	Sep 22, 2010
484	Real Property Leasing Procurement Process	Sep 30, 2010
485	Assessment of the SEC's Privacy Program	Sep 29, 2010
486	Review of PRISM Automated Procurement System Support Contracts	Sep 30, 2010

Table 2
Reports Issued with Costs Questioned or Funds Put to Better Use
(including disallowed costs)

	Number of Reports	Value
A. REPORTS ISSUED PRIOR TO THIS PERIOD		
For which no management decision had been made on any issue at the commencement of the reporting period	3	$6,976,143.00
For which some decisions had been made on some issues at the commencement of the reporting period	0	$0
B. REPORTS ISSUED DURING THIS PERIOD	3	$231,363.00
TOTAL OF CATEGORIES A AND B	6	$7,207,506.00
C. For which final management decisions were made during this period	2	$30,312.00
D. For which no management decisions were made during this period	4	$2,609,575.00
E. For which management decisions were made on some issues during this period	1	$4,567,619.00
TOTAL OF CATEGORIES C, D AND E	7	$7,207,506.00

Table 3
Reports With Recommendations on Which Corrective Action Has Not Been Completed

RECOMMENDATIONS OPEN 180 DAYS OR MORE

Audit/Inspection/ Evaluation/ or Investigation # and Title	Issue Date	Summary of Recommendation
428 - Electronic Documents Program	7/25/2007	Issue program guidance.
		Develop written procedures for loading data work from the regional offices.
439 - Student Loan Program	3/27/2008	In consultation with the Union, develop a detailed distribution plan.
446B - SEC's Oversight of Bear Stearns and Related Entities: Broker-Dealer Risk Assessment (BDRA) Program	9/25/2008	Ensure the BDRA system includes financial information, staff notes and other written documentation and is used to generate management reports.
		Resolve technological problems with the BDRA system.
450 - Practices Related to Naked Short Selling Complaints and Referrals	3/8/2009	Improve analytical capabilities of the Enforcement Complaint Center's e-mail complaint system.
		Improve the Complaints, Tips and Referrals database to include additional information about and better track complaints.
		Ensure the Office of Internet Enforcement updates and resumes using previous complaint referral tracking system or develops a new system.
455 - Attorney Annual Certification of Bar Membership	9/9/2008	Require all SEC attorneys to certify annually that they are active bar members and to acknowledge that their failure to maintain active bar membership may result in referral to the appropriate authorities and/or disciplinary action.
432 - Oversight of Receivers and Distribution Agents	12/12/2007	Provide guidance and training to Division of Enforcement staff on receiver/distribution agent oversight.
433 - Corporation Finance Referrals	09/30/2008	Develop a centralized tracking system for Divisions of Enforcement and Corporation Finance staff regarding non-delinquent filer referrals.
		Enhance CF's gatekeeper role once outcome information becomes more available.

Audit/Inspection/ Evaluation/ or Investigation # and Title	Issue Date	Summary of Recommendation
456 - Public Transportation Benefit Program	3/27/2009	Implement additional management controls over regional office program operations.
458 - SEC Oversight of Nationally Recognized Statistical Rating Organizations (NRSROs)	8/27/2009	Develop measures for determining whether subscriber fees charged by the credit rating agencies are reasonable.
		Review the OIG findings on conducting examinations before issuing orders approving applications and, as appropriate, seek legislative authority to conduct examinations as part of the NRSRO application process.
		Review the OIG findings concerning Public Company Accounting Oversight Board (PCAOB) oversight of NRSRO auditors and, as appropriate, seek legislative authority to provide the PCAOB with oversight over audits of NRSROs.
		Review the OIG findings on monitoring of credit ratings and direct the recommendation of appropriate rules to implement a comprehensive credit rating monitoring requirement for NRSROs.
		Review the OIG findings on credit ratings disclosures and, as appropriate, direct the recommendation of additional rule amendments to enhance the disclosures surrounding the credit ratings process.
		Review the OIG findings on the Rule 17g-5 information disclosure program and Regulation FD and, as appropriate, direct the assessment of the potential effects on competition in the credit rating industry of the re-proposed amendments and recommend rule changes, if appropriate.
		Review the OIG findings on public comment on a firm's application and the status of competition and direct the incorporation of seeking and consideration of public comments into the SEC's NRSRO oversight process.
459 - Regulation D Exemption Process	3/31/2009	Evaluate the Electronic Data Gathering And Retrieval (EDGAR) authentication process and make necessary changes to further streamline or simplify the process.
		Analyze how other agencies have implemented authentication processes and implement any appropriate procedures.

Audit/Inspection/ Evaluation/ or Investigation # and Title	Issue Date	Summary of Recommendation
460 - Management and Oversight of Interagency Acquisition Agreements (IAAs) at the SEC	3/26/2010	Identify the universe of open interagency acquisitions and the corresponding amounts obligated and expended on each interagency acquisition, and reconcile the universe of open interagency acquisitions with the financial information maintained by the Office of Financial Management (OFM) regarding open interagency acquisitions and the corresponding amounts obligated and expended.
		Maintain interagency acquisition data in the appropriate centralized automated system to ensure appropriate access to and accuracy of data and to provide for report generation capabilities.
		Establish appropriate internal controls to provide reasonable assurance that, in the future, interagency acquisition agreement data is accurate, timely, complete and reliable.
		Develop internal written policies and procedures for administering interagency acquisitions that are based on appropriate risk assessments, address both Economy Act and Non-Economy Act acquisitions, and incorporate Federal Acquisition Regulation (FAR) Subpart 17.5, the Office of Federal Procurement Policy's (OFPP's) guidance on interagency acquisitions, and other requirements regarding interagency acquisitions, as appropriate.
		In developing written policies and procedures for assisted interagency acquisitions, incorporate the requirements of the Economy Act, the OFPP guidance on interagency acquisitions, and other controlling authorities, and coordinate with OFM to assure its minimum requirements are also included.
		Benchmark other federal agencies' written policies and procedures for interagency acquisitions when developing its IAA written policies and procedures.
		Develop written policies and procedures regarding interagency acquisitions that include timeframes and procedures for closing out Economy Act and non-Economy Act interagency acquisitions and deobligating funds for both assisted and direct acquisitions, and ensure the close-out procedures identify the Commission's process for coordinating with servicing agencies.
		Promptly identify all IAAs that have expired and have not been closed, and deobligate any funds that remain on the expired agreements.

Audit/Inspection/ Evaluation/ or Investigation # and Title	Issue Date	Summary of Recommendation
		Take action to close the interagency acquisitions identified for which the performance period expired and deobligate the $6.9 million in unused funds that remain on the interagency acquisitions, in accordance with the appropriate close-out procedures.
		Update the interagency acquisition Determinations and Findings and interagency acquisition forms to include the information required by the FAR, Treasury Financial Manual Bulletin No. 2007-03 (in consultation with the OFM), and the OFPP guidance on interagency acquisitions.
		Develop and implement appropriate procedures to review interagency acquisition cost estimates to ensure they are reasonable and properly supported.
		Assess the Mid-Atlantic Cooperative Administrative Support Unit (CASU) IAA to determine if the costs incurred are reasonable and the CASU IAA is in the best interest of the Commission.
		Consider sources of administrative support services that charge lower amounts if it is determined that the Mid-Atlantic CASU IAA does not provide the best value to the Commission.
		Provide additional training to contracting staff and customers regarding interagency acquisitions, which includes training on developing and ensuring the adequacy of statements of work and statements of objectives according to applicable guidance and requirements.
461 - Review of the Commission's Restacking Project	3/31/2009	Conduct appropriate analysis and complete and submit an Exhibit 300 to the Office of Management and Budget (OMB).
		Develop and adopt policies and procedures for investments in space consistent with OMB guidance.
464 - Notification to the OIG of Decisions on Disciplinary Actions and Settlement Agreements Involving Subjects of OIG Investigations	1/23/2009	Provide the OIG with three business days notice prior to decisions on disciplinary action.
		Provide the OIG with five business days notice prior to executing settlement agreements.

