

July 2011

SECURITIES AND EXCHANGE COMMISSION

Existing Post- Employment Controls Could Be Further Strengthened

U.S. Government Accountability Office

GAO

YEARS

1921-2011

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SECURITIES AND EXCHANGE COMMISSION

Existing Post-Employment Controls Could Be Further Strengthened

Why GAO Did This Study

Many Securities and Exchange Commission (SEC) employees leave the SEC each year, and some of these former employees go to work for firms regulated by SEC or the law or consulting firms that represent them. This practice raises questions about the potential impact on SEC's ability to effectively carry out its mission, including the potential for undue influence by former SEC employees on SEC matters or cases. The Dodd-Frank Wall Street Reform and Consumer Protection Act required GAO to examine the movement of former SEC employees to regulated firms and the associated concerns. Among other things, this report examines (1) the extent to which employees leave SEC to work for or represent regulated entities and the potential issues associated with such movements and (2) internal controls SEC has in place to manage potential conflicts of interest and how these controls compare across other agencies. To address these objectives, GAO analyzed data on former SEC employees, reviewed SEC's and other agencies' internal controls, and interviewed current and former SEC officials.

What GAO Recommends

GAO recommends that SEC establish standards for documentation of ethics advice on current and post-employment issues associated with the movement of employees between SEC and other employers. SEC generally agreed with GAO's recommendation and stated that it has begun drafting standards.

View [GAO-11-654](#) or key components. For more information, contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov.

What GAO Found

Because SEC historically has not collected future employer information from separating employees on an agencywide basis, complete information on where former SEC officials obtained employment is not currently available. Based on available SEC attrition data, about 37 percent of the more than 2,000 employees who separated from SEC between October 2005 and September 2010 were in occupation categories that included examiners, accountants, economists, or attorneys—occupations particularly relevant to SEC examinations and investigations. GAO analyzed notice of appearance requests—which are required when former SEC employees wish to appear before SEC, within 2 years of their separation, for purposes of representing their firm or client—submitted between October 2005 and October 2010. Sixteen entities, consisting primarily of law and consulting firms, accounted for approximately 35 percent of the individuals filing these notices. GAO also selected a nongeneralizable sample of 150 former employees from occupation categories relevant to SEC's examination and investigative efforts and searched publicly available sources for information about their post-SEC employment. These individuals frequently obtained positions with financial, consulting, or law firms that represent firms regulated by SEC. According to SEC officials, representatives from law and financial firms, and academic researchers with whom GAO spoke, the potential benefits of employees moving between SEC and the private sector include bolstering SEC's ability to attract experts to help fulfill its mission and increasing understanding of SEC rules and regulations among industry participants. Academic researchers and citizen advocacy groups described potential challenges of such movements, such as the appearance of potential conflicts of interest when former SEC staff work for or represent regulated firms.

SEC has a number of controls for managing post-employment and conflict-of-interest issues, and many of SEC's controls are similar to those of other agencies. For example, the SEC Ethics Office provides information to employees about ethics rules and regulations as well as agency-specific conflict-of-interest and post-employment restrictions. Also, some SEC divisions and offices take steps through staffing and work processes to manage potential conflicts of interest and have multiple levels of review and systems for documenting key decisions, such as closing SEC investigations. As previously recommended by GAO, SEC also recently began collecting future employer information from separating employees. This information can be used as part of SEC's mandatory exit interviews to advise departing staff about potential conflicts of interest they might encounter in their new positions related to their SEC experience. While SEC ethics officials routinely advise current and former employees on post-employment and conflict-of-interest issues, SEC has not consistently documented this advice. The agency's lack of documentation standards could limit SEC's and employees' ability to demonstrate that appropriate consultation occurred and could contribute to questions about the movement of employees between SEC and the private sector.

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Abbreviations

CFTC	Commodity Futures Trading Commission
DOD	Department of Defense
FCC	Federal Communications Commission
Federal Reserve	Board of Governors of the Federal Reserve System
FINRA	Financial Industry Regulatory Authority
FTC	Federal Trade Commission
NCUA	National Credit Union Administration
OCIE	Office of Compliance Inspections and Examinations
OGE	Office of Government Ethics
OPM	Office of Personnel Management
SEC	Securities and Exchange Commission
SEC IG	Securities and Exchange Commission Inspector General

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United States Government Accountability Office
Washington, DC 20548

July 12, 2011

The Honorable Tim Johnson
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United State Senate

The Honorable Spencer Bachus
Chairman
The Honorable Barney Frank
Ranking Member
Committee on Financial Services
House of Representatives

The Securities and Exchange Commission's (SEC) mission is to protect investors; maintain fair, orderly, and efficient securities markets; and facilitate capital formation. To meet its goals, SEC requires public companies to disclose meaningful financial and other information to the public, conducts examinations of firms it regulates, and conducts investigations of potential securities law violations. As of June 14, 2011, a total of 3,729 permanent employees were working at SEC. SEC employs many professionals, such as attorneys, securities examiners, and accountants to carry out its mission. A number of employees leave the SEC each year to pursue other opportunities, including working for financial services firms. However, members of Congress, the SEC Inspector General (SEC IG), and others have raised concerns about the potential impact on SEC's ability to effectively carry out its mission when employees leave the agency to work for firms regulated by SEC or for law firms that may represent firms regulated by SEC. These concerns include the potential for undue influence by former employees on SEC matters or cases, particularly those related to examinations and investigations of firms that may employ or be represented by former SEC employees.

Congress has enacted specific, post-employment restrictions designed to protect the U.S. government from the improper use of government information or undue influence exerted by former government employees. These restrictions prohibit former federal employees from engaging in

certain activities, such as representing certain clients on particular matters before their former agency, for a specified period of time after leaving federal service.¹ SEC also has established agency-specific policies to address post-employment and conflict-of-interest issues.² Nevertheless, questions remain about the potential for former SEC employees to work on matters in which they have personally and substantially participated and SEC's efforts to protect against outside influence on current SEC employees.³

Section 968 of the Dodd–Frank Wall Street Reform and Consumer Protection Act required us to review concerns associated with former SEC employees obtaining employment at SEC-regulated entities—a phenomenon often referred to as the “revolving door.”⁴ This report examines (1) the extent to which employees leave SEC to work for or represent SEC-regulated entities and the potential issues associated with such movement, (2) SEC's internal controls to manage potential conflicts of interest associated with these movements and how these controls compare to controls of other agencies, and (3) potential options for SEC to better manage potential conflicts of interest.

To address these objectives, we obtained and analyzed SEC data for employees who left the agency between October 2005 and September 2010. We assessed the reliability of these data by verifying that data fields, such as occupation types, job descriptions, and date ranges, were reasonable and consistent with our data request, and determined that the data were reliable for purposes of this report. We also obtained and analyzed documentation on all letters filed by former SEC employees requesting approval to appear before SEC from October 2005 to October

¹18 U.S.C. § 207.

²17 C.F.R. part 200, subpart M.

³For this report, we examined concerns associated with the movement of employees between SEC and private firms, such as regulated financial institutions and law firms that represent them. We focused on concerns related to the criminal conflict-of-interest restrictions for current employees in 18 U.S.C. § 208, the post-employment restrictions in 18 U.S.C. § 207, and the existing procedures for promoting compliance with them. We also examined SEC's existing controls related to hiring, staffing, decision-making, and its employee exit procedures. Our work does not address other federal ethics laws, such as those related to bribery and those involving the representation of foreign entities.

⁴Pub. L. No. 111-203, 124 Stat. 1376, 1914 (2010).

