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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Chairman, Subcommittee On Oversight And Investigation Committee On Energy And Commerce House Of Representatives

Statistics On SEC's Enforcement Program

SEC is authorized by legislation to investigate suspected violations of the federal securities laws and, where warranted, to bring enforcement actions against suspected violators. This report presents statistics on SEC's enforcement activities, such as number, type and age of investigations, and number of actions for fiscal years 1977 through 1983. While data presented may indicate level of effort and area of emphasis, according to industry experts and SEC the overall effectiveness of the program is difficult to measure because there is no reliable method for estimating the violative conduct SEC has prevented.

UNITED STATES GENERAL ACCOUNTING OFFICE

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT
DIVISION

B-217030

The Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives

Dear Chairman Dingell:

This report responds to your request for a review of the effectiveness of the Securities and Exchange Commission's (SEC) Enforcement Program. Industry experts we interviewed and the SEC agreed that the program's overall effectiveness is difficult to measure because there is no reliable method for estimating the amount of violative conduct SEC has prevented. Because of this, we agreed with your office to provide statistics on SEC's enforcement activities for fiscal years 1977 through 1983, and/or changes in these activities. In commenting on our draft report, SEC stated that it remains committed to and has made certain improvements to the enforcement program. We are not questioning SEC's commitment and did not analyze the management of the program. However, we have begun a review of this area and will report on it at a later date. Details of our scope and methodology are contained in appendix VII.

HOW THE ENFORCEMENT PROCESS WORKS

SEC was created by the Securities Exchange Act of 1934 to administer federal securities laws designed to protect the investing public. It carries out this responsibility through eight programs. Of its three primary programs, one is designed to provide full disclosure to investors, while another regulates the securities industry. The third, the Prevention and Suppression of Fraud (Enforcement) Program, is intended to prevent fraud in the securities market.

The Enforcement Program is SEC's largest program. This program receives about one third of the Commission's total resources. In fiscal year 1983, approximately 610 staff years and about $30 million were devoted to this program. Under the program, SEC conducts investigations of possible violations of the federal securities laws and institutes the enforcement proceedings against suspected violators. The types of violations investigated include activities such as trading on the basis of insider information, market manipulation, and sale of unregistered securities.

The Commission's Enforcement Program is administered by the Division of Enforcement within SEC headquarters and the nine regional offices located throughout the United States. Staff of these offices perform investigations and make recommendations to the Commission for enforcement action.

SEC's investigations are fact finding in nature. As a result, the SEC may conduct an investigation on mere suspicion that the laws have been or are about to be violated, or even to determine if it, as a regulatory body, has jurisdiction in a particular matter.

Since each investigation is unique, the enforcement process may vary depending upon the circumstances. The following is an explanation of the process as it generally works.

The initial stage of the enforcement process is the intelligence analysis. This is the evaluation of information that may indicate the existence of past or imminent violations of the federal securities laws. Information on possible violations is received from a number of sources, such as public complaints; inspections of books and records of brokers and dealers; review and analysis of market surveillance and news media data; and referrals from federal, state, or local agencies.

After this information is evaluated, enforcement staff decide to either pursue or drop the matter. If the matter is pursued, either an investigation or a Matter Under Inquiry (MUI) will be opened. A MUI is opened when more information is needed to determine the merits of pursuing the issue. This allows the staff to spend up to 80 working hours researching the matter. If information obtained during the MUI phase indicates that the matter should be pursued, an investigation is opened.

An investigation can be conducted informally or formally. Under an informal investigation, the staff can proceed without obtaining formal Commission approval. This is done when witnesses and others are willing to cooperate and voluntarily provide information. If it is necessary to compel testimony and the production of records, the Commission's approval of a formal investigation is necessary. Such approval gives designated staff power to issue subpoenas for testimony and the production of documents. During the period covered by our review, formal investigations averaged 50 percent of the investigations opened.

An investigation may involve a routine examination into the conduct of a single person or entity or a complex inquiry into an elaborate scheme involving many persons and entities. An investigation may not result in any action or, conversely, it may result in a series of separate enforcement actions against any number of defendants. Those individuals or other legal entities named in civil injunctive actions are called defendants, whereas those named in administrative proceedings are called respondents. For ease of discussion, we refer to both as defendants.

Generally, the Commission uses two types of enforcement actions against those who violate the securities laws. One type is a civil injunctive action in a U.S. District court. Civil injunctions are court orders prohibiting existing or imminent violations of the securities laws and sometimes provide other equitable relief, such as a freeze on funds to protect the investing public. The second type is an administrative proceeding before an administrative law judge. Administrative proceedings provide other types of remedies, such as suspension from doing business, limitations of activities, a bar from doing any further business, or a bar from participation in the securities industry. These are generally used in instances where violations have occurred by regulated entities or by persons associated with such entities. The Commission may, however, refer an investigation to the Department of Justice for criminal prosecution or to a state or local agency or a self-regulatory organization for their appropriate action.