Audit/Inspection/ Evaluation/ or Investigation # and Title	Issue Date	Summary of Recommendation
465 - Review of the SEC's Compliance with the Freedom of Information Act (FOIA)	9/25/2009	Collaborate with office and division managers to review position descriptions of current FOIA/ Privacy Act staff and FOIA liaisons to include appropriate FOIA task descriptions and performance standards, and review pay grades to ensure they reflect actual FOIA responsibilities and duties.
466 - Assessment of the SEC Information Technology (IT) Investment Process	3/26/2010	Improve the oversight of IT investments to ensure that projects are in compliance with the requirements in the Capital Planning and Investment Control (CPIC) policies and procedures specifically dealing with the implementation of the control and evaluate phases of the CPIC process.
		Require status updates be provided for all ongoing projects every six months to manage resources (*i.e.,* staff, cost and time) for IT investments of $200,000 and above.
		Immediately fill the position of Assistant Director for the Project Management Office with an experienced and qualified candidate.
		Perform an assessment of the project management function to compare the current ratio of projects per project manager to the industry's acceptable ratio of projects per project manager.
		Formally delegate authority to the Chief Information Officer (CIO) necessary for the management and oversight of the CPIC process, to include the full authority to develop and execute all information technology policy, as approved by the Chairman.
		Revise 17 C.F.R. § 200.13 to provide the CIO with full authority to develop and issue IT policies and carry out the prescribed substantive responsibilities under 44 U.S.C. § 3506 and OMB Guidance M-09-02, and remove the CIO/Director of the Office of Information Technology (OIT) from under the supervision of the Executive Director or any position other than the Chairman for those substantive responsibilities.
		Revise SEC Regulation (SECR) 24-02 to add a responsibility that the division directors, office heads, and regional directors ensure that all IT investments within their responsibility adhere to the CPIC policies and procedures, and create an enforcement mechanism for the CIO and Information Officers Council to utilize when they discover investments that have been funded outside of the CPIC process.
		Conduct periodic internal reviews to ensure that the requirements in Operating Directive 24-02.01, IT Investment Management, are enforced, (*e.g.,* the requirement that two representatives from the program area be identified for all ongoing projects).

Audit/Inspection/ Evaluation/ or Investigation # and Title	Issue Date	Summary of Recommendation
		Require that all divisions and offices use OIT's project management system and update and maintain the data in the system for the investments within their program areas.
471 - Audit of the Office of Acquisitions' Procurement and Contract Management Functions	9/25/2009	Determine the universe of active and open contracts and the corresponding value of the contracts and reconcile this information with the OFM's active contract list.
		Develop an internal process to ensure procurement data is accurately and fully reported in the Federal Procurement Data System for both SEC headquarters and regional offices.
		Develop an acquisition training plan to ensure compliance with OFPP training requirements.
		Provide regional offices with oversight, including the proper use of Contracting Officer's Technical Representatives, Inspection and Acceptance Officials, Point-of-Contact personnel and other personnel who handle procurement and contracting activities.
		Revise and finalize data migration plan and include key controls or steps to ensure accuracy of migrated data.
		Re-educate the acquisition workforce on the FAR requirements that are related to time-and-materials and labor-hour contracts.
		Update SECR 10-14, Procurement Contract Administration, regarding contract closeout and ensure that it properly aligns with the FAR.
474 - Assessment of the SEC's Bounty Program	3/29/2010	Develop a communication plan to address outreach to both the public and the SEC personnel regarding the SEC bounty program, which includes efforts to make information available on the SEC's Intranet, enhance information available on the SEC's public website, and provide training to employees who are most likely to deal with whistleblower cases.

Audit/Inspection/ Evaluation/ or Investigation # and Title	Issue Date	Summary of Recommendation
		Develop and post to the SEC's public website an application form that asks the whistleblower to provide information, including, *e.g.*, (1) the facts pertinent to the alleged securities law violation and an explanation as to why the subject(s) violated the securities laws; (2) a list of related supporting documentation available in the whistleblower's possession and available from other sources; (3) a description of how the whistleblower learned about or obtained the information that supports the claim, including the whistleblower's relationship to the subject(s); (4) the amount of any monetary rewards obtained by the subject violator(s) (if known) as a result of the securities law violation and how the amount was calculated; and (5) a certification that the application is true, correct, and complete to the best of the whistleblower's knowledge.
		Establish policies on when to follow up with whistleblowers who submit applications to clarify information in the bounty applications and obtain readily available supporting documentation prior to making a decision as to whether a whistleblower's complaint should be further investigated.
		Develop specific criteria for recommending the award of bounties, including a provision that where a whistleblower relies partially upon public information, such reliance will not preclude the individual from receiving a bounty.
		Examine ways in which the Commission can increase communications with whistleblowers by notifying them of the status of their bounty requests without releasing non-public or confidential information during the course of an investigation or examination.
		Develop a plan to incorporate controls for tracking tips and complaints from whistleblowers seeking bounties into the development of the Division of Enforcement's (Enforcement's) tips, complaints and referrals processes and systems for other tips and complaints, which should provide for the collection of necessary information and require processes that will help ensure that bounty applications are reviewed by experienced Commission staff, decisions whether to pursue whistleblower information are timely made, and whistleblowers who provide significant information leading to a successful action for violation of the securities laws are rewarded.

Audit/Inspection/ Evaluation/ or Investigation # and Title	Issue Date	Summary of Recommendation
		Require that a bounty file (hard copy or electronic) be created for each bounty application, which should contain at a minimum the bounty application, any correspondence with the whistleblower, documentation of how the whistleblower's information was utilized, and documentation regarding significant decisions made with regard to the whistleblower's complaint.
		Incorporate best practices from the Department of Justice (DOJ) and the Internal Revenue Service (IRS) into the SEC bounty program with respect to bounty applications, analysis of whistleblower information, tracking of whistleblower complaints, recordkeeping practices, and continual assessment of the whistleblower program.
		Set a timeframe to finalize new policies and procedures for the SEC bounty program that incorporate the best practices from DOJ and the IRS, as well as any legislative changes to the program.
475 - Evaluation of the SEC Privacy Program	3/26/2010	Finalize the outstanding draft privacy-related policies and procedures and implement them throughout the agency by the end of the fiscal year.
476 - Evaluation of the SEC Encryption Program	3/26/2010	Revise the encryption policy and require that all portable media be encrypted.
		Eliminate the option for divisions and offices to select whether or not they will encrypt portable media, *i.e.*, thumb drives, CD/DVDs, etc.
PI-09-05 - SEC Access Card Readers in Regional Offices	2/22/2010	Ensure, on a Commission-wide basis, that all regional offices are capable of capturing and recording building entry and exit information of Commission employees.
PI-09-07 - Employee Recognition Program and Grants of Employee Awards	3/10/2010	Review and update internal regulation and policy for the SEC's Employee Recognition Program (ERP), and post the revised regulation and/or policy to the SEC's Intranet site.
		Ensure the revised ERP regulation and/or policy specifically addresses whether informal recognition awards are authorized and, if so, what criteria, standards and approvals pertain.
		Ensure the revised ERP regulation and/or policy makes clear that appropriated funds may not be used to pay for employee parking as an award.
		Review various Budget Object Class (BOC) codes currently used for non-monetary employee awards, select the most apposite BOC and ensure all properly authorized non-monetary awards are charged to that BOC.