2010, and conducted Web-based searches on a nongeneralizable sample of 150 SEC employees who separated from SEC between October 2005 and September 2010 to determine where they had obtained employment after separating from SEC. To describe SEC's internal controls, we obtained documentation on controls related to managing potential post-employment and conflict-of-interest issues, reviewed SEC-specific post-employment guidance and policies, and interviewed management and staff of relevant SEC divisions and offices. To determine how SEC's controls compare to controls of other agencies, we obtained documentation and interviewed officials from seven agencies, some of which are federal enforcement and regulatory agencies with missions similar to that of SEC: Commodity Futures Trading Commission (CFTC), Department of Defense (DOD), Federal Communications Commission (FCC), Board of Governors of the Federal Reserve System (Federal Reserve), Federal Trade Commission (FTC), Financial Industry Regulatory Authority (FINRA), and National Credit Union Administration (NCUA). All of these agencies are federal agencies with the exception of FINRA, which is a self-regulatory organization for broker-dealers. We obtained documentation on their internal controls related to managing potential conflict-of-interest and post-employment issues. In addition, we reviewed *Standards for Internal Control in the Federal Government* to identify any controls that may help manage potential conflict-of-interest and post-employment issues.⁵ Finally, we interviewed academic researchers and representatives of law firms, financial firms, and consumer advocacy groups to obtain their perspectives on options to manage potential conflict-of-interest issues relating to the movement of employees between SEC and SEC-regulated firms or firms that represent SEC-regulated firms. For a detailed description of our scope and methodology, see appendix I.

We conducted our work between August 2010 and July 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁵GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: Nov. 1, 1999).

Background

Various criminal statutes, agency-specific policies, and professional standards address potential post-employment and conflict-of-interest questions. Executive branch employees, including SEC employees, are subject to criminal conflict-of-interest statutes. For example, restrictions on the activity of former federal employees and restrictions on current federal employees negotiating for private employment are reflected in sections 207 and 208 of Title 18 of the United States Code (sections 207 and 208) and associated regulations. Specifically, section 208 prohibits employees from personally and substantially participating in government decisions that affect their financial interests, including the interests of any organization with which he or she is in negotiations or with which he or she has a prospective employment relationship. After separating from an agency, section 207 provisions can restrict former employees from representing a firm to his or her former agency for defined cooling-off periods that vary according to the former employee's involvement and seniority.⁶ Examples of conduct prohibited by section 207 include the following:

- Former personnel are permanently barred from communicating with or appearing before, with the intent to influence, their former agency on behalf of their new employer for particular matters on which they were personally and substantially involved, which involved a specific party or parties at the time of such participation.⁷
- For 2 years after leaving federal service, former personnel may not communicate with or appear before, with the intent to influence, their former agency on behalf of their new employer on particular matters that were pending under their official responsibility in their last year of service, which involved a specific party or parties at the time it was pending, even if the employee was not directly involved with the matter.⁸

⁶18 U.S.C. § 207. A former employee is not prohibited by this restriction from providing "behind-the-scenes" assistance in connection with the representation of another person or firm. See 5 C.F.R. § 2641.201(d)(2). Further, this restriction prohibits only those communications and appearances that are made "with the intent to influence."

⁷18 U.S.C. § 207(a)(1). An employee can participate "personally" in a matter even though he or she only directs a subordinate's participation. He or she participates "substantially" if his or her involvement is of significance to the matter. Therefore, while a series of peripheral involvements may not be substantial, participation in a single critical step may be substantial.

⁸18 U.S.C. § 207(a)(2).

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- For 1 year after leaving federal service, a former senior-level employee may not contact his or her former agency on behalf of any other person in connection with any matter on which the person represented by the former employee is seeking official action.⁹

The Office of Government Ethics (OGE) oversees a uniform system of ethics standards across the executive branch. Among other responsibilities, OGE formulates and interprets ethical standards and conflict-of-interest rules, reviews ethics programs at agencies, and provides support to agency ethics officials. While OGE sets ethical standards and specifies appropriate regulation for the executive branch, individual agencies, such as SEC, are responsible for implementing ethics programs. With OGE's concurrence, agencies also may supplement executive branch-wide ethics regulations. For example, as part of supplemental regulation specific to SEC, former SEC employees (within 2 years of separating from the agency) must submit a notice of appearance, also referred to as an 8b letter, to request approval to appear before SEC for purposes of representational activity.¹⁰ These notices typically contain a former employee's name, current employer, and the nature of the matter about which they would like to appear before SEC. Federal ethics regulations overseen by OGE include rules requiring that agencies provide training and information about post-employment and other conflict-of-interest issues to their employees.¹¹ SEC's Ethics Office serves as the agency's focal point in carrying out these responsibilities.

In addition to criminal statutes and agency-specific regulations, attorneys and accountants are subject to professional standards that relate to post-employment activities. Attorney members of state bar associations are subject to the rules of professional conduct for each state, which may be

⁹18 U.S.C. § 207(c). "Senior" is generally defined as an employee whose basic pay is equal to or greater than 86.5 percent of the rate of basic pay for level II of the Executive Schedule (more than \$155,440.50 in 2010). However, the Office of Government Ethics has granted an exception to SEC so that no employees under pay plan SK, which may include pay levels greater than the prescribed threshold, are considered "senior." See 5 C.F.R. part 2641, app. A. The SK pay plan applies to SEC employees formerly under the GS pay plan.

¹⁰17 C.F.R. § 200.735-8(b).

¹¹5 C.F.R. § 2638.203(a)(3), (b)(7).

based on the American Bar Association Model Rules of Professional Conduct. The model rules address client-lawyer relationships, including special conflicts of interest for former and current government officers and employees.¹² For certified public accountants, the American Institute of Certified Public Accountants professional code of conduct includes both principles and rules that apply to its members in all areas of accounting practice. Among other tenets, these rules outline standards for an accountant's independence, integrity, and objectivity.¹³

Four SEC IG reports issued during 2009 through 2011 have highlighted concerns regarding the appearance of conflicts of interest at SEC.¹⁴ These reports did not conclude that former SEC employees violated post-employment restrictions; although, the reports noted some related concerns based on reviews of particular SEC investigations and the actions of former employees, including the following:

- The SEC IG's report found that the SEC's lack of documentation resulted in an unclear record of what projects a former associate director in the Division of Trading and Markets recused herself from and on what projects she continued to work during employment negotiations with a trading firm.

¹²American Bar Association Model Rules of Professional Conduct Rule 1.11(a)(2) states that, with some exceptions, a lawyer may not represent a client in connection with a matter in which the lawyer participated personally and substantially as a public officer or government employee, unless the appropriate government agency gives its informed consent.

¹³Rule 101 states that a member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by the council. Rule 102 states that in the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

¹⁴See SEC, Office of Inspector General, *Investigation of Whether a Former Associate Director in the SEC's Division of Trading and Markets Violated Conflict of Interest Restrictions in Connection With Her Employment at an Electronic Market Making Firm*, OIG-540 (Washington, D.C., Jan. 25, 2011); *Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme*, OIG-526 (Washington, D.C., Mar. 31, 2010); *Allegations of Conflict of Interest, Improper Use of Non-Public Information and Failure to Take Sufficient Action Against Fraudulent Company*, OIG-496 (Washington, D.C., Jan. 8, 2010); and *Allegations of Improper Disclosures and Assurances Given*, OIG-502 (Washington, D.C., Sep. 30, 2009).

