

BENCHMARKING COMMISSION PROCEDURES

EXECUTIVE SUMMARY

We conducted an audit to compare certain Commission¹ procedures to those of other federal agencies, which have similar executive, legislative, and judicial responsibilities. Our objective was to identify possible improvements to the Commission's procedures based on best practices in the federal government (benchmarking).²

In some instances, the Commission's procedures are similar to other federal agencies, in part because of governing federal law (e.g., rulemaking is subject to the Administrative Procedures Act). In other cases, procedural differences between the Commission and other federal agencies reflect deliberate policy decisions by the Commission, or differences in mission.

We are not making any recommendations in this audit report. We are providing the information to the Commission to aid in its evaluation of its procedures to assure that it promptly disposes of all matters affecting the rights of those regulated.³

SCOPE AND OBJECTIVES

Our objective was to identify possible improvements to the Commission's procedures based on best practices in the federal government. We obtained information from selected federal agencies, which have executive, legislative, and judicial responsibilities similar to those of the Commission.

In order to benchmark Commission procedures, we identified significant time-consuming activities related to the Commission's executive, legislative, and judicial responsibilities.

The information we obtained may be useful to the Commission under 17 C.F.R. 200.68. This rule states that,

¹ In this audit report, the term Commission refers to the Chairman and the Commissioners of the Securities and Exchange Commission and not the agency as a whole.

² "Benchmarking is a continuous, systematic process for evaluating the products, services, and work processes of organizations that are recognized as representing best practices for the purpose of organizational improvement" (Michael J. Spendolini, The Benchmarking Book, 1992).

³ 17 CFR 200.68.

“The Commission should evaluate continuously its practices and procedures to assure that it promptly disposes of all matters affecting the rights of those regulated.”

During the audit, we interviewed staff at selected federal agencies (see below). We also reviewed supporting documentation describing these federal agencies’ organizations and procedures.

The audit was performed in accordance with generally accepted government auditing standards from June 1999 to December 1999.

BACKGROUND

The following is a description of the federal agencies we surveyed:⁴

- Commodity Futures Trading Commission (CFTC): Consists of five Commissioners who are appointed by the President, with the advice and consent of the Senate. The Commissioners serve a five-year term. The President designates one Commissioner as Chairman. No more than three of the Commissioners can belong to the same political party.
- Equal Employment Opportunity Commission (EEOC): Consists of five Commissioners who are appointed by the President, with the advice and consent of the Senate. The General Counsel is also appointed by the President and confirmed by the Senate. The Commissioners serve a five-year term. The President designates a Chairman and a Vice-Chairman. No more than three of the Commissioners can belong to the same political party.
- Federal Communication Commission (FCC): Consists of five Commissioners who are appointed by the President, with the advice and consent of the Senate. The Commissioners serve a five-year term. The President designates one Commissioner as Chairman. No more than three of the Commissioners can belong to the same political party.
- Federal Deposit Insurance Corporation (FDIC): Management of FDIC consists of a five-person Board of Directors that includes a Chairman, Vice-Chairman, and Appointive Director. The Comptroller of the Currency, who supervises federally chartered or national banks, and the Director of the Office of Thrift Supervision, who supervises federally chartered savings associations, are also members of the Board. Board members serve a six-year term. The President, with the advice and consent of the Senate appoints all five Board members. No more than three of the Board members can belong to the same political party.
- Federal Election Commission (FEC): Consists of six Commissioners who are appointed by the President, with the advice and consent of the Senate. The Staff Director and the General Counsel are statutory officers. The

⁴ These agencies are classified as either Independent Establishments (or Agencies) or Government Corporations.

Commissioners serve a six-year term. No more than three of the Commissioners can belong to the same political party.

- Federal Maritime Commission (FMC): Consists of five Commissioners appointed by the President, with the advice and consent of the Senate. The President designates one Commissioner as Chairman. The Commissioners serve a five-year term. No more than three of the Commissioners can belong to the same political party.
- Federal Reserve Board (FRB): Consists of seven Governors including the Chairman, who are appointed by the President, with the advice and consent of the Senate. The Governors serve 14-year terms. Only one Governor can be appointed from one of the twelve Federal Reserve Districts at any one time, and each Governor shall be selected “with due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and the geographical divisions of the country.” The President, with the advice and consent of the Senate, also appoints the President of each Reserve Bank.
- Federal Trade Commission (FTC): Consists of five Commissioners appointed by the President, with the advice and consent of the Senate. The Commissioners serve a seven-year term. The President designates one Commissioner as Chairman. No more than three of the Commissioners can belong to the same political party.
- International Trade Commission (ITC): Consists of six Commissioners appointed by the President, with the advice and consent of the Senate. The Commissioners serve a nine-year term. The President designates the Chairman and the Vice-Chairman for two-year terms, and succeeding Chairmen may not be of the same political party. No more than three of the Commissioners can belong to the same political party.
- National Labor Relations Board (NLRB): Consists of two separate components. The Board itself has five members appointed by the President, with the advice and consent of the Senate. The President, with the advice and consent of the Senate also appoints the General Counsel, who is independent of the Board. The General Counsel recommends appointments of the regional directors, but the Board appoints them. No more than three of the Commissioners can belong to the same political party.