Audit/Inspection/ Evaluation/ or Investigation # and Title	Issue Date	Summary of Recommendation
		Approve requests to use appropriated funds for non-monetary employee awards only after ensuring an authorized agency officer has approved the awards under statutory and regulatory authority.
ROI-470 - Allegations of Conflict of Interest and Investigative Misconduct	2/24/2010	Institute procedures to require that a decision be made, documented and approved where Enforcement has informed the Commission it is continuing to consider recommending charges.
ROI-481 - Employees' Securities Transactions	3/3/2009	Have an employee's direct supervisor review a list of all pending cases in the group over the last year to compare against a list of all securities reported on Office of Government Ethics Form 450 for each employee.
		Conduct separate comprehensive and more frequent training on Commission Rule 5, its purpose and its requirements, for all SEC employees, supervisors and contractors.
ROI-491 - Allegation of Fraudulently Obtained Award Fees	3/29/2010	Make efforts to recapture a portion of additional award fees a contractor obtained based on potentially inaccurate data.
		Assign all contracts over $1 million to staff at the level of Assistant Director or higher, as well as the Office of Acquisitions, which provides oversight for various SEC acquisitions.
		Ensure there is a process to validate any additional fees awarded under contracts.
ROI-496 - Allegations of Conflict of Interest, Improper Use of Non-Public Information and Failure to Take Sufficient Action Against Fraudulent Company	1/8/2010	Consider promulgating or clarifying procedures for documenting the reasons specific issues referred to Enforcement by the Office of Compliance, Inspections and Examinations (OCIE) are not investigated.
		Consider methods to ensure no appearance of impropriety when a former SEC attorney represents a company shortly after SEC work provided specific, sensitive information related to the company.
ROI-502 - Allegations of Improper Disclosures and Assurances Given	9/30/2009	Clarify policies on disclosure of non-public information, including what constitutes non-public information related to Enforcement investigations and parameters for discretionary release.
		Clarify Commission's policies regarding under what circumstances the staff is obligated to seek formal approval before making decisions that may bind the Commission.
ROI-505 - Failure to Timely Investigate Allegations of Financial Fraud	2/26/2010	Ensure as part of changes to complaint handling system that databases used to refer complaints are updated to accurately reflect status of investigations and identity of staff.

Table 4
Summary of Investigative Activity

CASES	NUMBER
Cases Open as of 3/31/10	13
Cases Opened during 4/01/10 - 9/30/10	13
Cases Closed during 4/01/10 - 9/30/10	10
Total Open Cases as of 9/30/10	16
Referrals to Department of Justice for Prosecution	3
Prosecutions	0
Convictions	0
Referrals to Agency for Disciplinary Action	3
PRELIMINARY INQUIRIES	**NUMBER**
Inquiries Open as of 3/31/10	71
Inquiries Opened during 4/01/10 - 9/30/10	42
Inquiries Closed during 4/01/10 - 9/30/10	23
Total Open Inquiries as of 9/30/10	90
Referrals to Agency for Disciplinary Action	6
DISCIPLINARY ACTIONS	**NUMBER**
Removals (Including Resignations and Retirements)	6
Demotions	1
Suspensions	2
Reprimands	1
Warnings/Other Actions	2

Table 5
Summary of Complaint Activity

DESCRIPTION	NUMBER
Complaints Pending Disposition at Beginning of Period	7
Hotline Complaints Received	132
Other Complaints Received	232
Total Complaints Received	364
Complaints on which a Decision was Made	360
Complaints Awaiting Disposition at End of Period	11
Disposition of Complaints During the Period	
Complaints Resulting in Investigations	11
Complaints Resulting in Inquiries	42
Complaints Referred to OIG Office of Audits	9
Complaints Referred to Other Agency Components	134
Complaints Referred to Other Agencies	8
Complaints Included in Ongoing Investigations or Inquiries	21
Response Sent/Additional Information Requested	47
No Action Needed	96

Table 6
References to Reporting Requirements of the Inspector General Act

The Inspector General Act of 1978, as amended, specifies reporting requirements for semiannual reports to Congress. The requirements are listed below and indexed to the applicable pages.

Section	INSPECTOR GENERAL ACT REPORTING REQUIREMENT	PAGES
4(a)(2)	Review of Legislation and Regulations	81-83
5(a)(1)	Significant Problems, Abuses, and Deficiencies	13-18, 24-44, 48-76
5(a)(2)	Recommendations for Corrective Action	24-44, 48-76
5(a)(3)	Prior Recommendations Not Yet Implemented	91-99
5(a)(4)	Matters Referred to Prosecutive Authorities	48-76, 101
5(a)(5)	Summary of Instances Where Information Was Unreasonably Refused or Not Provided	85
5(a)(6)	List of OIG Audit and Evaluation Reports Issued During the Period	87
5(a)(7)	Summary of Significant Reports Issued During the Period	24-44, 48-76
5(a)(8)	Statistical Table on Management Decisions with Respect to Questioned Costs	89
5(a)(9)	Statistical Table on Management Decisions on Recommendations That Funds Be Put To Better Use	89
5(a)(10)	Summary of Each Audit, Inspection or Evaluation Report Over Six Months Old for Which No Management Decision Has Been Made	85
5(a)(11)	Significant Revised Management Decisions	85
5(a)(12)	Significant Management Decisions with Which the Inspector General Disagreed	85
5(a)(14)	Appendix of Peer Reviews Conducted by Another OIG	107
5(a)(15)	List of Outstanding Peer Review Recommendations Not Fully Implemented	107
5(a)(16)	List of Peer Reviews Conducted of Another OIG	107

U.S. Securities and Exchange Commission

SEMIANNUAL REPORT TO CONGRESS

APPENDIX A

PEER REVIEWS OF OIG OPERATIONS

PEER REVIEW OF THE NATIONAL CREDIT UNION ADMINISTRATION OIG'S AUDIT OPERATIONS

During the semiannual reporting period, the SEC OIG completed an external peer review of the audit activities of the National Credit Union Administration (NCUA) OIG. Based on our risk assessments, we selected for review audits conducted under generally accepted government auditing standards by the NCUA OIG that were completed during the period from April 1, 2008 to October 30, 2009. In our opinion, the system of quality control for the audit organization of the NCUA OIG in effect for the period ended October 30, 2009, was suitably designed and complied with to provide the NCUA OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. There are no outstanding recommendations in connection with the peer review and the SEC OIG's report of the NCUA OIG's audit operations is available on our website at http://www.sec-oig.gov/Reports/AuditsInspections/2010/478.pdf.

PEER REVIEW OF THE SEC OIG'S AUDIT OPERATIONS

During the semiannual reporting period, the SEC OIG did not have an external peer review conducted of its audit operations. Peer reviews of OIG audit operations are required to be conducted every three years. The most recent peer review of the SEC OIG's audit operations was conducted by the Corporation for Public Broadcasting (CPB) OIG. The CPB OIG issued its report on the SEC OIG's audit operations in January 2010. This report concluded that the SEC OIG's system of quality for its audit function was designed to meet the requirements of the quality control standards established by the U.S. Comptroller General in all material respects. The report is available on our website at http://www.sec-oig.gov/Reports/Other/CPB_PeerReviewSEC.pdf.

PEER REVIEW OF THE SEC OIG'S INVESTIGATIVE OPERATIONS

During the semiannual reporting period, the SEC OIG did not have an external peer review of its investigative operations. Peer reviews of Designated Federal Entity OIGs, such as the SEC OIG, are conducted on a voluntary basis. The most recent peer review of the SEC OIG's investigative operations was conducted by the U.S. Equal Employment Opportunity Commission (EEOC) OIG. The EEOC OIG issued its report on the SEC OIG's investigative operations in July 2007. This report concluded that the SEC OIG's system of quality for the investigative function conformed to the professional standards established by the President's Council on Integrity & Efficiency and the Executive Council on Integrity & Efficiency (now the Council of the Inspectors General on Integrity & Efficiency).

APPENDIX B

Written Testimony of H. David Kotz
Inspector General of the
Securities and Exchange Commission

Before the U.S. Senate
Committee on Banking, Housing and Urban Affairs

Wednesday, September 22, 2010
10:00 a.m.