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- The SEC IG report raised questions about the extent to which a company's SEC connections and aggressive tactics may have influenced SEC decisions about the examination and resulting investigation of the regulated entity.
 - The SEC IG report found that a former head of the Division of Enforcement at a field office appeared to have violated state bar rules by working for a client involved in ongoing SEC matters in which he had participated while employed at SEC.¹⁵
-

While Employee Movement between SEC and the Private Sector Offers Potential Benefits to Each Side, It Also Raises Questions

SEC Only Recently Has Begun to Collect Future Employer Information from Departing Employees

SEC only recently began asking separating employees—on an agencywide basis—for future employer information. As a result, comprehensive data to determine where former employees obtained employment after separating from SEC were not yet available. We previously recommended that SEC request that departing employees provide the name of their next employer as part of SEC's exit procedures.¹⁶ In response, the Office of Compliance Inspections and Examinations (OCIE) began conducting exit interviews with departing

¹⁵SEC informed the former employee that it was improper for him to represent this particular client on three separate occasions. Although federal law prohibits "representation" before a federal agency, "behind-the-scenes" assistance provided by former federal employees is not prohibited if the assistance does not involve a communication to or an appearance before an employee of the United States. 5 C.F.R. § 2641.201(d)(3).

¹⁶GAO, *Mutual Fund Trading Abuses: SEC Consistently Applied Procedures in Setting Penalties, but Could Strengthen Certain Internal Controls*, [GAO-05-385](#) (Washington, D.C.: May 16, 2005).

OCIE staff in December 2005 that included documentation about their post-employment plans. However, no other divisions or offices appeared to make similar efforts until December 2010—at which time the SEC Ethics Office implemented an agencywide process to collect post-employment information. Specifically, the Ethics Office revised the interview form that ethics officials use when conducting the mandatory exit interviews of all separating employees. The revised interview form includes a question asking for the separating employee's next employer, which respondents are asked to provide voluntarily. As of March 11, 2011, the Ethics Office had conducted 47 exit interviews and documented future employer information for most of the separating employees.

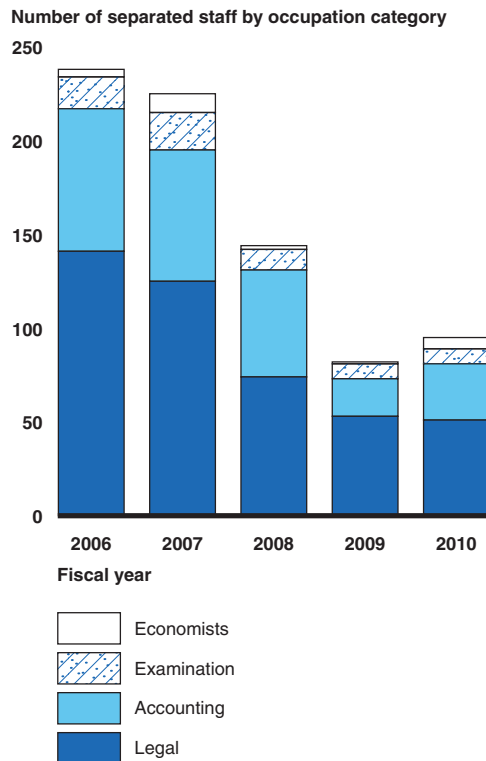
While SEC recently has started to collect future employer information from separating employees, it consistently has maintained information on the number of employees leaving the agency each year and for what purposes (such as retirement). According to SEC's data, in fiscal years 2006 through 2010 a total of 2,127 employees separated from the agency.¹⁷ About 37 percent of these employees were included in occupation categories that captured examiners, accountants, economists, and attorneys—occupations relevant to SEC's examination and investigative efforts—who separated from SEC due to resignation, retirement, or removal.¹⁸ The other 63 percent of employees had occupations such as information technology specialist, human resource specialist, and secretary, among several other occupations. Figure 1 shows the attrition trend for selected occupation categories for fiscal years 2006 through 2010. In addition to the occupation categories of departing employees, we also reviewed the length of tenure of employees

¹⁷The data for fiscal year 2010 are from October 1, 2009 through September 17, 2010. There were a total of 2,173 separation records for 2,127 individuals for this time period. The additional separation records are due to individuals who separated from SEC more than once during this time period.

¹⁸These particular occupations are highlighted in organization charts and job descriptions for key SEC offices and divisions, and the reported occupation classifications were commonly associated with higher-level managers (including directors and SEC commissioners) represented in SEC attrition data. To calculate the number of separations, we included resignations, removals, most retirements, and select terminations. Given our focus on the movement of former SEC employees to regulated firms or firms that represent regulated firms, we excluded transfers to other government agencies, retirements due to disability, death, termination during a probationary period, and expiration of term appointments. According to SEC, 48 fellowships were included in separations due to expiration of term appointments from October 1, 2005 through September 17, 2010.

in the selected categories for the same time period. We found that the average SEC tenure of departing employees increased during this period, with the average service years at time of separation increasing from 8.3 years in fiscal year 2006 to 13.5 years in fiscal year 2010 for employees in occupation categories we considered relevant to SEC's examination and investigative efforts. According to SEC officials, the decline in the number of employees leaving SEC and the increase in the tenure of departing employees during this period primarily was attributable to the financial crisis and economic recession, which made private-sector employment less available and attractive.

Figure 1: Attrition for Select Occupation Categories of SEC Employees, Fiscal Years 2006 through 2010



Source: GAO analysis of SEC data.

Note: Data for fiscal year 2010 are through September 17, 2010. In addition to examiners, the examination occupation category includes a smaller number of other occupations such as investigators. To calculate the number of separations, we included resignations, removals, most retirements, and select terminations. Given our focus on the movement of former SEC employees to regulated firms or firms that represent regulated firms, we excluded transfers to other government agencies, retirements due to disability, death, terminations during a probationary period, and expiration of term appointments (including term appointments for fellowship programs).

Available Data Suggest Former SEC Employees Often Obtained Positions with Regulated Entities or Firms That Represent Them

Using sources such as letters from former employees requesting to appear before SEC, Web-based search results, and interviews with those knowledgeable about SEC, we found that former SEC employees frequently obtained employment with financial entities or law or consulting firms that represent them. We reviewed 825 notice of appearance requests (also referred to as 8b letters) that the agency received from October 2005 through October 2010 that were submitted by former SEC employees that the SEC subsequently approved.¹⁹ We found that SEC received these notices from 224 individuals employed at 136 separate entities ranging from financial companies to legal and consulting firms.²⁰ Sixteen entities accounted for approximately 35 percent of the individuals filing notices of appearance during this period. Of the 16 entities, 9 were law firms, 5 were consulting firms, 1 was a financial firm, and 1 was an independent regulatory entity.

We also conducted searches for a nongeneralizable sample of 150 former employees who separated from SEC between October 2005 and September 2010, and found that many of these employees later obtained employment at law, consulting, or financial firms.²¹ Of the 150 former employees we selected, 113 had resigned from SEC, 35 had retired, and 2 had been removed from their positions. We found post-employment information for 64 of the 150, including 2 retirees. Of the 64 former employees, 22 individuals had obtained employment at law firms, 15 at consulting firms, 13 at financial firms, and 14 at other entities after their separation from SEC.²² We also spoke with the Association of SEC Alumni, which collects information on current employer information as part of its membership application.²³ Association representatives indicated

¹⁹According to an SEC Ethics Office official, SEC historically has not tracked 8b denials. The official said that former employees typically call to informally inquire about their proposed request and usually do not submit an 8b letter if the request is not expected to be approved.

