



OFFICE OF
INSPECTOR GENERAL

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

MEMORANDUM

August 24, 2017

To: Jay Clayton
Chairman

From: Carl W. Hoecker 
Inspector General

Re: Review of Certain Actions Taken by Commissioner
Michael Piwowar as Acting Chairman

Attached please find the results of our review of certain actions taken by Commissioner Michael Piwowar as Acting Chairman of the U.S. Securities and Exchange Commission (SEC). The Office of Inspector General received a request from four Members of the U.S. Senate to conduct the review. We have transmitted these results directly to those Members.

We did not find that Commissioner Piwowar's actions as Acting Chairman violated any of the laws currently governing the SEC and our review identified no evidence that his actions could either undermine the SEC's mission or potentially prove to be a waste of SEC staff time and resources.

This report is provided to you for informational purposes only.

If you have any questions pertaining to this matter, please do not hesitate to contact me.

Attachment

cc: Lucas Moskowitz, Chief of Staff, Office of the Chairman
Sean Memon, Deputy Chief of Staff, Office of the Chairman
Peter Uhlmann, Managing Executive, Office of the Chairman
Michael S. Piwowar, Commissioner
Richard Grant, Counsel to the Commissioner, Office of Commissioner Piwowar
Kara M. Stein, Commissioner
Robert Peak, Advisor to the Commissioner, Office of Commissioner Stein
Robert Stebbins, General Counsel



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August 24, 2017

The Honorable Elizabeth Warren
United States Senate
317 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Brian Shatz
United States Senate
722 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Robert Menendez
United States Senate
528 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
United States Senate
713 Hart Senate Office Building
Washington, D.C. 20510

Re: Response to March 29, 2017, Request Letter

Dear Senators Warren, Brown, Menendez, and Shatz:

This letter responds to your letter of March 29, 2017, requesting that my office review certain actions taken by Securities and Exchange Commission (SEC or Commission) Commissioner Michael Piwowar during his tenure as Acting Chairman. In response, we conducted a review and below is a summary of the results.

Background

Dr. Piwowar was first appointed to the SEC by President Barack Obama and was sworn in on August 15, 2013. He was designated Acting Chairman of the SEC by President Donald Trump from January 23, 2017, to May 4, 2017, when the Senate confirmed Jay Clayton as the next Chairman of the SEC. During Commissioner Piwowar's tenure as Acting Chairman, he took actions related to SEC policy, regulation, or guidance in the following three areas: (1) Conflict Minerals rule; (2) Pay Ratio rule; and (3) Formal Order of Investigation delegation.

a. Conflict Minerals Rule

On January 31, 2017, Acting Chairman Piwowar issued two public statements with respect to the Conflict Minerals rule. The first statement described the ongoing litigation surrounding the rule and noted that the transition period provided for in the rule had expired and, as a result of both the unexpected duration of the litigation and the expiration of the transition period, directed staff to consider whether (1) the guidance issued by the Division of Corporation Finance in 2014 is still appropriate and (2) additional relief is appropriate. The public statement also encouraged interested parties to submit detailed comments within the following 45 days. The statement specifically noted that the staff's guidance remained in effect.

In the companion statement issued on January 31, 2017, Commissioner Piwowar provided additional justification for his direction to the staff. He stated, in relevant part, the following:

While visiting Africa last year, I heard first-hand from the people affected by this misguided rule. The disclosure requirements have caused a *de facto* boycott of minerals from portions of Africa, with effects far beyond the Congo-adjacent region (*italics in original*). Legitimate mining operators are facing such onerous costs to comply with the rule that they are being put out of business. It is also unclear that the rule has in fact resulted in any reduction in the power and control of armed gangs or eased the human suffering of many innocent men, women, and children in the Congo and surrounding areas. Moreover, the withdrawal from the region may undermine U.S. national security interests by creating a vacuum filled by those with less benign interests.