Introduction

Thank you for the opportunity to testify before this Committee on the subject of "Oversight of the SEC's Inspector General's Report on the 'Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme' and Improving SEC Performance." I appreciate the interest of the Chairman, the Ranking Member, as well as the other members of the Committee, in the Securities and Exchange Commission (SEC or Commission) and the Office of Inspector General (OIG). In my testimony, I am representing the OIG, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

I would like to begin my remarks by briefly discussing the role of my Office and the oversight efforts we have undertaken during the past few years. The mission of the Office of Inspector General is to promote the integrity, efficiency and effectiveness of the critical programs and operations of the SEC. The SEC Office of Inspector General includes the positions of the Inspector General, Deputy Inspector General, Counsel to the Inspector General, and has staff in two major areas: Audits and Investigations.

Our audit unit conducts, coordinates and supervises independent audits and evaluations related to the Commission's internal programs and operations. The primary purpose of conducting an audit is to review past events with a view toward ensuring compliance with applicable laws, rules and regulations and improving future performance. Upon completion of an audit or evaluation, the OIG issues an independent report that identifies any deficiencies in Commission operations, programs, activities or functions and makes recommendations for improvements in existing controls and procedures.

The Office's investigations unit responds to allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff and contractors. We carefully review and analyze the complaints we receive and, if warranted, conduct a preliminary inquiry or full investigation into a matter. The misconduct investigated ranges from fraud and other types of criminal conduct to violations of Commission rules and policies and the Government-wide conduct standards. The investigations unit conducts thorough and independent investigations into allegations received in accordance with the applicable Quality Standards for Investigations. Where allegations of criminal conduct are involved, we notify and work with the Department of Justice and the Federal Bureau of Investigation as appropriate.

Audit Reports

Over the past 2½ years since I became the Inspector General of the SEC, our audit unit has issued numerous reports involving matters critical to SEC programs and operations and the investing public. These have included an examination of the Commission's oversight of Bear Stearns and the factors that led to its collapse, an audit of the SEC Division of Enforcement's (Enforcement's) practices related to naked short selling complaints and referrals, a review of the SEC's bounty program for whistleblowers, and an analysis of the SEC's oversight of credit rating agencies. In addition, following a comprehensive investigative report related to the Madoff Ponzi scheme in which our Office identified systematic breakdowns in the manner in

which the SEC conducted its examinations and investigations (discussed in more detail below), we performed three comprehensive reviews providing the SEC with 69 specific and concrete recommendations to improve the operations of both Enforcement and the Office of Compliance Inspections and Examinations (OCIE).

Investigative Reports

The Office's investigations unit has also conducted numerous comprehensive investigations into significant failures by the SEC in accomplishing its regulatory mission, as well as investigations of allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff members and contractors. Several of these investigations involved senior-level Commission staff and represent matters of great concern to the Commission, Congressional officials and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including removal of employees from the Federal service, as well as recommendations for improvements in agency policies, procedures and practices.

Specifically, we have issued investigative reports regarding a myriad of allegations, including claims of failures by Enforcement to pursue investigations vigorously or in a timely manner, improper securities trading by Commission employees, conflicts of interest by Commission staff members, unauthorized disclosure of non-public information, whistleblower allegations of contract fraud, preferential treatment given to prominent persons, retaliatory termination, perjury by supervisory Commission attorneys, failure of SEC attorneys to maintain active bar status, falsification of federal documents, and the misuse of official position, government resources and official time. In August 2009, we issued a 457-page report of investigation analyzing the reasons why the SEC failed to uncover Bernard Madoff's $50 billion Ponzi scheme. More recently, we issued a thorough and comprehensive report of investigation regarding the history of the SEC's examinations and investigations of Robert Allen Stanford's (Stanford's) $8 billion alleged Ponzi scheme, which report is discussed in detail below and is the subject of this hearing.

Commencement of Stanford Investigation

On October 9, 2009, I received a letter from the Ranking Member of this Committee, the Honorable Richard Shelby, and the Honorable David Vitter requesting a comprehensive investigation of the handling of the SEC's investigation into Robert Allen Stanford and his various companies, including the history of all the SEC's investigations and examinations regarding Stanford. On October 13, 2009, the OIG opened our investigation into the Stanford matter.

Document and E-mail Review

Between October 13, 2009 and February 16, 2010, the OIG investigative team made numerous requests to the SEC's Office of Information Technology (OIT) for the e-mails of current and former SEC employees for various periods of time pertinent to the investigation. The e-mails were received, loaded onto computers with specialized search tools and searched on a continuous basis throughout the course of our investigation.

In all, OIT provided e-mails for a total of 42 current and former SEC employees for various time periods pertinent to the investigation, ranging from 1997 to 2009. We estimate that we obtained and searched over 2.7 million e-mails during the course of the investigation.

On October 27, 2009, we sent comprehensive document requests to both Enforcement and OCIE specifying the documents and records we required to be produced for the investigation. We carefully reviewed and analyzed the information we received as a result of our document production requests. These documents included all records relating to the SEC's Fort Worth office's examinations in 1997 of Stanford Group Company's Broker-Dealer, in 1998 of Stanford Group Company's Investment Advisor, in 2002 of Stanford Group Company's Investment Advisor, and in 2004 of Stanford Group Company's Broker-Dealer. These also included investigative records relating to the Fort Worth office's 1998 inquiry regarding Stanford Group Company and its investigation of Stanford Group Company, which was opened in 2006.

We also sought and reviewed documents from the Financial Industry Regulatory Authority (FINRA), including documents concerning communications between FINRA or its predecessor, the National Association of Securities Dealers (NASD), and the SEC concerning Stanford, and FINRA documents pertaining to the SEC's examinations and inquiries regarding Stanford.

Testimony and Interviews

The OIG conducted 51 testimonies and interviews of 48 individuals with knowledge of facts or circumstances surrounding the SEC's examinations and/or investigations of Stanford and his firms. I personally led the questioning in the testimony and interviews of the witnesses in this investigation.

Specifically, we conducted on-the-record and under oath testimony of 28 individuals, including all of the relevant examiners and investigators who worked on SEC matters relating to Stanford. We also conducted interviews of 20 other witnesses, including former SEC employees, whistleblowers, victims of the alleged Ponzi scheme, and officials from the Texas State Securities Board.

Issuance of Comprehensive Report of Investigation

On March 31, 2010, we issued to the Chairman of the SEC a comprehensive report of our investigation in the Stanford matter containing over 150 pages of analysis and 200 exhibits. The report of investigation detailed all of the SEC's examinations and investigations of Stanford from 1997 through 2009 and the agency's response to all complaints it received regarding the activities of Stanford's companies, tracing the path of these complaints through the Commission from their inception and reviewing what, if any, investigative or examination work was conducted with respect to the allegations in the complaints.

Results of the OIG's Stanford Investigation

The OIG's investigation determined that the SEC's Fort Worth office was aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme, having come to that conclusion a mere two years after Stanford Group Company, Stanford's investment adviser, registered with the SEC in 1995. We found that over the next eight years, the SEC's Fort Worth Examination group conducted four examinations of Stanford's operations, finding in each examination that the certificates of deposit (CDs) Stanford was promoting could not have been "legitimate," and that it was "highly unlikely" that the returns Stanford claimed to generate could have been achieved with the purported conservative investment approach utilized. The SEC's Fort Worth examiners conducted examinations of Stanford in 1997, 1998, 2002 and 2004, concluding in each instance that Stanford's CDs were likely a Ponzi scheme or similar fraudulent scheme. The only significant difference in the examination group's findings over the years was that the potential fraud was growing exponentially, from $250 million to $1.5 billion.

The first SEC examination occurred in 1997, just two years after Stanford Group Company began operations. After reviewing Stanford Group Company's annual audited financial statements in 1997, a former branch chief in the Fort Worth Broker-Dealer Examination group stated that, based simply on her review of the financial statements, she "became very concerned" about the "extraordinary revenue" from the CDs and immediately suspected the CD sales were fraudulent. In August 1997, after just six days of field work in an examination of Stanford, the examiners concluded that Stanford International Bank's statements promoting the CDs appeared to be misrepresentations. The examiners noted that while the CD products were promoted as being safe and secure, with investments in "investment-grade bonds," the interest rate, combined with referral fees of between 11% and 13.75% annually, was simply too high to be achieved through the purported low-risk investments.