²⁰Many of the 825 individuals filed more than one 8b letter during the sample time period. For example, one former SEC employee filed 21 separate 8b letters during this period.

²¹From this time period, we selected the first group of 50, the middle group of 50, and the last group of 50 employees according to the date they separated from SEC.

²²Other entities included financial regulators, academic entities, and nonfinancial businesses.

²³The Association of SEC Alumni was formed in 1990 and is a nonprofit charitable organization that sponsors activities for SEC alumni, among other activities.

that employment paths vary when employees leave SEC but that, in general, people go to work for law firms, financial firms, or retire. SEC officials also stated that former employees go to work for various firms, such as financial or accounting firms, after separating from the agency.

SEC Officials and Others Cited Both Benefits and Challenges of Movement between SEC and Regulated Entities or Firms That Represent Them

Collectively, SEC officials, academic researchers, citizen advocacy groups, and representatives from financial firms and law firms with whom we spoke said that there are a number of benefits and challenges of employee movement between SEC and the private sector. SEC officials, academic researchers, and representatives from financial firms and law firms cited the following benefits:

- *Better regulatory understanding and compliance.* SEC experience may bring about a better understanding of securities regulation and compliance in the private sector, which could benefit SEC and securities firms or firms that represent securities firms. Former SEC personnel who take positions in the regulated industry or their representatives, including law firms, may have enhanced credibility as a result of their SEC experience, and thus greatly aid in encouraging firms to adopt a culture of compliance.
- *Better communications.* When employees of regulated entities or law firms representing regulated entities are familiar with SEC regulations and the context of securities investigations and enforcement, SEC and the employees of regulated entities or law firms may communicate more efficiently and openly about the matter being discussed.
- *Recruitment of specialized expertise.* The perceived value of SEC experience may bolster the agency's ability to recruit individuals with current knowledge and expertise in securities products and other areas that SEC regulates. Attracting specialized market experts, as well as those with the expertise that SEC traditionally has sought (including lawyers, accountants, and compliance personnel) helps the agency fulfill its mission of investor protection.

Academic researchers and citizen advocacy groups identified the following challenges of employee movement between SEC and the private sector:

- *Competing interests for current SEC employees.* SEC employees may be influenced by the prospect of future employment opportunities to

be more lenient or favor prospective future employers while undertaking SEC actions. For example, according to one academic researcher, a current SEC employee could seek enforcement compromises through settlements rather than pursue prosecution actions. Such an outcome might result in more desirable terms for the securities firm, which might lead to a more favorable reputation of the SEC employee within the industry, while still successfully bringing to conclusion an enforcement action for SEC.

- *Appearance of undue influence.* Personal contact between current and former SEC employees may create the appearance of conflicts of interest. For example, even without direct evidence that undue influence has affected an enforcement action, the appearance of a conflict of interest could undermine confidence in the enforcement process and SEC.

According to SEC officials, SEC has controls to address these challenges, as described in the next section of this report.

Although SEC Has Multiple Controls Related to Conflicts of Interest, Documentation of Ethics Issues Varies

SEC Provides Information to Employees on Post-Employment Requirements and Restrictions but Has Not Consistently Documented Ethics Advice

SEC has a number of controls for managing post-employment and conflict-of-interest issues. These include training and information for employees, staffing decisions, work process controls, ethics advice, exit requirements for departing employees, and supplemental post-employment rules for certain employees.

Training and Information

According to federal ethics regulations, federal agencies must have an ethics training program to educate employees about ethics laws and rules and how to obtain ethics advice.²⁴ SEC requires its new employees to attend initial training that includes ethics-related issues and provides new employees printed information that outlines post-employment restrictions and provides contact information for agency ethics officials. SEC also requires that new employees submit financial disclosures, as applicable, to identify any personal financial interests they may have and determine if any potential financial conflicts of interest exist.

In addition to providing initial training and information to new employees, SEC makes training available and provides information to all employees on an ongoing basis, including information about post-employment rules and conflict-of-interest issues. SEC's 2011 training plan includes both in-person and online training sessions that cover topics such as conflicts of interest, employment seeking, post-employment issues, and SEC supplemental rules.²⁵ The SEC Ethics Office currently provides information about ethics rules and regulations (as well as conflict-of-interest and post-employment restrictions) to employees through the SEC intranet and by e-mail. For example, the Ethics Office recently completed an SEC ethics manual that summarizes post-employment and conflict-of-interest rules and regulations (both federal and agency-specific). The manual is available to employees through the SEC intranet.

Staffing Decisions

SEC divisions and offices we reviewed take steps during their staffing processes that are designed to manage, or that may have the effect of managing, potential conflicts of interest involving current employees. While individuals are ultimately responsible for identifying conflicts of interest, the divisions and offices we spoke with take additional steps to help manage these issues. For example, offices within the Division of Corporation Finance, which reviews company filings and disclosures in 12

²⁴An agency's training program must include, at least, an initial agency ethics orientation for all employees. 5 C.F.R. § 2638.701. Within 90 days from the time an employee begins work for an agency, the agency must provide employees ethics standards and any agency supplemental standards to keep or view, or summaries of these standards and ethical principles. The agency must also provide employees contact information for the designated agency ethics official and other agency officials available to advise employees on ethics issues. 5 C.F.R. § 2638.703.

²⁵We were unable to obtain information on SEC training plans and materials prior to fiscal year 2011 due to a lack of documentation of prior years' training plans within the SEC Ethics Office.

groups organized by industry, often rotate staff assignments for different stages of the file review process each year to provide a fresh look at the disclosures or for training purposes. This rotation process also helps prevent employees from becoming too close to specific companies. Additionally, the Division of Enforcement has a 1-year recusal policy that prohibits new employees from working on matters that involve their former employers or clients of their former employers, regardless of the employees' previous involvement in a particular matter. Division of Enforcement officials told us supervisors generally were aware of matters from which their staff recuse themselves, and would use that information in future staffing decisions to further avoid potential conflicts of interest involving division employees.

Work Process Controls

According to SEC managers and employees with whom we spoke, systems for documenting key decisions, multiple levels of review, and controls for staff involvement and communication reduce the likelihood that any individual employee could exert undue influence on SEC decisions related to examinations and investigations. For example, within OCIE, work papers document decisions and actions related to examinations, and a tracking system documents higher-level data such as examination dates, participants, findings, and actions taken.²⁶ Similarly, the Division of Enforcement documents investigations using an electronic case management system that, among other things, identifies and documents individuals with substantial involvement in particular matters or cases and documents key decisions such as the closing of investigations. This information is available to division managers to research particular conflict-of-interest issues involving specific employees or to support requests for information by the Ethics Office. The division also has a multilayered review process. For example, according to SEC officials, numerous staff and supervisors participate in decisions to recommend whether an enforcement case should be litigated or settled, and if settled, what the specifics of the settlement terms should be. These decisions then are reviewed by staff in other SEC divisions and offices, the Office of General Counsel, and individual commissioners and their counsel. The Division of Enforcement also recently updated its controls for handling tips, complaints, and referrals to better manage and

²⁶An SEC IG report recommended that OCIE consider improving its documentation procedures to limit the ability of OCIE employees to delete examination work papers (OIG-496). In response, SEC has been considering how to further track all of OCIE's work on one system.

document referrals it receives from other SEC divisions and offices.²⁷ The division has developed training to remind employees of their responsibilities regarding impartiality when performing their official duties and to instruct employees where they can find additional information about impartiality. Finally, to help ensure the division maintains its independence and transparency, the Division of Enforcement has an external communication policy that outlines best practices for senior officials' communications with outside parties related to ongoing, active investigations. The policy encourages senior officials to include the enforcement staff working on an investigation in any material communications with outside parties. It also directs senior officials to consider notifying staff not included in such communications and to consider documenting such events through written notes, emails, or workpapers. Some of these controls were implemented by SEC in response to SEC IG reviews and recommendations related to potential conflict-of-interest issues.²⁸

Ethics Advice

The Ethics Office manages issues related to conflicts of interest involving SEC employees. Employees are encouraged to seek guidance from the Ethics Office and to notify supervisors of conflict-of-interest issues, particularly if they have a conflict of interest that requires a recusal from matters to which they have been assigned. According to the SEC Ethics Counsel, ethics officials frequently advise current and former employees about issues related to their involvement in SEC matters. Since 2009, employees have been able to use an internal, online system on a voluntary basis to document their recusal information, as SEC lacks discretionary authority to require employees to document recusal information. Additionally, ethics officials provide written and oral advice to employees about potential conflicts of interest.