On April 7, 2017, Acting Chairman Piwowar issued another statement on the Conflict Minerals rule. The statement noted that on April 3, 2017, the United States District Court for the District of Columbia issued a final judgment in the litigation regarding the Conflict Minerals rule and remanded it to the SEC. The United States Court of Appeals for the District of Columbia had previously found that the Conflict Minerals rule “violate[s] the First Amendment to the extent the statute and rule require regulated entities to report to the Commission and to state on their website that any of their products have ‘not been found to be “DRC conflict free.””” The statement indicated that the SEC would be called upon to determine how to address the Court of Appeals’ decision. Accordingly, it instructed staff to begin work on a recommendation for future SEC action. The statement further noted “[t]he primary function of the extensive and costly requirements for due diligence on the source and chain of custody of conflict minerals set forth in paragraph (c) of Item 1.01 of Form SD is to enable companies to make the disclosure found to be unconstitutional.” The statement concluded that until the regulatory uncertainties are resolved, “it is difficult to conceive of a circumstance that would counsel in favor of enforcing Item 1.01(c) of Form SD.”¹

The SEC Division of Corporation Finance also issued a public statement on April 7, 2017. The statement noted that the district court’s remand presented significant issues for the Commission to address. It also noted that, as a result of a request by Acting Chairman Piwowar, Corporation Finance had received several comments regarding the desirability of additional guidance on whether relief under the rule was appropriate. It ultimately stated:

In light of the uncertainty regarding how the Commission will resolve those issues and related issues raised by commenters, the Division of Corporation Finance has determined that it will not recommend enforcement action to the Commission if companies, including those that are subject to paragraph (c) of Item 1.01 of Form SD, only file disclosure under the provisions of paragraphs (a) and (b) of Item 1.01 of Form SD.

The statement further noted that it was subject to any further action taken by the Commission, expressed the Division’s position on enforcement action only, and did not express any legal conclusion on the rule.

¹ According to Item 1.01(c) (Conflict Minerals Disclosure and Report), Form SD essentially requires that due diligence be conducted on the source and chain of custody of conflict minerals. If, as a result of the due diligence, the registrant determines that its conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country, the registrant must disclose its determination and the due diligence it undertook. If this is not the case, the registrant must file and publicly post an audited Conflict Minerals report.

b. Pay Ratio Rule

With respect to the Pay Ratio rule, on February 6, 2017, Acting Chairman Piwowar issued a public statement titled “Reconsideration of Pay Ratio Rule Implementation.” The Pay Ratio rule requires a public company to disclose the ratio of compensation of its chief executive officer to the median compensation of its employees. The Commission delayed compliance for companies until their first fiscal year beginning on or after January 1, 2017. Acting Chairman Piwowar’s statement noted that it was his understanding that some issuers had begun to encounter unanticipated compliance difficulties that may hinder their ability to meet the reporting deadline. As such, he sought public input on “. . . any unexpected challenges that issuers have experienced as they prepare for compliance with the rule and whether relief is needed.” He also directed the staff to “. . . reconsider the implementation of the rule based on any comments submitted and to determine as promptly as possible whether additional guidance or relief may be appropriate.”

c. Formal Order of Investigation Authority

The Federal securities laws authorize the SEC, or any officer designated by the SEC, to issue subpoenas requiring a witness to provide documents and testimony under oath. *See* Section 19(c) of the Securities Act of 1933, Section 21(b) of the Securities Exchange Act of 1934, Section 209(b) of the Investment Advisers Act of 1940, and Section 42(b) of the Investment Company Act of 1940. The Commission designates members of the staff to act as officers of the Commission in an investigation, thus authorizing them to subpoena documents and testimony, by issuing a Formal Order of Investigation. Prior to 2009, Formal Orders of Investigation could be issued only upon Commission approval. In 2009, the Commission amended its rules to delegate authority to the Director of the Division of Enforcement to issue Formal Orders of Investigation.² In addition, 17 C.F.R. § 200.30-4 (Delegation of Authority to Director of Division of Enforcement), which delegates the authority to issue Formal Orders of Investigation to the Director of Enforcement, also authorizes the Chairman to designate “from time to time” “such other person or persons” with the power to grant this authority under the direction of the Director.³ Pursuant to § 200.30-4, the authority to issue Formal Orders of Investigation was sub-delegated to a handful of senior officers in the Enforcement Division, including Associate Directors and Associate Regional Directors. On February 1, 2017, Acting Chairman Piwowar removed the sub-delegation so that only the Director of Enforcement can currently issue Formal Orders of Investigation.