The branch chief concluded after the 1997 examination was finished that the CDs declared above-market returns were "absolutely ludicrous" and that the high referral fees paid for selling the CDs indicated that they were not "legitimate CDs." The Assistant District Administrator for the Fort Worth Examination program concurred, noting that there were "red flags" about Stanford's operations that caused her to believe Stanford Group Company was operating a Ponzi scheme, specifically noting the fact that the interest being paid on these CDs "was significantly higher than what you could get on a CD in the United States." She further concluded that it was "highly unlikely" that the returns Stanford claimed to generate could be achieved with the conservative investment approach Stanford claimed to be using.

In the SEC's internal tracking database, where it recorded information about its examinations, the Broker-Dealer Examination group characterized its conclusion from the 1997 examination of Stanford Group Company as "Possible misrepresentations. Possible Ponzi scheme." Our investigation found that in 1997, the examination staff determined, as a result of their findings, that an investigation of Stanford by the Fort Worth Enforcement group was warranted, and referred a copy of their examination report to the Enforcement group for review and disposition. In fact, when the former Assistant District Administrator for the Fort Worth Examination program retired in 1997, her "parting words" to the aforementioned branch chief

were to "keep your eye on these people [referring to Stanford] because this looks like a Ponzi scheme to me and some day it's going to blow up."

We also found that in June 1998, the Investment Adviser Examination group in Fort Worth began another examination of Stanford Group Company. This Investment Adviser examination arrived at the same conclusions that the broker-dealer examination had reached. The Investment Adviser examiners found very suspicious Stanford's "extremely high interest rates and extremely generous compensation" in the form of annual recurring referral fees, as well as the fact that Stanford Group Company was so "extremely dependent upon that compensation to conduct its day-to-day operations."

In November 2002, the SEC's Investment Adviser Examination group conducted yet another examination of Stanford Group Company. In this examination, the staff identified the same red flags that had been noted in the previous two examinations, including the fact that "the consistent, above-market reported returns" were "very unlikely" to be able to be achieved with Stanford's investments.

The Investment Adviser examiners also found that the list of investors provided by Stanford Group Company was inaccurate, as the list they received of the CD holders was inconsistent with the total CDs outstanding based upon referral fees. The examiners noted that although they did follow up with Stanford Group Company about this discrepancy, they never obtained "a satisfactory response, and a full list of investors."

After the examiners began this third examination of Stanford, the SEC received multiple complaints from outside entities reinforcing and bolstering the examiners' suspicions about Stanford's operations. However, the SEC failed to follow up on these complaints or take any action to investigate them. On December 5, 2002, the SEC received a complaint from a citizen of Mexico, who raised the same concerns the examination staff had raised. While the examiners characterized the concerns expressed in this complaint as "legitimate," we found that the SEC did not respond to the complaint and did not take any action to investigate the claims made therein.

In 2003, the SEC Enforcement staff received two new complaints that Stanford was a Ponzi scheme, but we found that nothing was done to pursue either of them. On August 4, 2003, the SEC was forwarded a letter that discussed several similarities between a known Ponzi scheme and Stanford's operations. Then, on October 10, 2003, the NASD forwarded a letter dated September 1, 2003, from an anonymous Stanford insider to the SEC's Office of Investor Education and Advocacy, which stated, in pertinent part:

> STANFORD FINANCIAL IS THE SUBJECT OF A LINGERING CORPORATE FRAUD SCANDAL PERPETUATED AS A "MASSIVE PONZI SCHEME" THAT WILL DESTROY THE LIFE SAVINGS OF MANY; DAMAGE THE REPUTATION OF ALL ASSOCIATED PARTIES, RIDICULE SECURITIES

> AND BANKING AUTHORITIES, AND SHAME THE UNITED STATES OF AMERICA.

Our investigation found that while this letter was minimally reviewed by various Enforcement staff, the Enforcement group decided not to open an investigation or even an inquiry into the complaint. The Enforcement branch chief responsible for the decision explained his rationale as follows:

> [R]ather than spend a lot of resources on something that could end up being something that we could not bring, the decision was made to – to not go forward at that time, or at least to – to not spend the significant resources and – and wait and see if something else would come up.

In October 2004, the Fort Worth Examination staff conducted a fourth examination of Stanford Group Company. The examiners once again analyzed the CD returns using data about the past performance of the equity markets and concluded that Stanford Group Company's sales of the CDs violated numerous federal securities laws.

While the Fort Worth Examination group made multiple efforts after each examination of Stanford Group Company to convince the Enforcement group to open and conduct an investigation of Stanford, we found that the Enforcement group made no meaningful effort to investigate the potential fraud or to consider an action to attempt to stop it until late 2005. In 1998, the Enforcement group opened a brief inquiry, but then closed it after only three months, when Stanford failed to produce documents evidencing fraud in response to a voluntary document request. In 2002, no investigation was opened even after the examiners specifically identified in an examination report multiple violations of securities laws by Stanford. In 2003, after receiving the three separate complaints about Stanford's operations, the Enforcement group decided not to open up an investigation or even an inquiry, and did not follow up to obtain more information about the complaints.

In late 2005, after a change in leadership in the Enforcement group and in response to the continuing pleas by the Fort Worth examiners, who had been watching the potential fraud grow in examination after examination, the Enforcement group finally agreed to seek a formal order from the Commission to investigate Stanford. However, even at that time, the Enforcement group missed an opportunity to have the SEC bring an action against Stanford Group Company for its admitted failure to conduct any due diligence regarding Stanford's investment portfolio. Such an action could have potentially halted the sales of the Stanford International Bank CDs though the Stanford Group Company investment adviser, and would have provided investors and prospective investors with notice that the SEC considered Stanford Group Company's sales of the CDs to be fraudulent. We found that this particular action was not considered, partially because the new head of the Enforcement group in Fort Worth was not aware of the findings of the Investment Adviser group's examinations in 1998 and 2002, or even that Stanford Group Company had registered as an investment adviser, a fact she learned for the first time in the course of our investigation in January 2010.

We did not find that the reluctance on the part of the SEC's Fort Worth Enforcement group to investigate Stanford was related to any improper professional, social or financial relationship on the part of any current or former SEC employee. We found evidence, however, that SEC-wide institutional influence did factor into the Enforcement group's repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. We found that senior Fort Worth officials perceived that they were being judged on the numbers of cases they brought, so-called "stats," and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered "quick-hit" or slam-dunk" cases, were not encouraged.

We also found that a former head of Enforcement in Fort Worth, who played a significant role in multiple decisions over the years to quash investigations of Stanford, sought to represent Stanford on three separate occasions after he left the Commission, and in fact, represented Stanford briefly in 2006 before he was informed by the SEC Ethics Office that it was improper for him to do so.

Our investigation revealed that this individual while working at the SEC was responsible for decisions: (1) in 1998 to close an inquiry opened regarding Stanford after the 1997 examination; (2) in 2002, in lieu of responding to a complaint or investigating the issues it raised, to forward it to the Texas State Securities Board; (3) also in 2002, not to act on the Examination staff's referral of Stanford for investigation after its Investment Adviser examination; (4) in 2003, not to investigate Stanford after a complaint was received comparing Stanford's operations to a known fraud; (5) in 2003, not to investigate Stanford after receiving a complaint from an anonymous insider alleging that Stanford was engaged in a "massive Ponzi scheme;" and (6) in 2005, to summarily inform senior Examination staff after a presentation was made on Stanford at a quarterly summit meeting that Stanford was not a matter they planned to investigate.

Yet, in June 2005, a mere two months after leaving the SEC, this former head of the Enforcement group in Fort Worth e-mailed the SEC Ethics Office that he had been "approached about representing [Stanford] . . . in connection with (what appears to be) a preliminary inquiry by the Fort Worth office." He further stated, "I am not aware of any conflicts and I do not remember any matters pending on Stanford while I was at the Commission."