²⁷Specifically, Division of Enforcement staff must place comments in a tips, complaints, and referrals system to memorialize decisions and actions regarding the assignment, disposition, and/or resolution of tips, complaints, and referrals. Additionally, SEC has been developing a new, automated system for capturing information related to the work performed by staff assigned to tips, complaints, and referrals.

²⁸See SEC, Office of Inspector General, *Program Improvements Needed Within the SEC's Division of Enforcement*, OIG-467 (Washington, D.C., Sept. 29, 2009); *Re-Investigation of Claims by Gary Aguirre of Improper Preferential Treatment and Retaliatory Termination*, OIG-431 (Washington, D.C., Sept. 30, 2008); and OIG-496.

Although we found that Ethics Office officials may document their advice through e-mail or other methods, documentation has not been done consistently or routinely and SEC lacks standards for documenting ethics advice about conflicts of interest and post-employment issues to current and former employees.²⁹ According to *Standards for Internal Control in the Federal Government*, federal agencies' internal control steps and key events—which in this context could include ethics advice provided—should be clearly documented and readily available.³⁰ Without standards for documenting ethics advice, SEC currently relies on institutional memory and the ability of individuals still working at the agency to recall past ethics advice and documentation they may have kept. These documentation practices may create challenges, particularly in situations in which an ethics official who provided advice has separated from SEC. Further, the lack of standards for documenting ethics advice may impair SEC's ability to clearly demonstrate that such advice was provided.

According to the SEC Ethics Counsel, the nature of ethics issues, specifically the way that each situation involves circumstances and experiences unique to each employee, makes it difficult to standardize documentation or advice. However, the movement of SEC employees to the private sector presents unique risks to SEC relating to its management of documentation of ethics advice. Findings in a recent SEC IG report highlight these potential risks. The SEC IG reviewed issues involving a former associate director in the Division of Trading and Markets who left SEC to work for a high-frequency trading firm. While at SEC, the employee's division examined a market event in which the role of high-frequency trading firms was being explored. The SEC IG found that the former employee took appropriate steps to recuse herself after a potential employment offer was initiated by a high-frequency trading firm; however, SEC's lack of documentation resulted in an unclear record of the projects from which she recused herself and the projects on which she continued to work.³¹ While the SEC IG's report concluded that there was no evidence suggesting the former associate director had violated any post-employment restrictions, this case highlighted the potential risks

²⁹Under 5 C.F.R. § 2638.203(b)(8), ethics officials are to ensure that "records are kept, when appropriate, on advice rendered."

³⁰[GAO/AIMD-00-21.3.1.](#)

³¹OIG-540.

of inadequate documentation, which could raise questions about the appearance of conflicts of interest and might harm SEC's reputation.³²

Exit Process

SEC also has controls in place for managing an employee's separation from the agency. When employees leave SEC, they must complete an exit process that includes counseling on post-employment restrictions and receiving information about post-employment rules. As mentioned previously, starting in December 2010, the SEC Ethics Office began administering mandatory exit interviews for all departing employees that includes a question asking for the separating employee's next employer, which respondents are asked to provide voluntarily. This information then can be used as part of the exit interview to advise departing staff about potential conflicts of interest related to their SEC experience they may encounter in their new positions. The Ethics Office maintains hard copies of these employee exit forms. SEC also requires senior employees to obtain post-employment counseling from the Ethics Office prior to seeking outside employment, as a way to provide advice about post-employment rules and regulations and help protect SEC and employees from potential conflicts of interest or misconduct.

Supplemental Rules

In addition to agencywide controls and office- or division-specific practices, SEC has supplemental rules, developed under the agency's authority, that affect the post-employment activities of certain former employees.³³ These rules, under specific conditions, require former employees or firms that hire them to receive permission to appear before SEC regarding particular matters. More specifically:

- As discussed previously, former employees wishing to appear before SEC within 2 years of separating from the agency must request approval from SEC by filing a notice of appearance letter (an 8b letter). An 8b letter would include the name of the former employee's current employer, previous position at SEC, and the matter for which the former employee was seeking to appear before SEC.

³²The SEC IG noted that there was evidence the former associate director had worked "behind the scenes" at the firm with which she obtained employment, but the nature of the activity did not appear to violate any criminal statutes, the SEC Standards of Ethical Conduct, or Washington, D.C. bar rules. See OIG-540.

³³17 C.F.R. § 200.735-8(b)(d).

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- Similarly, firms participating in a matter—or with an interest in participating in a matter—that have hired a former SEC employee who is prohibited from working on that matter must provide to SEC in writing (referred to as an 8d letter) that the firm has appropriate controls in place to separate, or “wall off,” the disqualified individual. SEC reviews the firm’s statements about controls and determines whether the firm can participate in the matter. SEC refers to this rule as its “imputation of disqualification” rule.

SEC ethics officials review 8b and 8d letters. For 8b letters, they determine whether any conflicts of interest exist concerning the former employee and the matter for which he or she wishes to appear. Ethics officials consult with former SEC supervisors and peers of the individual, and possibly the former employee, regarding the matter. SEC stamps 8b letters when approved or issues a response to a former employee when an 8b letter is not approved. For 8d letters, the SEC General Counsel forwards the letters to ethics officials, who conduct research and recommend a response. In turn, the General Counsel issues a written response to firms based on the Ethics Office’s review. SEC maintains hard copies of the 8b and 8d letters and the agency’s 8d letter responses.

While Select Agencies Have Controls Similar to SEC’s to Help Manage Post-Employment and Conflict-of-Interest Issues, Differences Exist

SEC’s controls to help manage post-employment and conflict-of-interest issues are similar to the controls of the other agencies we reviewed. We spoke with representatives of seven agencies and found that the agencies shared several types of controls similar to those of SEC, such as training and exit requirements for departing employees (see fig. 2). Much like SEC, all the agencies train and educate employees about post-employment restrictions and conflict-of-interest issues and collect financial disclosures from certain employees. Similar to SEC, five agencies reported they had mandatory exit procedures for departing employees, although the form and substance of these procedures may vary. For example, CFTC withholds an employee’s last paycheck until the employee has completed a clearance checklist and requires all senior employees to complete an ethics briefing. No other agency we contacted said they used this approach to ensure employee participation in the exit process.