AUDIT RESULTS

We found that, in some cases, the Commission’s procedures are similar to the other federal agencies. In part, the similarities are due to the requirements of federal law (*e.g.*, rulemaking procedures are subject to the Administrative Procedures Act (APA)). In other cases, the procedural differences between the Commission and the other federal agencies reflect deliberate policy decisions by the Commission, or

differences in mission. Accordingly, we are not making any recommendations in this audit report.

Described below are the significant activities of the Commission. We have provided a general discussion of the procedures at the Commission and the other federal agencies. Our results are summarized in Appendix A.

EXECUTIVE RESPONSIBILITIES

AUTHORITY TO INITIATE INVESTIGATIONS

The Commission's Enforcement staff may conduct a preliminary inquiry or investigation without Commission approval, provided that subpoenas are not needed. If subpoena authority is needed, the staff seek a formal order as described below. Staff at the CFTC, NLRB, FTC, FMC, FCC, FDIC, and FRB can also initiate an investigation without the Commissioners' ⁵ approval. The following agencies have a different process:

- The ITC's operating divisions can initiate an informal investigation based on a complaint from a US domestic industry or a referral from the Department of Commerce. If there is a preliminary finding by the Commissioners that the US domestic industry may have been harmed, a formal investigation is initiated. Formal investigations require the Commissioners' approval and the Commissioners are more directly involved with the conduct of the investigation, but still delegate much of the day-to-day decisions to the operating divisions.
- The Commissioners approve the initiation of all investigations at the FEC.
- Depending on the Act that was allegedly violated, staff at the EEOC can only initiate an investigation, if a complaint is received. EEOC Commissioners can initiate investigations without a complaint.

AUTHORITY TO COMPEL TESTIMONY AND DOCUMENTS

Section 21(b) of the Exchange Act authorizes,

“any member of the Commission or any officer designated by it...to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, paper, correspondence, memoranda, or other records which the Commission deems relevant or material to the inquiry.”

The Commission grants this authorization to the staff by reviewing an action memorandum that justifies the need for subpoena authority and issuing a Formal

⁵ In this audit report, the term Commissioners also refers to Board Members or Governors, depending on the agency.

Order. The action memorandum also serves to inform the Commission of any novel or complex issues. The Duty Officer, acting for the Commission, almost always considers the Formal Order. Once the Formal Order is granted, the staff has the authority to issue subpoenas to any person for records or testimony significant to the investigation. Like most agencies, the Commission cannot directly enforce its own subpoenas. It must bring an enforcement action to obtain a court order directing compliance with the subpoena. Pursuant to delegated authority, the Commission's approval is not required for the staff to enforce a subpoena in federal court. However, the staff must receive written approval from the Division Director or other senior staff, in his absence.

All of the agencies surveyed have statutory authority to issue subpoenas. The CFTC, FMC, FTC, and ITC also require Commissioner approval to issue subpoenas. The FEC requires Commissioner approval of each individual subpoena to be issued. However, many of the agencies we surveyed have a more decentralized approach than the Commission's. For instance:

- The NLRB has delegated general subpoena authority to the field offices.
- The FDIC has delegated general subpoena authority to the operating divisions and the Office of the General Counsel (OGC).
- The FRB has delegated general subpoena authority to the OGC with the concurrence of the operating division (*i.e.*, Banking, Supervision, and Regulation).
- The FCC has delegated general subpoena authority to the Division of Enforcement, with the concurrence of the General Counsel.
- The EEOC has delegated general subpoena authority to the field offices, except for investigations under the Equal Pay Statute (the statute prohibits the delegation). Investigations under this statute are rare, however.