After the SEC Ethics Office denied the former head of Enforcement in Fort Worth's June 2005 request, in September 2006, Stanford retained this individual to assist with inquiries Stanford was receiving from regulatory authorities, including the SEC. The former head of Enforcement in Fort Worth met with Stanford Financial Group's General Counsel in Stanford's Miami office and billed Stanford for his time on this representation. In late November 2006, he called his former subordinate, the Assistant Director working on the Stanford matter in Fort Worth, who asked him during the conversation, "[C]an you work on this?," and in fact told him, "I'm not sure you're able to work on this." After this call, the former head of Enforcement in Fort Worth belatedly sought permission from the SEC's Ethics Office to represent Stanford. The SEC Ethics Office replied that he could not represent Stanford for the same reasons given a year earlier and he discontinued his representation.

In February 2009, immediately after the SEC sued Stanford, this same former head of Enforcement in Fort Worth contacted the SEC Ethics Office a third time about representing Stanford in connection with the SEC matter – this time to defend Stanford against the lawsuit filed by the SEC. An SEC Ethics official testified that he could not recall another instance in which a former SEC employee contacted the Ethics Office on three separate occasions trying to represent a client in the same matter. After the SEC Ethics Office informed the former head of Enforcement in Fort Worth for a third time that he could not represent Stanford, he became upset with the decision, arguing that the matter pending in 2009 "was new and was different and unrelated to the matter that had occurred before he left." When asked during our investigation why he was so insistent on representing Stanford, he replied, "Every lawyer in Texas and beyond is going to get rich over this case. Okay? And I hated being on the sidelines."

Based upon this evidence, our investigation determined that the former head of Enforcement in Fort Worth's representation of Stanford appeared to violate state bar rules that prohibit a former government employee from working on matters in which that individual participated as a government employee.

In summary, our report of investigation concluded overall that the SEC's Fort Worth office was aware since 1997 that Stanford was likely operating a Ponzi scheme after conducting examination after examination for a period of eight years, but merely watched the alleged fraud grow, and failed to take any action to stop it.

Recommendations of the OIG's Stanford Report of Investigation

We provided our Report of Investigation on the SEC's handing of the Stanford matter to the Chairman of the SEC on March 31, 2010. We recommended that the Chairman carefully review the Report's findings and share with Enforcement management the portions of the Report that related to the performance failures by those employees who still work at the SEC, so that appropriate action (which may include performance-based action, if applicable) would 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 and timely manner.

We also made numerous recommendations to improve the operations of several divisions and offices within the SEC. Specifically, we recommended that:

(1) Enforcement ensure that the potential harm to investors if no action is taken is considered as a factor when deciding whether to recommend an enforcement action, including consideration of whether this factor, in certain situations, outweighs other factors such as litigation risk;

(2) Enforcement emphasize the significance of bringing cases that are difficult, but important to the protection of investors, in evaluating the performance of an Enforcement staff member or a regional office;

(3) Enforcement consider the significance of the presence or absence of U.S. investors in determining whether to open an investigation or recommend an enforcement action that otherwise meets jurisdictional requirements;

(4) There be improved coordination between the Enforcement and OCIE on investigations, particularly those investigations initiated by an OCIE referral to Enforcement;

(5) Enforcement re-evaluate the factors utilized to determine when referral of a matter to state securities regulators, in lieu of an SEC investigation, is appropriate;

(6) There be additional training of Enforcement staff to strengthen their understanding of the laws governing broker-dealers and investment advisers; and

(7) Enforcement emphasize the need to coordinate with the Office of International Affairs and the Division of Risk, Strategy, and Financial Innovation, as appropriate, early in the course of investigations.

We also referred our Report of Investigation to the Commission's Ethics Counsel for referral to the Bar Counsel offices in the two states in which the former Head of Enforcement in Fort Worth was admitted to practice law.

Follow-up on Recommendations

My Office is committed to following up with respect to all of the recommendations made in our Stanford report to ensure that appropriate changes and improvements are made in the SEC's operations as a result of our findings. We are aware that many improvements have already been undertaken under the direction of Chairman Schapiro and Enforcement Director Khuzami as a result of the findings and many recommendations we made as a result of our Madoff investigation. We note that Enforcement has indicated that it has taken action on the recommendations of our Stanford report, and we are in the process of reviewing those actions to ensure that they are adequate and fully address the OIG's concerns. We are confident that under Chairman Schapiro's leadership, the SEC will carefully take the appropriate steps to implement fully our Stanford recommendations and ensure that fundamental changes are made in the SEC's operations so that the errors and failings we found in our investigation are properly remedied and not repeated in the future.

Similarities to Failures in the Madoff Matter

While my Office has not conducted any formal analysis of similarities between the findings in our Madoff and Stanford reports, we have identified some striking parallels between the two situations. First, in both cases, the SEC received credible and substantive complaints about possible fraud, but failed to follow up appropriately on these complaints. Second, in both the Madoff and Stanford matters, the SEC had in its possession ample evidence of potential fraud, which should have triggered thorough and comprehensive Enforcement investigations and actions. Third, and most unfortunately, in both situations, prompt and effective action on the part of the SEC could have potentially uncovered fraud and prevented investors from losing billions of dollars.

Our Office intends to remain vigilant to ensure that the SEC benefits from the lessons learned as a result of its failures in both these cases and makes the necessary improvements to ensure that such failures do not occur again in the future.

Conclusion

In conclusion, I appreciate the interest of the Chairman, the Ranking Member and the Committee in the SEC and my Office and, in particular, in the facts and circumstances pertinent to our Stanford report. I believe that the Committee's and Congress's continued involvement with the SEC is helpful to strengthen the accountability and effectiveness of the Commission. Thank you.

Testimony of H. David Kotz
Inspector General of the
Securities and Exchange Commission

Before the Financial Crisis Inquiry Commission

Wednesday May 5, 2010

Introduction

Thank you for the opportunity to testify today before this Commission on the subject of the implementation of the Securities and Exchange Commission's (SEC's or Commission's) Consolidated Supervised Entities (CSE) program and the adequacy of the SEC's oversight of The Bear Stearns Companies, Inc. (Bear Stearns) and other CSE program participants. I appreciate the interest in the SEC and the Office of Inspector General (OIG). In my testimony today, I am representing the OIG, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

The SEC OIG's mission is to promote the integrity, efficiency and effectiveness of the critical programs and operations of the SEC. This mission has become increasingly important in light of the current economic crisis facing our nation. The SEC OIG includes the positions of the Inspector General, Deputy Inspector General, Counsel to the Inspector General, and has staff in two major areas: Audits and Investigations.

Our audit unit conducts, coordinates and supervises independent audits and evaluations related to the Commission's internal programs and operations. The primary purpose of conducting an audit is to review past events with a view toward ensuring compliance with applicable laws, rules and regulations and improving future performance. Upon completion of an audit or evaluation, the OIG issues an independent report that identifies any deficiencies in Commission operations, programs, activities, or functions and makes recommendations for improvements in existing controls and procedures.

The Office's investigations unit responds to allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff and contractors. We carefully review and analyze the complaints we receive and, if warranted, conduct a preliminary inquiry or full investigation into a matter. The misconduct investigated ranges from fraud and other types of criminal conduct to violations of Commission rules and policies and the Government-wide conduct standards. The investigations unit conducts thorough and independent investigations into allegations received in accordance with the applicable Quality Standards for Investigations. Where allegations of criminal conduct are involved, we notify and work with the Department of Justice and the Federal Bureau of Investigation as appropriate.

Investigative Reports

Over the past 2½ years since I became the Inspector General of the SEC, my Office's investigative unit has conducted numerous comprehensive investigations into significant failures by the SEC in accomplishing its regulatory mission, as well as investigations of allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff members and contractors. Several of these investigations involved senior-level Commission staff and represent matters of great concern to the Commission, Congressional officials and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including removals from the Federal service, as well as recommendations for improvements in agency policies, procedures and practices.