Figure 2: Agency-Identified Practices and Controls for Managing Potential Post-Employment and Conflict-of-Interest Issues by Select Agencies and SEC

	Select agencies GAO reviewed ^a							
	SEC	CFTC	DOD	FCC	Federal Reserve	FTC	FINRA	NCUA
Provide training	●	●	●	●	●	●	●	●
Provide information	●	●	●	●	●	●	●	●
Collect financial disclosures	●	●	●	●	●	●	●	●
Database for potential conflicts of interest					● ^b			
Mandatory exit procedures ^c	●	●	●		●	●		●
Agency-specific supplemental post-employment rules	●	●			●	●		
Other statutory post-employment rules			●		● ^b			●

Source: GAO Interviews with and documentation from selected agencies.

^aWe reviewed CFTC, DOD, FCC, Federal Reserve, FTC, FINRA, and NCUA. All of these agencies are federal agencies with the exception of FINRA, a self-regulatory organization for broker-dealers.

^bFederal Reserve Banks have these controls. Federal Reserve Banks are part of the Federal Reserve System and they combine both public and private elements.

^cThe other agencies we interviewed have voluntary exit procedures.

Additionally, similar to SEC, three agencies have agency-specific supplemental rules related to post-employment. For example, CFTC has a supplemental rule that requires former employees who intend to represent clients before CFTC within 2 years of leaving the agency to notify CFTC in writing before beginning representation.³⁴ FTC has a supplemental clearance rule that requires former employees to receive clearance to communicate with, appear before, or work behind-the-scenes on any FTC matter or proceeding that was pending while they were employed at FTC, even if their participation in the matter or proceeding at their new place of employment is solely in a behind-the-scenes capacity.³⁵ Further, members of the Federal Reserve's Board of Governors are prohibited from holding any position with a member bank of the Federal Reserve System for 2 years after they leave the Board, though only if they have not completed the term to which they were appointed.³⁶

³⁴ 17 C.F.R. § 140.735-6(e).

³⁵ 16 C.F.R. § 4.1(b).

³⁶ 12 U.S.C. § 242.

While SEC's controls are similar to many of those of other agencies, there are some differences. Within the Federal Reserve System, the Federal Reserve Banks have a system for tracking their examiners' prior employment and banking relationships to help manage potential conflicts of interest. Specifically, Federal Reserve Banks (which combine both public and private elements) have a system available to compare examiners' prior employment and banking relationships with staffing assignments to verify that examiners are sufficiently independent of potential impairments. Further, certain former employees of Federal Reserve Banks and NCUA are subject to additional statutory post-employment rules. The Intelligence Reform and Terrorism Prevention Act of 2004 provides that former senior examiners from Federal Reserve Banks and NCUA, as well as former senior examiners of other federal agencies that examine financial institutions, are prohibited for 1 year from accepting compensation from certain banks or credit unions they examined during their last year of employment.³⁷

Finally, SEC's recently implemented practice of collecting and documenting new employer information during exit interviews is unique among the other federal agencies we reviewed. FINRA, a self-regulatory organization, began requesting new employer information by e-mail from departing employees on a voluntary basis in September 2010, and began compiling the information into a database in November 2010. While many of the agencies we reviewed informally may ask employees the name of their new employer, none but SEC and FINRA systematically document such information.

³⁷ 12 U.S.C. § 1820(k).

While Stakeholders Identified Additional Options for Managing Potential Conflicts of Interest, Each Involves Advantages and Disadvantages

Stakeholders with whom we spoke identified additional options for managing potential conflicts of interest, and existing controls at the other agencies provide examples of other options. These options include improving documentation of employee recusals, developing a database to identify potential conflicts, tracking employees' participation in SEC matters, and the extension or expansion of cooling-off periods. Each of these options has advantages and disadvantages.

Better documentation of recusals. Establishing better documentation of employee recusals and related matters may provide SEC with additional information that it could use to screen for potential conflicts of interest. While SEC currently has an online system in which recusals can be documented, employee use of the system is optional. According to the SEC IG, better documentation of recusals and the related matters would help in creating a history of steps employees have taken to avoid potential conflicts of interest and would provide supervisors with information on matters for which certain employees have recused themselves and on which they cannot work. However, according to SEC officials, supervisors are generally aware of the matters from which their employees have recused themselves. Further, requiring documentation of recusals would require SEC supervisors or ethics officials to develop a method to enforce the requirement and ensure that recusals are in fact being documented. Some SEC employees stated that documenting recusals may have a limited impact on further managing potential conflicts of interest. Specifically, they stated that it is in an employee's interest to avoid potential conflicts of interest regardless of whether or not recusals are documented. Lastly, according to the SEC Ethics Counsel, SEC does not have the discretionary authority to require documentation of recusals.

Developing a database to help identify potential conflicts of interest. Developing a database that contains information on each SEC employee's prior employment, financial interests, and work history while at SEC could help manage potential conflicts of interest involving current and former employees. SEC managers could use the information when considering staffing decisions, such as those related to SEC examinations or investigations. As previously mentioned, the Federal Reserve Banks use a system to track their employees' prior employment and banking relationships to identify potential conflicts of interest. According to Federal Reserve officials, the system is updated on an annual basis or as necessary based on such events as changes in an employee's investments. In SEC's case, such a database could also be used when employees separate from the agency, to document matters for

which they were personally and substantially involved while an SEC employee. However, setting up such a database would require employees to identify and self report potential conflicts of interest to SEC. Thus, the system would not help identify any potential conflicts or issues that employees do not report. Establishing such a database also would go beyond the current online recusal system SEC has in place, and thus likely would require SEC to either enhance that system to include additional information or develop a new system entirely. Further, while the system would provide additional transparency about potential conflicts of interest, a few SEC employees and academics with whom we spoke suggested that such documentation would not deter an individual from violating conflict-of-interest restrictions if the individual has intentions to do so.

Tracking employees' participation in SEC matters. Maintaining a list of matters in which employees participate, such as enforcement cases or examinations, may help to promote transparency by documenting what employees have worked on prior to separating from the agency. Such a list could help SEC identify potential conflicts of interest. For example, the list could be maintained by employees and then provided to the Ethics Office during their exit interview so that ethics officials could review the list of matters and discuss any potential issues that might be related to an employee's post-SEC employment. According to representatives from citizen advocacy groups with whom we spoke, documentation of matters SEC employees participate in may help to provide transparency on potential conflicts when they leave SEC to work for law firms or financial firms. Current systems in the Division of Enforcement, Division of Corporation Finance, and OCIE do not track employee participation in all matters, so SEC would need to evaluate methods to determine the best manner in which to document this information. For example, while providing a list of matters in which employees have participated might be sufficient for a review during their exit interview, documenting this information in a system may provide more benefits, such as the ability to readily search for the information in the future. Further, the level of participation in a matter also would need to be determined before establishing whether employee participation in a specific SEC matter was personal and substantial and therefore subject to specific post-employment restrictions. Lastly, according to SEC officials, such documentation may not be necessary because the Ethics Office can coordinate with SEC managers to determine in which matters an employee participated, and their level of participation.

Extending cooling-off periods. Extending cooling-off periods beyond the current limits placed on federal government employees under section 207 would further limit former SEC employees, including former senior-level employees, from communicating with or appearing before the SEC for certain matters they participated in while at SEC.³⁸ According to academic researchers with whom we spoke and representatives from citizen advocacy groups, extending these cooling-off periods would allow for additional time to pass so that the impact of a former SEC employee then working on an SEC-related matter would be greatly diminished. Once the former employee is able to work on these matters, their knowledge of and familiarity with specific SEC matters would be limited, and thus the impact of participating in such matters would be reduced. However, representatives from law firms and financial firms stated that existing cooling-off periods are sufficient to diminish the impact or influence that a former SEC employee might have on a matter. Representatives from law firms, including some with former SEC employees, stated that any useful information former SEC employees take with them when they separate from SEC likely would be of little value by the time current cooling-off periods expire. Some SEC employees with whom we spoke also stated that extending cooling-off periods would place significant limitations on the ability of SEC employees to obtain employment outside of the agency. For example, employers might not find it feasible to hire SEC employees that are not able to represent their company or communicate with SEC for an extended period of time. Lastly, an extension of cooling-off periods under section 207 would require legislative action, because federal agencies, including SEC, do not have authority to extend cooling-off periods.