AUTHORITY TO INSTITUTE CIVIL AND ADMINISTRATIVE ACTIONS

The Commission has independent litigation authority for civil and administrative actions. The Commission's Enforcement staff need approval to institute civil litigation in district court or an administrative proceeding (AP) before an administrative law judge (ALJ). An action memorandum is prepared by the Enforcement staff and is used to request authority from the Commission to litigate.

The FTC, CFTC, FMC, FRB, and FEC also require Commissioner approval to institute civil litigation or APs. The following agencies have a different process:

- The NLRB has delegated the authority to institute APs to its regional directors, but requires approval by the Board and the OGC for civil litigation.

- The FDIC has delegated the authority to institute APs and civil litigation to the operating divisions, except receivership actions in district court requires the Board's approval.
- The FCC has delegated the authority to institute both civil litigation and APs to the Division of Enforcement.
- In most cases, the EEOC has delegated the authority to institute civil litigation and APs to the General Counsel. However, the Commissioners expect that the General Counsel will further delegate this authority to the heads of the field offices, depending on the experience and knowledge of each office head. Despite the delegation, certain cases need to be approved by the Commissioners (depending on the anticipated cost of litigation, case precedent, novelty of the issues, etc.).
- The ITC only brings enforcement actions related to subpoena enforcement or collection of civil penalties. Subpoena enforcement actions are rare and require Commissioner approval.

AUTHORITY TO SETTLE ENFORCEMENT ACTIONS

Under the Administrative Procedures Act (5 U.S.C.A. section 554(c)(1)), federal agencies are required to consider settlement offers. The Commission must approve all settlements, either at a closed meeting or seriatim through an action memorandum.⁶

The FEC, CFTC, and FTC use a similar process as the Commission. The NLRB, FRB⁷, FMC, FDIC⁸, FCC, and EEOC generally delegate settlement authority to the operating division(s) or field offices, provided that the settlement is within certain general parameters. Since the ITC only brings enforcement actions related to subpoena enforcement, it does not settle cases.

EMERGENCY ACTIONS

Occasionally, immediate Commission action is required (*e.g.*, for trading suspensions, to seek temporary restraining orders). Commission Rule 17 CFR 200.43 states that one Commissioner, acting as the Duty Officer, can approve Commission actions (except rulemaking). The authority is used when, in the opinion of the Duty Officer, immediate action is required and, because of its urgency, the

⁶ The Commission's approval is not required if the settlement obtains all of the relief that was authorized. In civil injunctive actions, the staff can accept the court's entry of such an order. In administrative proceedings, the Office of the Secretary has delegated authority to enter an order for full relief in any proceeding previously instituted.

⁷ At the FRB, each individual Federal Reserve Bank has the authority to approve settlements with the concurrence of the General Counsel and the Director of Banking, Supervision, and Regulation.

⁸ At the FDIC, the Case Review Committee (which acts for the Board) must approve all settlements. The Committee can approve those settlements, which are within acceptable parameters. Otherwise, it must be sent to the Board for approval.

action cannot practicably be scheduled for consideration at a Commission meeting or *seriatim*.

The Duty Officer rotates daily among the Commissioners (except for the Chairman). Actions taken by the Duty Officer are subject to subsequent approval by the Commission. Any Commissioner can request to have a Duty Officer action reviewed by the Commission.

The federal agencies we reviewed do not have Duty Officers or a similar concept, either because they generally do not have urgent matters, or they have delegated the necessary authorities to their operating divisions, field offices, etc. The following is a description of the process at the CFTC, ITC, and FMC.

- The CFTC Chairman has the authority to act unilaterally in emergency situations. If the Chairman is unavailable, the authority rests with the most senior Commissioner. The action is subject to subsequent approval by the Commissioners.
- The ITC Chairman has certain unilateral authorities, however, the other Commissioners can override them.
- The FMC staff will locate the Commissioners (*e.g.*, telephone, pagers, etc.) and take an oral vote in emergency situations.

LEGISLATIVE RESPONSIBILITIES

RULEMAKING

All the federal agencies we reviewed have the authority to make rules pursuant to the statutes they administer. The rulemaking process is similar throughout the federal government, because of the requirements of the APA and other administrative statutes (*e.g.*, the Regulatory Flexibility Act). In all cases, proposed rules are published in the Federal Register for public comment, with final rules approved by the Commissioners.⁹

GUIDANCE AND EXEMPTIONS

The Commission's operating divisions provide guidance to the public. As a general rule, this guidance is exempt from the APA procedural rulemaking requirements. The guidance can include no-action letters, responses to telephone inquiries, and staff bulletins. For instance, the Division of Market Regulation has delegated authority to issue no-action letters, but the Commission must approve exemptions.

