
MEMORANDUM

To: Linda Thomsen

From: Mary Beth Sullivan *MBSullivan*

Date: December 12, 2007

Re: Oversight of Receivers and Distribution Agents (Report No. 432)

Attached is our evaluation report on the Oversight of Receivers and Distribution Agents. The report reflects the comments we received on prior drafts.

We hope you found the report useful and welcome any suggestions from you concerning how we could improve future evaluations and audits. The courtesy and cooperation of you and your staff are greatly appreciated.

Attachment

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OVERSIGHT OF RECEIVERS AND DISTRIBUTION AGENTS

EXECUTIVE SUMMARY

Our evaluation found that the Division of Enforcement's (Enforcement's) oversight of receivers and other third party agents (distribution agents)¹ responsible for collecting, safeguarding or disbursing assets can be enhanced through better reporting by receivers and distribution agents.

Orders appointing receivers and distribution agents do not typically specify how often, and in what format, they should report financial information about cash and non-cash assets collected by receivers and administrative costs incurred by receivers/distribution agents. Also, the Commission does not consistently track this information.

Enforcement should better ensure that receivers and/or distribution agents provide periodic, formal reports describing receivers' efforts to garner assets, administrative costs incurred and the financial condition of the assets collected. Enforcement should also request that receivers/distribution agents provide a final accounting of all assets collected and disbursed in a specified format. Enforcement should provide guidance or training to staff on receiver/distribution agent oversight.

Enforcement generally agreed with the report's findings and recommendations.

OBJECTIVES, SCOPE AND METHODOLOGY

Our objective was to review Enforcement's coordination with receivers and distribution agents and to identify improvements in Enforcement's oversight of receivers/distribution agents.

We considered the following topics:

- How often and in what format receivers/distribution agents should report their activities, administrative costs (billings; job-related expenses such as lodging and travel; professional fees paid for legal, accounting and other services), and the financial condition of the assets collected by receivers;

¹ For simplicity, we use the term "distribution agent" to include all third-party agents (except receivers) in both civil and administrative proceedings who oversee or disburse funds through an appointment outlined in a court or Commission order. Examples of third party agents include distribution consultants, fund administrators, and plan administrators.

- Whether receivers/distribution agents should provide a final accounting of all assets collected and disbursed;
- Whether Enforcement should issue staff guidance or provide training on receiver/distribution agent oversight (*e.g.*, reviewing administrative costs and drafting distribution plans); and
- Whether receivers/distribution agents should be audited at the conclusion of the receivership or funds distribution.

We discussed these topics with Enforcement staff who work with receivers and distribution agents. We reviewed documentation, such as orders appointing receivers/distribution agents, administrative costs, activity reports, and financial statements from receivers/distribution agents, and distribution plans from seven Enforcement cases (five civil cases and two administrative proceedings) in which receivers/distribution agents were appointed.

We conducted this evaluation from March 2007 to September 2007 in accordance with the Quality Standards for Inspections, issued in January 2005, by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency.

BACKGROUND

A court or the Commission may appoint a receiver or a distribution agent to safeguard assets, create a proposed distribution plan, and distribute assets in accordance with a distribution plan approved by the court or the Commission. In some administrative proceeding cases, Commission staff distribute assets.

For assets that are within the jurisdiction of the court presiding over an Enforcement civil case, the Commission typically recommends a receiver to the court. A court appoints a receiver to preserve the property of a defendant pending action against him. A receiver may be appointed when there is danger that, in the absence of such an appointment, the property could be lost, removed or dissipated. In Commission civil cases, a receiver is authorized to garner assets and take over a business or public company.

While a judge in a securities case brought by the Commission usually appoints a receiver recommended by Enforcement staff, the judge may select any qualified receiver. An Enforcement attorney typically drafts a proposed court order appointing and outlining the receiver's responsibilities. The judge may make changes to and issues the final order.

Although a receiver reports to the court (not the Commission), Commission staff monitor a receiver's activities and review a receiver's administrative costs. The judge must approve a receiver's administrative costs before the receiver is paid. Enforcement attorneys may object to any administrative costs that appear too high or unreasonable.

Other third party agents, such as distribution consultants, fund administrators and

plan administrators (distribution agents)², perform several functions similar to those performed by receivers. They may safeguard assets, develop a proposed distribution plan, and distribute assets in accordance with an approved plan. In Commission civil cases, distribution agents (unlike receivers) are not permitted to garner assets or take over a business or public company. Distribution agents may be appointed through a court order in civil cases or a Commission order in administrative proceedings. Commission staff monitor the activities of distribution agents similarly to the way they monitor receivers' activities.