Expanding cooling-off periods. Expanding cooling-off periods to include behind-the-scenes activity may provide an additional mechanism to manage potential conflicts of interest. While section 207 places restrictions on communication and representational activities, it does not bar behind-the-scenes activity.³⁹ Including behind-the-scenes assistance as part of the post-employment restrictions would help manage situations,

³⁸ After an individual has separated from an agency, section 207 provisions restrict the individual from representing a firm to their former agency for defined cooling-off periods that vary according to the former employee's involvement and seniority.

³⁹ 18 U.S.C. § 207(b) places restrictions on former government employees providing behind-the-scenes assistance to certain interests only if they participated in ongoing trade or treaty negotiations during their last year of government service.

such as those identified in a recent SEC IG report, in which a former SEC employee can work on a matter shortly after leaving SEC as long as he or she is not communicating with SEC or representing a firm or client before SEC.⁴⁰ For example, a senior-level SEC employee could leave SEC and obtain employment with a regulated firm and, shortly after separating from SEC, would be able to assist the firm with developing a comment letter or a defense strategy regarding an SEC matter so long as that individual does not sign the comment letter or appear before or communicate with SEC. However, similar to the extension of cooling-off periods, expanding restrictions to include behind-the-scenes assistance would require revisions to governmentwide post-employment statutes. Finally, behind-the-scenes assistance may already be addressed in professional association ethics standards or rules for attorneys and accountants. For example, state bar professional conduct rules generally would prohibit former government attorneys from providing behind-the-scenes assistance if they previously participated personally and substantially in that matter.

Conclusions

SEC has established a number of controls to address potential post-employment and conflict-of-interest issues, including providing training to current employees about post-employment restrictions and imposing post-employment requirements and restrictions. However, SEC has not consistently documented ethics-related advice. Better documentation of ethics advice could improve SEC's ability to demonstrate that its officials are providing appropriate advice to current and former employees, and that the agency is taking steps to minimize the potential for post-employment violations or conflicts of interest. It would also add transparency to SEC's implementation of agency-specific controls related to post-employment and conflict-of-interest issues, which could better protect the agency from concerns about its employees and their movement between SEC and SEC-regulated firms or firms that represent them. Conversely, without standards for documenting ethics advice, inconsistent documentation prevents SEC from being able to readily determine the extent to which previous conversations or requests occurred regarding specific employees' post-employment or conflict-of-interest issues, particularly in situations where the relevant ethics official who provided the advice has separated from SEC. Further, without such

⁴⁰OIG-540.

documentation, SEC lacks evidence of steps it has taken when providing ethics advice to current and former employees about post-employment or conflict-of-interest issues.

Recommendation for Executive Action

To promote transparency and help strengthen SEC's procedures for documenting events related to potential current and post-employment issues associated with the movement of employees between SEC and other employers, we recommend that the SEC Chairman establish standards for documentation of ethics advice.

Agency Comments

We provided a draft of this report to SEC for review and comment. In its comment letter, which is reprinted in appendix II, SEC generally agreed with our findings and recommendation. SEC also stated that, pursuant to our recommendation, it has started to draft standards concerning the documentation of ethics advice relating to the issues identified in this report. SEC also provided technical comments that we incorporated where appropriate.

We are sending copies of this report to the appropriate congressional committees and the Chairman of the Securities and Exchange Commission, and other interested parties. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact me at (202) 512-8678 or clowersa@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.



A. Nicole Clowers
Director, Financial Markets and Community Investment

Appendix I: Scope and Methodology

To determine how many individuals separated from the Securities and Exchange Commission (SEC), we obtained and analyzed SEC separation data for employees who left the agency between October 1, 2005 and September 17, 2010. We identified 2,127 employees who had left the agency during that time. We assessed the reliability of the data we obtained from SEC by verifying that date ranges were consistent with our data request, that data elements were consistent with agency descriptions, and that occupation types were reasonable for the nature of SEC's mission. Additionally, we verified that occupation codes matched job descriptions and verified justifications for duplicate entries. We determined that the data were sufficiently reliable for purposes of this report. For reporting on these data, we developed occupation categories relevant to SEC's examination and investigative efforts—accounting, legal, economists, and examination—based on our review of occupation codes reflected within SEC attrition data and the Office of Personnel Management (OPM) job series codes: accounting and budget group (OPM codes 0500–0599); legal and kindred group (OPM codes 0900–0999); economists (OPM code 110); and the inspection, investigation, enforcement, and compliance group (OPM codes 1800–1899), respectively. We excluded occupations (such as information technology specialist, human resource specialist, and secretary) not consistent with the categories we developed. We also considered selected separation types for our analysis. We included resignations, removals, select terminations, and most retirements.¹ We excluded transfers to other government agencies, retirements due to disability, death, termination during a probationary period, and expiration of term appointments. As shown in table 1, a total of 784 individuals met the selected criteria for type of separation and occupation type. The following table provides the number of individuals who fit in one of the selected separation types from each occupation category:

¹We excluded retirements due to disability; we included all other retirements represented in these data.

Table 1: SEC Separations by Occupation Category, October 2005 through September 2010

Occupation category	Number of separated employees
Accounting	253
Legal	444
Examination	64
Economists	23
Total	784

Source: GAO analysis of SEC data.

Note: Data for fiscal year 2010 are through September 17, 2010. In addition to examiners, the examination occupation category also includes a smaller number of other occupations such as investigators. To calculate the number of separations, we included resignations, removals, most retirements, and select terminations. Given our focus on the movement of former SEC employees to regulated firms or firms that represent regulated firms, we excluded transfers to other government agencies, retirements due to disability, death, termination during a probationary period, and expiration of term appointments (including term appointments for fellowship programs).

To determine where some former SEC employees obtained employment after separating from SEC, we obtained and analyzed notice of appearance requests (also referred to as 8b letters). Specifically, we obtained and analyzed a total of 825 letters filed by former SEC employees requesting approval to appear before SEC from October 3, 2005 through October 4, 2010. These letters typically included the name of the former employee, their former position with SEC, and their current employer at the time they filed the letter, among other information. We also conducted Internet-based searches on a nonprobability sample from the 784 individuals who met the selected criteria for types of separation and occupation types described previously. We selected the sample of 150 individuals by selecting the 50 most recently separated employees in our data set (May 21, 2010 to September 10, 2010), the 50 who separated from SEC in the median period of time in our data set (April 5, 2007 to July 13, 2007), and the 50 least recently separated SEC employees in our data set (October 1, 2005 to December 30, 2005). We searched for the 150 selected individuals using the Web-based information sources LinkedIn.com and Martindale.com, which are a professional networking site and a site containing profiles for lawyers and firms in the United States, respectively. We also reviewed Internet search results including employer Web sites and trade journal articles. We considered our Internet search results to be sufficiently reliable for purposes of this report if the search result source specifically referenced the individual's name, former SEC position, and approximate separation time, as indicated in SEC's attrition data. When approximate separation time was not included, we considered other publicly available information

such as location or education. Lastly, we conducted an interview with the Association of SEC Alumni to obtain officials' perspectives on where former SEC employees obtain employment after separating from SEC.