There are situations where the staff has delegated authority to act, but the issue is significant, novel, complex, etc. The staff will typically prepare an advice

⁹ The Commission must also approve the rule proposals and any other action relating to rulemaking (*e.g.*, concept releases, extension of the comment period).

memorandum to the Commission. The memorandum indicates that, unless the Commission instructs otherwise, the staff will take the intended action (as described in the memorandum) on a certain date. For instance, the Commission is given an opportunity to review staff legal bulletins before they are issued. Interpretative releases are approved by the Commission and are published in the Federal Register.

Generally, the other federal agencies, in some form or another, have similar processes to provide guidance. For the most part, providing guidance is an informal process with significant authority granted to the operating divisions. The FCC, FDIC, and FMC also have the authority to exempt entities from certain provisions of their statutes.

REVIEW OF SELF-REGULATORY ORGANIZATION PROPOSED RULES

Self-Regulatory Organizations (SRO) are private organizations registered with the Commission that provide regulation of the securities industry.

The Commission's Division of Market Regulation (MR) reviews their proposed rules and has delegated authority to approve the rules, although they may inform the Commission before they make a final decision. On rare occasions, the rule is sent to the Commission for approval. MR's decision can be appealed to the Commission.

None of the other agencies has an equivalent function, except for the CFTC. At the CFTC, the Commissioners must approve all SRO rules.

JUDICIAL RESPONSIBILITIES

APPEAL OF SELF-REGULATORY ORGANIZATION DISCIPLINARY ACTIONS

SROs bring disciplinary actions against their members for violations of their rules and of the securities laws, as well as taking other adverse actions (*e.g.*, delistings) that are subject to Commission review. The SRO conducts an internal hearing and appeal process to determine if discipline is appropriate. A member who is not successful in appealing an adverse decision within the SRO may appeal to the Commission.¹⁰

OGC prepares a draft opinion,¹¹ often in consultation with the applicable operating division, which has expertise in the subject matter. The Commission considers the

¹⁰ The SRO's action may be appealed by either a member or any individual adversely affected by the SRO's action (*e.g.*, final disciplinary actions, denial or limitation on membership or participation, limitation on access to services, or bar from association).

¹¹ The opinion can either affirm or reverse the SRO's decision, or remand the proceeding back to the SRO for further action.

draft opinion either seriatim or, if the issues are novel or complex, at a closed Commission meeting.

After the Commission makes any changes to the OGC draft opinion and votes to approve it, the Commission issues its official opinion. After the opinion is issued, the individual may appeal it to a Court of Appeals.

Only CFTC makes appellate decisions with respect to SRO disciplinary actions. It uses a similar process to make those decisions.

APPEAL OF ADMINISTRATIVE LAW JUDGE INITIAL DECISIONS

ALJs issue initial decisions in APs. Either party (*i.e.*, the Division of Enforcement or the respondent) can appeal the initial decision. Appeals of ALJ initial decisions are subject to the APA. An appealed initial decision is without force and effect under the APA and is solely a recommendation. Consequently, the appeal process is generally similar throughout the Federal government.

The appeal process at the Commission is similar to appeals of SRO disciplinary action(s), described above. However, oral arguments before the Commission, if requested, are usually allowed in appeals of ALJ initial decisions. In preparation for the argument, OGC prepares a preargument memorandum, which summarizes the facts and analyzes the issues. Following the oral argument and an executive session, OGC drafts an opinion in accordance with the Commission's directions.¹²

The FEC does not have ALJs. Accordingly, they do not have an appeals process for ALJ initial decisions. The FTC has a similar appeal process to the Commission's, in that an oral argument is a right. The FDIC, ITC, FCC, NLRB, CFTC, FRB, and FMC require a showing that an oral argument is necessary (*e.g.*, that a briefing process would be inadequate) before granting it. The EEOC has never heard an oral argument and there is no provision for it in their rules of practice.

¹² It is worth noting that the hearing before the ALJ at some of the other federal agencies differs. At the Commission, the ALJ determines whether a violation has occurred and the remedy. However, at some federal agencies, the Commission determines the remedy. Secondly, at the Commission, the Division of Enforcement is almost always (*e.g.*, the Chief Accountant is the plaintiff in Rule 102(e) proceedings) the plaintiff. However, at some federal agencies, the ALJ decides disputes between members of the public.