Receivers and/or distribution agents should provide the courts (in civil cases) and Enforcement staff with periodic reports documenting their activities to garner assets³, administrative costs incurred, and a description of the assets garnered and disbursed (inflows and outflows). Receivers/distribution agents generally use their discretion in deciding how often, and in what format, to report this information, as the manner for reporting this information is not routinely specified in the appointment orders.

Inflows include cash and non-cash assets collected by the receiver/distribution agent and interest earned. Outflows include administrative costs, taxes, and distributions to harmed investors and the U.S. Treasury, and may also include expenses related to a business or public company taken over by a receiver.

When practicable, penalties and disgorgements collected by a receiver/distribution agent are distributed to harmed investors. One vehicle for the distribution of penalties is provided through the Fair Funds provision of Section 308(a) of the Sarbanes-Oxley Act of 2002.⁴ The Fair Funds provision allows the Commission to combine civil monetary penalties with disgorgements collected in Enforcement cases to establish funds for investors harmed by securities laws violations. Since 2002, \$8.4 billion has been ordered to be distributed to harmed investors, and \$1.8 billion has been paid out, through Fair Funds.⁵

In February 2007, Enforcement began using a new database system called Phoenix to track funds ordered and collected in civil cases and administrative proceedings. In 2008, Enforcement and OIT plan to record in Phoenix activities related to Enforcement actions, debt collections and distributions such as administrative costs and disbursements. Enforcement estimates it will take until 2008 to develop the Phoenix database and implement procedures to receive and record this information.

Previously, financial information was recorded in the Commission's Case Activity Tracking System (CATS). Phoenix can accommodate more detailed financial information than CATS did, and unlike CATS, Phoenix provides an audit trail showing changes to system data.

² See footnote 1.

³ Garnering assets refers only to receivers.

⁴ 15 U.S.C. § 7246.

⁵ GAO Report 07-830 "Securities and Exchange Commission: Additional Actions Needed to Ensure Planned Improvements Address Limitations in Enforcement Division Operations", August 2007, page 5.

RESULTS

Our interviews with Enforcement staff and review of a judgmental sample of seven cases (five civil cases and two administrative proceedings) indicated that Enforcement's oversight of receivers/distribution agents could be improved through better reporting by receivers/distribution agents. Currently, orders appointing receivers/distribution agents vary in their reporting requirements.

Enforcement staff could develop templates suggesting standard requirements in the proposed court orders they draft (for civil cases) or in the Commission orders for administrative proceedings. While each order needs to reflect the specific circumstances of a case, the templates could better ensure standard reporting requirements are included in the order.

In the seven cases we sampled, the orders appointing receivers/distribution agents required them to produce activity reports five out of seven times, statements showing administrative costs six out of seven times, reports on the financial condition of the assets collected three out of seven times and a final accounting two out of seven times. Documentation in the orders specified the frequency and format for reporting this information to a lesser extent (see Appendix).⁶

A Commission inter-office working group on distributions policy concluded in May 2007 that receivers/distribution agents currently do not use a standard format for their accounting reports. This group also found that the Commission does not have complete or consistent records showing the amount of assets overseen by receivers/distribution agents.

A report issued by the Government Accountability Office (GAO) in August 2007 concluded that Enforcement does not systematically collect or analyze key Fair Fund data, such as administrative costs incurred by consultants. GAO also concluded that Enforcement has not ensured that reports intended to provide expense data for completed Fair Fund plans contain consistent information or are analyzed. According to GAO, without such information, Enforcement's Fair Fund oversight capacity is limited.⁷

Enforcement generally agreed with this report's findings and recommendations, which are described below.

PERIODIC AND FORMALIZED REPORTING

Receivers and/or distribution agents typically report to varying degrees:

- Their activities to garner assets⁸ and planned future activities;

⁶ Even if reporting provisions are not specifically stated in a court order, receivers/distribution agents may produce documentation at their discretion or at the request of the Commission or other parties. For example, receivers/distribution agents typically report their administrative costs on a monthly or quarterly basis.

⁷ GAO report 07-830, page 6.

⁸ Activities to garner assets refers only to receivers.

- Their administrative costs; and
- The financial condition of the assets collected by receivers (including a final accounting).