To describe the advantages and disadvantages of employee movement between SEC and regulated firms or firms that represent them, we conducted in-person and telephone interviews with SEC officials, representatives of three securities firms and three law firms, four academic researchers who have conducted research on the financial industry and government regulators, and representatives of three citizen advocacy groups that conduct work on government ethics issues. We selected securities firms to interview based on reported total sales revenue. Specifically, using Nexis.com's Company Dossier file, we identified total annual sales revenue for firms with North American Industrial Code 523120, which corresponds to security brokerage firms, or code 523110, which corresponds to investment banking and securities firms. Total sales revenues reflected the most recently reported information for the individual financial institutions. We selected the three firms with the highest total annual sales revenue based on the results of this search.² We selected law firms to interview based on our analysis of 8b letters filed with SEC from October 3, 2005 to October 4, 2010. We identified and selected firms that were represented most frequently in terms of total number of 8b letters filed by employees, total number of employees that filed 8b letters, and total number of times a firm was in the list of most 8b letters filed by employees across individual years during the time period.

To describe internal controls SEC has in place to manage potential conflicts of interest associated with the movement of employees to the private sector, we obtained documentation on controls related to managing potential post-employment and conflict-of-interest issues. We reviewed SEC-specific post-employment guidance and policies, and interviewed managers and employees of relevant SEC divisions and offices. We selected SEC divisions and offices to review based on our analysis of SEC separation data. Starting with the 784 individuals who met the selected criteria for types of separation and occupation types described above, we categorized individuals as senior or nonsenior

²We excluded one firm from consideration because the company filed for bankruptcy after the latest total sales revenue was reported.

based on an employee's pay plan and grade at the time of his or her separation.³ Based on this group of 289 senior and 495 nonsenior individuals, we identified four divisions and offices with the highest attrition of senior and nonsenior employees. They were the Division of Corporation Finance (127 separations: 26 senior employees and 101 nonsenior employees); the Division of Enforcement (92 separations: 40 senior employees and 52 nonsenior employees); the Office of Compliance Inspections and Examinations (45 separations: 11 senior employees and 34 nonsenior employees); and the Office of the Chief Accountant (44 separations: 35 senior employees and 9 nonsenior employees). We interviewed management-level staff in each of these four divisions and offices. We also obtained documentation from the SEC Ethics Office and interviewed the SEC Ethics Counsel about controls and practices the Ethics Office has in place and perspectives on post-employment and conflict-of-interest issues. Furthermore, we reviewed *Standards for Internal Control in the Federal Government* to identify any controls that may help manage potential post-employment and conflict-of-interest issues.⁴

We interviewed SEC employees in three of the divisions and offices we selected.⁵ To collect perspectives from SEC employees on issues related to movements of SEC employees to the private sector and controls SEC has in place to manage these issues, we obtained and analyzed current SEC employee data as of January 24, 2011, for the Divisions of Corporation Finance and Enforcement and for the Office of Compliance Inspections and Examinations. In analyzing these data for 2,573 current employees, we examined current nonsenior employees in two assigned categories—newer employees (employees with 2 to 4.3 years of SEC experience) and more experienced employees (employees with more than 7 years of SEC experience). Based on SEC separation data, 4.3 years was the median amount of time an employee had spent at SEC

³We identified nonsenior employees as those within SEC pay plan SK, grade 14 and lower; senior employees included those within pay plan SK, grades above 14, or all other pay plans reflected in these data. The SK pay plan applies to SEC employees formerly under the GS pay plan.

⁴[GAO/AIMD-00-21.3.1.](#)

⁵Through our data analysis and initial interviews with SEC managers, we determined the Office of the Chief Accountant is a smaller office that accounted for less nonsenior employee attrition than other divisions and offices. Based on this information, we excluded the office from our employee interview selection criteria.

prior to separating from the agency. Using these data, we then randomly selected 10 employees to interview based on the following criteria: 1) one new and one experienced employee from each of the three divisions and offices we reviewed (six employees) and 2) two field-based employees—one new and one experienced—from each division or office with a field office location (four employees).⁶

To compare SEC's controls with controls across other agencies, we obtained documentation on internal controls related to managing potential conflicts of interest and post-employment issues and interviewed officials from seven agencies. We selected enforcement and regulatory agencies with missions similar to SEC's and another agency with experience managing post-employment issues. These agencies were the Commodity Futures Trading Commission, the Department of Defense, the Federal Communications Commission, the Board of Governors of the Federal Reserve System, the Federal Trade Commission, the Financial Industry Regulatory Authority, and the National Credit Union Administration.⁷ We also obtained documentation and interviewed officials from the Office of Government Ethics for perspectives on federal rules, restrictions, and controls related to conflict-of-interest and post-employment issues.

To identify additional options available to manage post-employment and conflict-of-interest concerns, we interviewed officials from the seven agencies identified above, academic researchers, and representatives from law firms, including some with former SEC employees, financial firms, and citizen advocacy groups. We also reviewed existing governmentwide, post-employment restrictions and obtained perspectives on the extent to which extensions or expansions of these restrictions would help to better manage post-employment and conflict-of-interest concerns. We also examined controls and post-employment restrictions specific to other agencies.

We conducted our work between August 2010 and July 2011 in accordance with generally accepted government auditing standards.

⁶The Division of Corporation Finance does not have employees who work in a field office location. Therefore, we only interviewed employees from SEC's headquarters location (Washington, D.C.) for this division.

⁷All these agencies are federal agencies with the exception of the Financial Industry Regulatory Authority, a self-regulatory organization for broker-dealers.

Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Securities and Exchange Commission



THE CHAIRMAN

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

June 22, 2011

Ms. Angela Nicole Clowers
Acting Director, Financial Markets and Community Investment
Government Accountability Office
441 G Street, NW
Washington, D.C. 20548

Dear Ms. Clowers:

This letter responds to your request, dated June 7, 2011, to review and comment on the draft report entitled *Securities and Exchange Commission: Existing Post-Employment Controls Could Be Further Strengthened* (GAO-11-654).

The SEC appreciates GAO's thorough review of our post-employment controls. The SEC already has in place a number of strong controls for managing post-employment and conflict-of-interest issues. As the report discusses, these include training and information for employees, staffing decisions and work process controls, ethics advice, exit process requirements for departing employees, and supplemental post-employment rules for certain employees. We appreciate that GAO acknowledges these controls and recognizes that they are similar to those of the other agencies that GAO reviewed. The SEC acknowledges that even strong programs can become stronger and, pursuant to GAO's recommendation, has begun drafting standards concerning the documentation of ethics advice relating to the issues identified in the report.

I understand that Shira Minton has separately conveyed to you a number of technical comments on the draft report.

Thank you for the consideration that you and your staff have shown to our staff and for the opportunity to comment on this draft report. If you have any questions or would like to further discuss this letter, please feel free to contact Shira Minton, Ethics Counsel, at (202) 551-7938.

Sincerely,

A handwritten signature in cursive script, appearing to read "Mary L. Schapiro".

Mary L. Schapiro
Chairman

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

A. Nicole Clowers, (202) 512-8678 or clowersa@gao.gov

Staff Acknowledgments

In addition to the contact named above, Andrew Pauline (Assistant Director), Heather Chartier, Chase Cook, James Lager, Tarek Mahmassani, Marc Molino, Luann Moy, Linda Rego, and Jennifer Schwartz made key contributions to this report.

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