The enforcement staff must obtain the Commission's specific approval for each enforcement action, including the naming of proposed defendants and the citing of alleged violations. After approval is granted, the official complaint is filed with a federal district court or an administrative law judge. Costly litigation is often avoided when consent agreements are reached in lieu of these legal proceedings. This occurs in situations where the Commission and the proposed defendant negotiate an agreement whereby the defendant agrees to accept the sanctions and remedies sought by the Commission without admitting or denying the charges.

POTENTIAL FOR VIOLATIONS HAS GROWN

According to SEC, the incidence of securities law violations is proportional to the size and activity of the securities market. From fiscal year 1977 through fiscal year 1983, the securities industry grew quite rapidly. For example, the number of shares traded on the New York Stock Exchange increased from 5.2 billion in calendar year 1977 to 21.6 billion in calendar year 1983--a net increase of over 300 percent. In addition, the number of first-time registrants with the Commission increased by 260 percent between fiscal years 1977 and 1983. First-time registrants are those businesses who file the first registration of a security as required by the Securities Act of 1983. During the same period broker-dealer registrations grew by 59 percent and investment company registrations grew by 52 percent.

The growth in the industry was accompanied by a corresponding increase in the indicators of potential securities law violations. Specifically, the number of public complaints and inquiries to SEC alleging security law violations increased from 8,500 to almost 29,000 between fiscal years 1977 and 1983.

The number of New York Stock Exchange "watch alerts" increased 310 percent and National Association of Securities Dealers Automated Quotation System "parameter breaks" increased 248 percent between calendar years 1977 and 1983. These two indicators are outputs of computerized market surveillance systems that, among other things, monitor unusual price or volume changes. (See app. II.)

As the SEC pointed out in comments on this report, the increase in market size and activity, coupled with changes in the legal environment, have increased the complexity of the Commission's enforcement mission and, consequently, the challenge to its enforcement resources.

CHANGES IN SEC'S ENFORCEMENT PROGRAM HAVE OCCURRED

Based on our analyses for fiscal years 1977 through 1983, we have several observations about the quantitative results of SEC's enforcement activities. Additional information not highlighted in this section may be found in the appendixes. These observations do not indicate effectiveness of the enforcement program, however.

Although funding for both SEC in total and the Enforcement Program increased during the years covered by our review, enforcement staff declined each year since 1979. During the 7-year period covered by our review, SEC's appropriation grew from $56 million to $90 million (59 percent), while the Enforcement Program's funding increased from $21 million to $30 million (47 percent). During this same period enforcement staffing declined from 633 to 610 (3.6 percent). This compares with a decrease in total SEC staffing from 1,934 to 1,921 (less than 1 percent) during the period. (See app. III.)

Our analysis also showed changes in selected measures of SEC's enforcement activity. Specifically, SEC reduced the number of pending investigations by 45 percent (from 1,361 to 750) between the beginning of fiscal year 1977 and the end of fiscal year 1983. During the period, the average age of pending investigations decreased from 884 days (2.4 years) to 707 days (1.9 years), and the percentage of investigations closed without enforcement actions grew from 43 percent in fiscal year 1977 to 48 percent in fiscal year 1983. The number of enforcement actions declined through fiscal year 1980 but then increased through fiscal year 1982 and leveled off through fiscal year 1983. (See app. IV.)

We also identified changes in the violations most commonly cited in formal investigations, civil injunctions, and administrative proceedings. For example, in comparing fiscal years 1977 and 1983, we noted that the percent of civil injunctions citing two of the most commonly named anti-fraud provisions[1] of the federal securities laws declined by 29 and 14 percentage points. Our analysis also showed a decrease in the percent of those formal investigations and civil injunctions citing the most often named reporting requirements of the securities laws. In addition, our analysis showed a decrease in the percent of those formal investigations and civil injunctions citing the most often named security registration violations, and an increase for those violations cited in administrative proceedings. Since our analysis consisted of a comparison between two years (fiscal years 1977 and 1983) it does not necessarily indicate overall trends in intervening years. (See app. V.). We did not attempt to evaluate an overall enforcement strategy that might be represented by these figures.

Our analysis showed a decline in the number of subjects identified in formal investigations and defendants named in enforcement actions. Specifically, 513 subjects were named in fiscal year 1977 formal investigations compared to 292 in fiscal year 1983. In fiscal year 1977, 747 defendants were named in civil injunctions compared to 429 in fiscal year 1983. For administrative proceedings, the figures were 254 in fiscal year 1977 and 172 in fiscal year 1983. However, our analysis did not show any significant changes in the types of defendants. SEC consistently named more individuals than other legal entities in enforcement actions. (See app. VI.)