Specifically, we have issued investigative reports regarding a myriad of allegations, including claims of Enforcement's failures to pursue investigations vigorously or in a timely manner, improper securities trading by Commission employees, improper conflicts of interest by Commission staff members, unauthorized disclosure of non-public information, whistleblower allegations of contract fraud, preferential treatment given to prominent persons, retaliatory termination, perjury by supervisory Commission attorneys, falsification of federal documents, and the misuse of official position, government resources and official time. In August 2009, we issued a 457-page report of investigation analyzing the reasons that the SEC failed to uncover Bernard Madoff's $50 billion Ponzi scheme. More recently, we issued a thorough and comprehensive report of investigation regarding the history of the SEC's examinations and investigations of Robert Allen Stanford's $8 billion alleged Ponzi scheme.

Audit Reports

Our audit unit has also issued numerous reports involving matters critical to SEC operations and the investing public. These have included audits of the Commission's CSE and broker-dealer risk assessment programs, an audit of the Division of Enforcement's (Enforcement's) practices related to naked short selling complaints and referrals, a review of Enforcement's process for recommending disgorgement waivers, and an analysis of the SEC's oversight of credit rating agencies. In addition, because our investigative report related to the Madoff Ponzi scheme identified systematic breakdowns in the manner in which the SEC conducted its examinations and investigations, we also performed three comprehensive reviews providing the SEC with 69 specific and concrete recommendations to improve the operations of both Enforcement and the Office of Compliance Inspections and Examinations (OCIE).

Bear Stearns-Related Audit Reports

One of the most significant audit reports we have prepared to date was a comprehensive report issued in September 2008, analyzing the Commission's oversight of the SEC's CSE program, through which the Commission exercised direct oversight over Bear Stearns, the Goldman Sachs Group, Inc. (Goldman Sachs), Morgan Stanley, Merrill Lynch & Co ("Merrill Lynch") and Lehman Brothers Holdings Inc. (Lehman Brothers).

The SEC initiated this audit based on a Congressional request received on April 2, 2008, from Charles E. Grassley, the Ranking Member of the United States Senate Committee on Finance, asking that the OIG analyze the Commission's oversight of CSE firms and broker-dealers subject to the Commission's risk assessment program. Specifically, Senator Grassley's letter requested a review of the Division of Trading and Market's (TM's) oversight of the five CSE firms, with a special emphasis on Bear Stearns, and asked that the OIG analyze how the CSE program was run and the adequacy of the Commission's monitoring of Bear Stearns. In response to this Congressional request, we conducted two separate audits: an audit of the CSE program as it related to Bear Stearns and an audit of TM's broker-dealer risk assessment program.

Background of the CSE Program

In 2004, the Commission adopted rule amendments under the Securities and Exchange Act of 1934, which created the voluntary CSE program. This program was established to allow the Commission to supervise certain broker-dealer holding companies on a consolidated basis. In this capacity, the Commission's supervision extended beyond the registered broker-dealer to the unregulated affiliates of the broker-dealer and the holding company itself.

A broker-dealer became a CSE by applying to the Commission for an exemption from the Commission's standard net capital rule, and the broker-dealer's ultimate holding company consenting to group-wide Commission supervision, if it did not already have a principal regulator. By obtaining an exemption from the standard net capital rule, the CSE firms' broker-dealers were permitted to compute net capital using an alternative method.

At the time of the OIG's audit fieldwork, which was subsequent to Bear Stearns' collapse in March 2008, the Commission exercised direct oversight of only four CSE firms: Goldman Sachs, Morgan Stanley, Merrill Lynch, and Lehman Brothers. On September 15, 2008, Lehman Brothers announced that it would file for bankruptcy protection, and the Bank of America announced its agreement to acquire Merrill Lynch. Both these firms had experienced serious financial difficulties. On September 21, 2008, the Federal Reserve approved (pending a statutory five-day antitrust waiting period), applications from Goldman Sachs and Morgan Stanley to become bank holding companies with the Federal Reserve as their new principal regulator.

The Collapse of Bear Stearns

Bear Stearns was a holding company that had two registered broker-dealers. Its main activities included investment banking, securities and derivatives sales and trading, clearance, brokerage and asset management. Bear Stearns was highly leveraged and had a large exposure (*i.e.*, concentration of assets) in mortgage-backed securities. Bear Stearns also had less capital and was less diversified than several other CSE firms.

In June 2007, two hedge funds that Bear Stearns managed collapsed because of subprime mortgage losses. Nearly a year later, during the week of March 10, 2008, rumors began to spread about liquidity problems at Bear Stearns. Due to Bear Stearns' lenders not rolling over secured financing, Bear Stearns began to face severe liquidity problems. As a result, on March 14, 2008, JP Morgan Chase & Co. (JP Morgan) provided Bear Stearns with emergency funding. According to Congressional testimony, after the markets closed on March 14, 2008, it became apparent that the Federal Reserve Bank of New York's (FRBNY's) funding could not stop Bear Stearns' downward spiral. On March 16, 2008, it was announced that Bear Stearns would be sold to JP Morgan, with financing support coming from the FRBNY. In May 2008, the sale of Bear Stearns was completed.

Audit Objectives and Work

The Congressional request the OIG received on April 2, 2008, noted that TM was responsible for regulating the largest broker-dealers and their associated holding companies and

requested a review of TM's oversight of the five CSE firms it directly oversaw, with a special emphasis on Bear Stearns. The request further called for the OIG to analyze how the CSE program was run, to examine the adequacy of the Commission's monitoring of Bear Stearns, and to make recommendations to improve the Commission's CSE program. The audit's objectives were to evaluate the Commission's CSE program, emphasizing the Commission's oversight of Bear Stearns and determine whether improvements were needed in the Commission's monitoring of CSE firms and its administration of the CSE program.

The audit was not intended to be a complete assessment of the multitude of events that led to Bear Stearns' collapse and, accordingly, did not purport to demonstrate any specific or direct connection between the failure of the CSE program's oversight of Bear Stearns and Bear Stearns' collapse.

Given the complexity of the subject matter, we retained an expert, Albert S. (Pete) Kyle, to provide assistance with the audit. Professor Kyle, a faculty member at the University of Maryland, is a renowned expert on many aspects of capital markets, and has conducted significant research on numerous finance-related matters. He served as a staff member of the Presidential Task Force on Market Mechanisms (the Brady Commission) after the stock market crash of 1987 and has worked as a consultant on financial topics for several government agencies.

Audit Findings

The OIG's audit identified significant deficiencies in the CSE program that warranted improvement. The CSE program's mission, as it was described on the SEC's website, provided in pertinent part:

> The regime is intended to allow the Commission to monitor for, and act quickly in response to, financial or operational weakness in a CSE holding company or its unregulated affiliates that might place regulated entities, including US and foreign-registered banks and broker-dealers, *or the broader financial system at risk.* [Emphasis added]

The audit found that the CSE program failed to carry out its mission in its oversight of Bear Stearns because, under the Commission and the CSE program's watch, Bear Stearns suffered significant financial weaknesses and the FRBNY needed to intervene during the week of March 10, 2008, to prevent significant harm to the broader financial system.

Overall, the audit found that there were significant questions about the adequacy of a number of the CSE program's requirements, given that Bear Stearns was compliant with several of these requirements, but nonetheless collapsed. In addition, the audit found that prior to Bear Stearns' collapse, TM became aware of numerous potential red flags regarding Bear Stearns' concentration of mortgage securities, high leverage, shortcomings of risk management in mortgage-backed securities and the lack of compliance with the spirit of certain Basel II

standards (*i.e.*, international standards for banking supervision), but did not take actions to limit these risk factors.

The audit further found that procedures and processes were not strictly followed. For example, the Commission issued an order that approved Bear Stearns to become a CSE prior to the completion of the inspection process. Further, the SEC's Division of Corporation Finance (Corporation Finance) did not review a Bear Stearns 10-K filing in a timely manner.