Results and Analysis

Based on our review and analysis of the issues raised in your March 29, 2017, letter as well as the laws currently governing the SEC’s organization, conduct, and procedures, we are unable to conclude that Commissioner Piwowar exceeded his authority during his 3-month tenure as SEC Acting Chairman. We are likewise unable to conclude that he violated other procedural requirements under current law, or that his actions lacked adequate justification. Moreover, we are unable to conclude that

² The Commission initially adopted the delegation for a 1-year period. Following the 1-year period, in August 2010, the Commission permanently delegated the authority to the Director of the Enforcement Division.

³ 17 C.F.R. §§ 200.30-4 and 200.30-4(a)(13).

Commissioner Piwowar's actions may serve to undermine the SEC's mission⁴ or could potentially prove to be a waste of the SEC staff's time and resources.

With respect to the issue of whether Commissioner Piwowar exceeded his authority because he was an acting, not a permanent, Chairman, we found the facts that Commissioner Piwowar (1) had not been confirmed by the Senate as SEC Chairman, and (2) would only serve as Acting Chairman until the Senate confirmed a permanent Chairman did not prevent him from performing the duties and fulfilling the responsibilities of a permanent Chairman. Specifically, Section 3 (Designation of the Chairman) of Reorganization Plan No. 10 (Reorg. Plan 10)⁵, provides that "[t]he functions of the Commission with respect to choosing a Chairman from among the Commissioners composing the Commission are hereby transferred to the President." President Trump, in accordance with Section 3 of Reorg. Plan 10, chose Commissioner Piwowar as Acting Chairman until a permanent Chairman, Jay Clayton, could be confirmed. Moreover, our review of Reorg. Plan 10 found no provision limiting the functions of an Acting Chairman based on the temporary status of his or her position.

Moreover, with respect to the lack of a traditional quorum during Commissioner Piwowar's tenure as Acting Chairman, 17 C.F.R. § 200.41 (Quorum of the Commission) provides that "[a] quorum of the Commission shall consist of three members; provided, however, that if the number of Commissioners in office is less than three, *a quorum shall consist of the number of members in office . . .*" (emphasis added). In the present case, there were two members of the Commission in office; therefore, a quorum existed under 17 C.F.R. § 200.41, and our review of that regulation found no provision requiring a "traditional" quorum of three members in order for a Commission action to proceed. Furthermore, as will be discussed below, we did not find that Commissioner Piwowar's decision to opine and seek public input on the final SEC Pay Ratio and Conflict Minerals rules constituted "agency action," therefore, no quorum was required in any event.

Additionally, we cannot conclude that then-Acting Chairman Piwowar was required to seek fellow Commissioner Stein's approval prior to directing SEC staff on January 31, 2017, to reconsider the appropriateness of the 2014 Conflict Minerals rule guidance. Furthermore, we cannot conclude that Commissioner Piwowar exceeded his authority by not seeking her approval. Specifically, Section 1(a)(2) of Reorg. Plan 10 (Transfer of Functions to the Chairman) provides that, among the executive and administrative functions transferred to the Chairman from the Commission, is "the distribution of business among [personnel employed under the Commission] and among administrative units of the Commission." Because President Trump designated Commissioner Piwowar "Acting Chairman" in accordance with Section 3 of Reorg. Plan 10, the ability to direct SEC staff and SEC administrative units to carry out Commission business would appear to fall squarely within Section 1(a)(2), which does not require fellow Commissioner approval. Our review also found that Section 1(a)(2) similarly applies to Commissioner Piwowar's February 6, 2017, direction to SEC staff to reconsider the implementation of

⁴ The SEC states that its mission "is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." "About the SEC/What We Do/Introduction," <http://www.sec.gov/Article/whatwedo.html>.