The orders appointing receivers/distribution agents or related documentation, however, do not consistently require the above information to be reported. The orders also do not typically specify the reporting frequency or format (presentation).⁹ As a result, information may often be provided at the receivers'/distribution agents' discretion, in their selected format. Even if the receivers/distribution agents provide the information listed above, a lack of consistency and the high volume of receivers'/distribution agents' reports makes this information difficult to identify and review.

According to Enforcement staff, while receivers/distribution agents generally act responsibly and charge reasonable fees, they sometimes fail to discuss their current or planned activities with Enforcement staff, over-bill for their time, claim unreasonably high expenses and, in the case of receivers, undertake actions to garner assets when there is little chance of success.

Enforcement staff also told us that it is often difficult to determine the administrative costs, interest and taxes that accrued over a particular reporting period or since the inception of the receivership/collection period. Sometimes this information is not provided or, if it is, it is not separately identified. This makes it difficult to determine the current value of the assets collected, as well as a receiver's/distribution agent's aggregate administrative costs at a given time.

Financial statement reporting might be appropriate when a receiver takes over and manages a business or public company, depending on the complexity of the receivership and the amount of assets available to distribute to harmed investors. In such cases, it could be useful if a receiver provided to Enforcement periodic financial statements (*i.e.*, income statement, balance sheet, statement of cash flow, statement of owner's equity).

Periodic and formalized reporting by receivers/distribution agents would help Enforcement staff to timely review and comment on receivers'/distribution agents' reports, evaluate the reasonableness of their administrative costs, and provide the Commission with current information on the value of the assets collected and accumulated administrative costs.

Recommendation A

As discussed above, Enforcement should decide how often (*e.g.*, monthly or quarterly) and in what format receivers and/or distribution agents should submit information documenting:

⁹ Based on our evaluation, we concluded that the format for reporting a receiver's/distribution agent's administrative costs and the financial condition of the assets collected were particularly important to ensure that financial information was completely, clearly and consistently reported. The manner of reporting a receiver's activities to garner assets may be less susceptible to a prescribed format.

- Activities taken to garner assets¹⁰ and planned future activities;
- Administrative costs; and
- The financial condition of the assets collected by receivers.

Enforcement should specify the above reporting requirements in a written document (e.g., in the proposed court or Commission order appointing a receiver or distribution agent).

FINAL ACCOUNTING

Enforcement staff told us that at the conclusion of a receivership or disbursement of funds, receivers/distribution agents generally provide a detailed accounting of what assets were collected and how the assets were distributed (e.g., to pay administrative costs, disbursements to harmed investors, the U.S. Treasury and others).

Receivers/distribution agents, however, are not typically required to present the information described above in a specific format, and a final accounting requirement is not consistently specified in the appointment order¹¹ (see Appendix). Receipt of a final accounting, in a specified format, would allow Enforcement staff to determine more easily how all assets were distributed.

Recommendation B

Enforcement should request that receivers/distribution agents provide a final accounting, in a particular format, which identifies the assets collected and disbursed. The receivers/distribution agents should document the details of all inflows and outflows and the ending fund balance. Enforcement should specify this reporting provision in a written document (e.g., in the proposed court or Commission order appointing a receiver or distribution agent).

GUIDANCE ON STAFF OVERSIGHT OF RECEIVERS/DISTRIBUTION AGENTS

Enforcement staff do not currently receive training on how to work with and monitor receivers/distribution agents. Such training would better ensure that appointment orders specify receivers'/distribution agents' responsibilities and could assist Enforcement staff in identifying and objecting to excessive administrative costs. Enforcement staff to whom we spoke generally agreed that staff training on monitoring receivers/distribution agents would be useful.

The training should cover:

- 1) An explanation of the receiver's status as an independent fiduciary who has ultimate responsibility to the appointing court (not Enforcement) and how this impacts issues related to attorney/client privilege and access to

¹⁰ See footnote 8.

¹¹ A final accounting requirement for administrative proceedings is specified in Rule 1105(f) of the Commission's *Rules of Practice and Rules on Fair Fund and Disgorgement Plans*, issued January 2006.

records by receivers and Enforcement staff.