The audit also identified numerous specific concerns with the Commission's oversight of the CSE program. Some of the concerns the audit identified included:

(a) Bear Stearns was compliant with the CSE program's capital and liquidity requirements; however, its collapse raised questions about the adequacy of these requirements.

(b) Although TM was aware, prior to Bear Stearns becoming a CSE firm, that Bear Stearns' concentration of mortgage securities was increasing for several years and was beyond its internal limits, and that a portion of their mortgage securities (*e.g.,* adjustable rate mortgages) represented a significant concentration of market risk, TM did not make any efforts to limit Bear Stearns' mortgage securities concentration.

(c) Prior to the adoption of the rule amendments that created the CSE program, the broker-dealers affiliated with the CSE firms were required either to maintain a debt-to-net capital ratio of less than 15 to 1 after their first year of operation, or to have net capital not less than the greater of $250,000 or two percent of aggregate debit items computed in accordance with the *Formula for Determination of Reserve Requirements for Broker-Dealers*. However, the program did not require CSE firms to have a leverage ratio limit. Further, despite TM being aware that Bear Stearns' leverage was high and some authoritative sources describing a linkage between leverage and liquidity risk, TM made no efforts to require Bear Stearns to reduce its leverage.

(d) TM was aware that the risk management of mortgages at Bear Stearns had numerous shortcomings, including the lack of expertise by risk managers in mortgage-backed securities at various times, the lack of timely formal review of mortgage models, persistent understaffing, a proximity of risk managers to traders suggesting a lack of independence, turnover of key personnel during times of crisis, and the inability or unwillingness to update models to reflect changing circumstances. Notwithstanding this knowledge, TM missed opportunities to push Bear Stearns aggressively to address these identified concerns.

(e) There was no documentation of discussions between TM and Bear Stearns concerning scenarios involving a meltdown of mortgage market liquidity, accompanied by a fundamental deterioration of the mortgages themselves. TM appeared to identify the types of risks associated with these mortgages that evolved into the sub-prime mortgage crisis, yet did not require Bear Stearns to reduce its exposure to sub-prime loans.

(f) Bear Stearns was not compliant with the spirit of certain Basel II standards and we did not find sufficient evidence that TM required Bear Stearns to comply with these standards.

(g) TM took no actions to assess the tolerance for risk on the part of Bear Stearns' Board of Directors and senior officials (*e.g.*, the Chief Executive Officer), although we found that this was a prudent and necessary oversight procedure.

(h) Without an appropriate delegation of authority, TM authorized the CSE firms' internal audit staff to perform critical audit work involving risk management systems, instead of this work being performed by the firms' external auditors, as the rule that created the CSE program required.

(i) In June 2007, two of Bear Stearns' managed hedge funds collapsed. Subsequent to this collapse, significant questions were raised about the lack of involvement in handling the crisis by some of Bear Stearns' senior management officials. However, TM did not reassess the communication strategy component of Bear Stearns' contingency funding plan after the collapse of the hedge funds, and very significant questions were once again raised about the handling of the crisis by some of Bear Stearns' management officials during the week of March 10, 2008.

(j) The Commission issued four of the five orders approving firms (including Bear Stearns) to use the alternative capital method, and thus become CSEs, before the inspection process was completed.

(k) Corporation Finance did not review Bear Stearns' most recent 10-K filing in a timely manner. The effect of this untimely review was that Corporation Finance deprived investors of material information that they could have used to make well-informed investment decisions (*i.e.*, whether to buy/sell Bear Stearns' securities). In addition, the information obtained through the review process (*e.g.*, Bear Stearns' exposure to subprime mortgages) could have been potentially beneficial to dispel the rumors that led to Bear Stearns' collapse.

Audit Recommendations

The audit identified 26 recommendations intended to improve the Commission's oversight of the CSE firms.

The recommendations included, among others:

(a) A reassessment of guidelines and rules regarding the CSE firms' capital and liquidity levels;

(b) Taking appropriate measures to ensure that TM adequately incorporates a firm's concentration of securities into the CSE program's assessment of a firm's risk management systems and more aggressively prompts CSE firms to take appropriate actions to mitigate such risks;

(c) A reassessment of the CSE program's policy regarding leverage ratio limits;

(d) Ensuring that: (1) the CSE firms have specific criteria for reviewing and approving models used for pricing and risk management, (2) the review and approval process conducted by the CSE firms is performed in an independent manner by the CSE's risk management staff, (3) each CSE firm's model review and approval process takes place in a thorough and timely manner, and (4) limits are imposed on risk taking by firms in areas where TM determines that risk management is not adequate;

(e) Being more skeptical of CSE firms' risk models and working with regulated firms to help them develop additional stress scenarios that have not already been contemplated as part of the prudential regulation process;

(f) Greater involvement on the part of TM in formulating action plans for a variety of stress or disaster scenarios, even if the plans are informal;

(g) Taking steps to ensure that mark disputes do not provide an occasion for CSE firms to inflate the combined capital of two firms by using inconsistent marks;

(h) Encouraging the CSE firms to present risk management data in a useful manner, which is consistent with how the CSE firms use the information internally and allows risk factors to be applied consistently;

(i) Ensuring (in accordance with Basel II) that the CSEs take appropriate capital deductions for illiquid assets and stressed repos, especially stressed repos where illiquid securities are posted as collateral;

(j) Greater discussion of risk tolerance with the Boards of Directors and senior management of CSE firms to better understand whether the actions of CSE firms' staff are consistent with the desires of the Boards of Directors and senior management;

(k) Requiring compliance with the existing rule that requires external auditors to review the CSE firms' risk management control systems, or seek Commission approval in accordance with the Administrative Procedures Act for this deviation from the current rule's requirement;

(l) Ensuring that reviews of a firm's contingency funding plan includes an assessment of a CSE firm's internal and external communication strategies;

(m) Developing a formal automated process to track material issues identified by the monitoring staff to ensure they are adequately resolved;

(n) Ensuring that all phases of a firm's inspection process are completed before recommending that the Commission allow any additional CSE firms the authority to use the alternative capital method;

(o) Improving collaboration efforts among TM, Corporation Finance, OCIE, and the Office of Risk Assessment (ORA);

(p) The development by Corporation Finance of internal guidelines for reviewing filings timely and tracking and monitoring compliance with its internal guidelines; and

(q) The creation of a Task Force led by ORA with staff from TM, the Division of Investment Management, and OCIE to perform an analysis of large firms with customer accounts that hold significant amounts of customer funds and have unregulated entities, to determine the costs and benefits of supervising these firms on a consolidated basis.

The Agency's Response

On September 26, 2008, a day after the OIG issued its final audit report on the SEC's Oversight of Bear Stearns and Related Entities, former SEC Chairman Christopher Cox announced that TM would end the CSE program. Notwithstanding the closure of the program, the SEC has made efforts to implement the recommendations contained in our report and to improve its operations accordingly. Specifically, with respect to recommendations that pertained directly to the terminated CSE program, TM has, where appropriate, considered the applicability of the OIG's recommendations to its oversight of broker-dealers and has consulted with the Federal Reserve, which assumed responsibility for overseeing the activities of several firms at the holding company level. As of March 31, 2010, management had completed implementation of 23 of the 26 recommendations contained in the OIG's audit report.

Concluding Remarks

In conclusion, we appreciate the Commission's interest in the SEC and our Office and, in particular, in our audit report pertaining to the CSE program and Bear Stearns. I believe that this Commission's analysis of these matters as part of its overall evaluation of the causes of the current financial and economic crisis in the United States is beneficial to strengthening the accountability and effectiveness of the SEC. Thank you.

U.S. Securities and Exchange Commission

Additional copies of this report may be obtained by contacting the Office of Inspector General at (202) 551-6061.

The report is also available on the Inspector General's website at hhtp://www.sec-oig.gov.