⁵ Effective May 24, 1950, 15 F.R. 3175, 64 STAT. 1265. Prepared by the President and transmitted to the Senate and the House of Representatives in Congress assembled, March 13, 1950, pursuant to the provisions of the Reorganization Act of 1949, approved June 20, 1949 [see 5 U.S.C. § 901 et seq. (2012)].

the SEC's Pay Ratio rule. He did not, therefore, appear to exceed his authority by directing SEC staff to reconsider implementing this particular rule without obtaining Commissioner Stein's approval.⁶

Furthermore, as mentioned above, we did not find that Commissioner Piwovar's decision to opine and seek public input on the final SEC Pay Ratio and Conflict Minerals rules constituted "agency action," which would have required Commissioner Stein's approval. Specifically, Federal case law has held that an "unofficial expression of the views of one member of [a commission] . . . is not a decisional pronouncement affecting legal rights and obligations" and does not, therefore, constitute "agency action for purposes of the Administrative Procedure Act, 5 U.S.C. § 702 (1970)."⁷ See generally *Illinois Citizens Committee for Broadcasting v. FCC*, 515 F.2d 397, 402 (D.C. Cir. 1974). Similarly, we did not find that seeking input from the general public rose to the level of "the whole or a part of an agency rule, order, license, sanction, relief, or the equivalent or denial thereof, or failure to act," which is how the Administrative Procedure Act defines "agency action." See 5 U.S.C. § 551(13) (2012) (Definitions).⁸

Also, we found that Reorg. Plan 10, which authorizes the Acting Chairman to assume the "executive and administrative functions of the Commission" when dealing with matters involving SEC staff and/or administrative units, applies equally to administrative decisions involving the SEC's Division of Enforcement. Specifically, Section 1(a)(2) authorized then-Acting Chairman Piwovar to remove the sub-delegation of authority to issue Formal Orders of Investigation because this decision involved "the distribution of business among [personnel employed under the Commission] and among administrative units of the Commission." Commissioner Piwovar did not, therefore, appear to exceed his authority by removing the sub-delegation of authority without first obtaining Commissioner Stein's approval. Similarly, our review identified no evidence indicating that any of Commissioner Piwovar's decisions, all of which were authorized under Reorg. Plan 10, either undermined the SEC's mission or proved to be a waste of SEC staff time and resources.

Finally, we found that Commissioner Piwovar's decision to remove the sub-delegation was not without legal basis. Specifically, 17 C.F.R. § 200.30-4, which delegated (among other investigative functions) the power to grant Formal Order of Investigation authority from the Commission to the Director of Enforcement, also authorized the Chairman (or, in this case, the Acting Chairman) to designate "from time to time" "such other person or persons" with the power to grant this authority under the direction of the Director.⁹ The Acting Chairman's power to sub-delegate Formal Order of Investigation authority is discretionary, and § 200.30-4 reasonably can be read to authorize the Acting Chairman to return to the Director the sole power to grant Formal Order of Investigation authority. There does not, therefore, appear to be a violation of this regulation in the present case.

⁶ During our review, the SEC's Office of General Counsel and then-Acting Chairman Piwovar's counsel were also of the opinion that Commissioner Stein's approval was not required for Commissioner Piwovar to take the actions detailed above.

⁷ Section 702 of the Administrative Procedure act provides, in relevant part, that "[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof." 5 U.S.C. § 702 (2012) (Right of Review).

⁸ During our review, the SEC's Office of General Counsel and then-Acting Chairman Piwovar's counsel were also of the opinion that Commissioner Stein's approval was not required for Commissioner Piwovar to take the actions detailed above.

⁹ 17 C.F.R §§ 200.30-4 and 200.30-4(a)(13).

Conclusion

In light of the foregoing, we do not find that Commissioner Piwovar's actions as Acting Chairman violated any of the laws currently governing the SEC and our review identified no evidence that his actions could either undermine the SEC's mission or potentially prove to be a waste of SEC staff time and resources.

Sincerely,

A handwritten signature in blue ink, appearing to read "Carl W. Hoecker". The signature is fluid and cursive, with a long horizontal stroke at the end.

Carl W. Hoecker
Inspector General