- 2) How to draft an order appointing a receiver/distribution agent and to specify the receiver's/distribution agent's reporting responsibilities in the order.
- 3) How to identify excessive billings for processing, preparation, and application fees; partner billings for work that could be completed by lower-paid attorneys or paralegals; excessive taxi or air fares; and overcharges for other job-related expenses.
- 4) How to question or to object to excessive administrative costs;
- 5) How to request information about a receiver's/distribution agent's fees, and when to suggest that a receiver/distribution agent be paid on a contingent fee basis.
- 6) Whether to recommend that a receiver/distribution agent not be permitted to charge for the preparation of billings, expenses and other fee documentation.
- 7) When it is appropriate for a receiver/distribution agent to provide the courts and Enforcement with financial statements describing the condition of assets collected and how to ensure that the costs of compiling financial statements do not outweigh the benefits to harmed investors who may receive compensation.
- 8) How to coordinate with a receiver/distribution agent and to keep informed of their current and planned activities, including understanding a receiver's strategies for garnering assets and ensuring that planned actions are cost-effective.
- 9) How to draft a distribution plan or review a plan drafted by a receiver/distribution agent.

Enforcement officials told us it would be useful if Enforcement developed written guidelines on how to manage receivers/distribution agents and a list of red flags. Additional oversight training could be included in Enforcement's chief enforcement conference, or informally by assigning more experienced staff to work with newer staff.

Recommendation C

Enforcement should provide guidance and/or training to its staff on overseeing receivers/distribution agents. The guidance and/or training should address the points listed above.

RECEIVER/DISTRIBUTION AGENT AUDIT

In any receivership or distribution, it is possible for a receiver/distribution agent to submit inflated or erroneous billings and expenses. It is also possible for a receiver/distribution agent to erroneously or fraudulently identify a person as a harmed investor who is entitled to compensation. Improper disbursements could be made to persons who submitted fabricated claims.

Currently, there are no provisions for an audit of a receiver's/distribution agent's records. An audit could include reviewing a sample of a receiver's/distribution agent's administrative costs and fund recipients.

We discussed with Enforcement the benefits and drawbacks of including a provision in the receiver/distribution agent appointment order that an audit may be conducted at the conclusion of a receivership or distribution.

Some Enforcement staff we interviewed suggested that an audit may be appropriate in certain circumstances, such as when Enforcement staff question bills or expenses, when a receiver/distribution agent fails to follow material reporting provisions specified in the appointment order, or when a receivership or distribution is unreasonably delayed. Enforcement staff also said the possibility of an audit might deter unscrupulous behavior by a receiver/distribution agent.

The majority of Enforcement staff we interviewed stated, however, that an audit is not an effective use of resources and Enforcement does not have the staff resources to conduct an audit. Hiring an outside party to conduct an audit could reduce funds distributed to harmed investors. Staff also said it is unlikely that a receiver/distribution agent would fraudulently identify a person as a harmed investor or inflate costs because doing so would risk the person's reputation and is punishable by law. In addition, receivers/distribution agents are expected to employ internal controls to address such risks.

Enforcement management said that once Enforcement adopts the recommendations already included in this report, its ongoing monitoring of receivers/distribution agents will be enhanced. Enforcement also plans to analyze and track (in the Phoenix database) the financial information it receives from receivers/distribution agents. Enforcement management stated that these types of on-going monitoring activities would make an audit unnecessary in most instances. Enforcement management also said they could request an audit of a receiver's records even if an audit provision is not included in the appointment order. Further, in an administrative proceeding, the Commission may remove a distribution agent. In court proceedings, the court, on its own initiative or on the Commission's motion, may remove the receiver/distribution agent. Management also said that receivers/distribution agents have, in the past, reduced administrative costs that were questioned by Enforcement staff. Asking a receiver/distribution agent to reduce costs could be more efficient than conducting an audit, according to Enforcement.

Based on the information provided to us by Enforcement, we are not making a recommendation regarding receiver/distribution agent audits at this time.

AGGREGATE DATA BASED ON REVIEW OF SEVEN ORDERS APPOINTING RECEIVERS/ DISTRIBUTION AGENTS

		Yes	No
1	Does the order state whether the receiver/distribution agent must produce activity reports describing his/her progress and activities? If yes:	5	2
	• Does the order state the frequency?	2	3
	• Does the order state the format?	0	5
2	Does the order state that the receiver/distribution agent must provide reports detailing his/her administrative costs? If yes:	6	1
	• Does the order state the frequency?	2	4
	• Does the order state the format?	0	6
3	Does the order state that the receiver/distribution agent must produce interim reports on the financial condition of the assets collected? If yes:	3	4
	• Does the order state the frequency?	2	1
	• Does the order state the format?	0	3
4	Does the order state that the receiver/distribution agent must provide a final accounting? If yes:	2	5
	• Does the order state the format?	1	1