Appendixes I through VI contain information on changes in SEC enforcement activities for fiscal years 1977 through 1983. As agreed with your office, we did not determine the reasons for or the effect of these changes.

AGENCY COMMENTS AND OUR EVALUATION

The SEC, in commenting on our report, expressed concern that our statistics could, without further interpretation, mislead a reader into concluding that the SEC "is not supportive of its enforcement program." The SEC asked that we modify our report to reflect certain "important considerations." (See app. VIII for the entire SEC letter.)

As indicated earlier in our report, we are not making conclusions about either SEC's commitment to its enforcement program or the effectiveness of the program. We are reporting statistical data on SEC's enforcement activities. Additional

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[1] Securities Act of 1933, Section 17a and Securities Exchange Act of 1934, Section 10b.

information on SEC's concerns and our observations about them follows.

SEC commented that by lumping regional office and headquarters direct and support enforcement staff together, we imply that SEC is not supportive of the enforcement program. We reported total enforcement figures agencywide as being representative of the program. The Commission suggested that we segregate regional and headquarters staff levels and then use the headquarters direct enforcement staff as the better indicator of SEC's commitment to the enforcement program. SEC's reasoning is that the regional offices assign staff to both enforcement and regulatory matters, and so level or degree of enforcement effort may vary. However, the enforcement division's staff are dedicated to enforcement matters. By following SEC's suggestion, the decline for direct headquarters enforcement staff (the enforcement division) would be approximately 1 percent over the period covered by our review; the decline for regional office enforcement staff and for headquarters support staff (staff in other headquarters offices which contribute to the enforcement effort) would be 4.4 and 10.5 percent, respectively.

SEC's data shows that regional staff resources constitute almost 70 percent of the total "Direct Enforcement Activities." Therefore, we continue to believe that statistics comparing the staff of all SEC enforcement offices may be more meaningful than those which only address the staff of the enforcement division. In addition, measuring the impact on the "total enforcement program" of the regional or headquarters reductions requires a more complex analysis than either we attempted or the SEC offered in its comments. Such an analysis would require relating the kinds of cases pursued to current market problems. It would also require an evaluation of the enforcement process, which we have begun in another assignment.

According to SEC, we should not include information in the report comparing enforcement program funding to total commission funding because funding is too unreliable a measure of a program's relative importance. SEC was concerned that our comparison would improperly reflect program priority and pointed out that changes in the level of funding are attributable to a number of items which affect enforcement's share of the SEC budget. We reported the changes to present a perspective on the program. We did not use them to formulate conclusions about the program's relative priority.

SEC expressed concern that our draft report's statement that enforcement resources declined implies that enforcement actions also dropped. SEC maintains that it has improved the productivity of the enforcement program and cites figures included in our report on the increased number of actions taken since fiscal year 1981. SEC cited additional figures on the increased actions per staff year as evidence to support its conclusions. While this may demonstrate more output by the staff, whether this demonstrates greater program productivity depends on the results obtained and more detail on the reasons for the reductions. We did not attempt such an analysis because of the large commitment of resources it would require.

SEC believes that our statement, in our draft report, that SEC reduced the number of pending (ongoing) investigations conveys the impression that "SEC is cutting back on enforcement." SEC stated that the reduction of pending investigations represents an important improvement in the enforcement program. It cited the reduction in the backlog of pending investigations and in the average age of investigations presented in our report as evidence of improved efficiency. We did not intend to imply that SEC is cutting back on enforcement. We cannot comment on the effect of these actions on program efficiency without an analysis of specific cases dropped and the resulting effect on market participants.

SEC believes that our report should contain information on environmental changes which impact upon the enforcement program. SEC specifically mentioned changes in the Nation's economic climate, the Nation's securities markets, the legal environment, and legal requirements as impacting on the complexity of enforcement matters, difficulty of conducting investigations, and evidentiary standards. We agree with the SEC's comment that it is now operating in a changing and more complex market environment, and we have incorporated this consideration into our report on page 6. We also agree that this is one factor that any reader should take into account in viewing the figures cited.

SEC commented that our report reflects improved management of the enforcement program. To support this opinion, it restated some of the data in our report, cited other factors, and concluded that these demonstrated a more effective enforcement process and underscored the excellent productivity achievements of the Commission's enforcement management.

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As arranged with your office, unless the contents of this report are publicly announced earlier, we plan no further distribution until 10 days from the date of this report. At that time, we will send copies to interested parties and make copies available upon request.

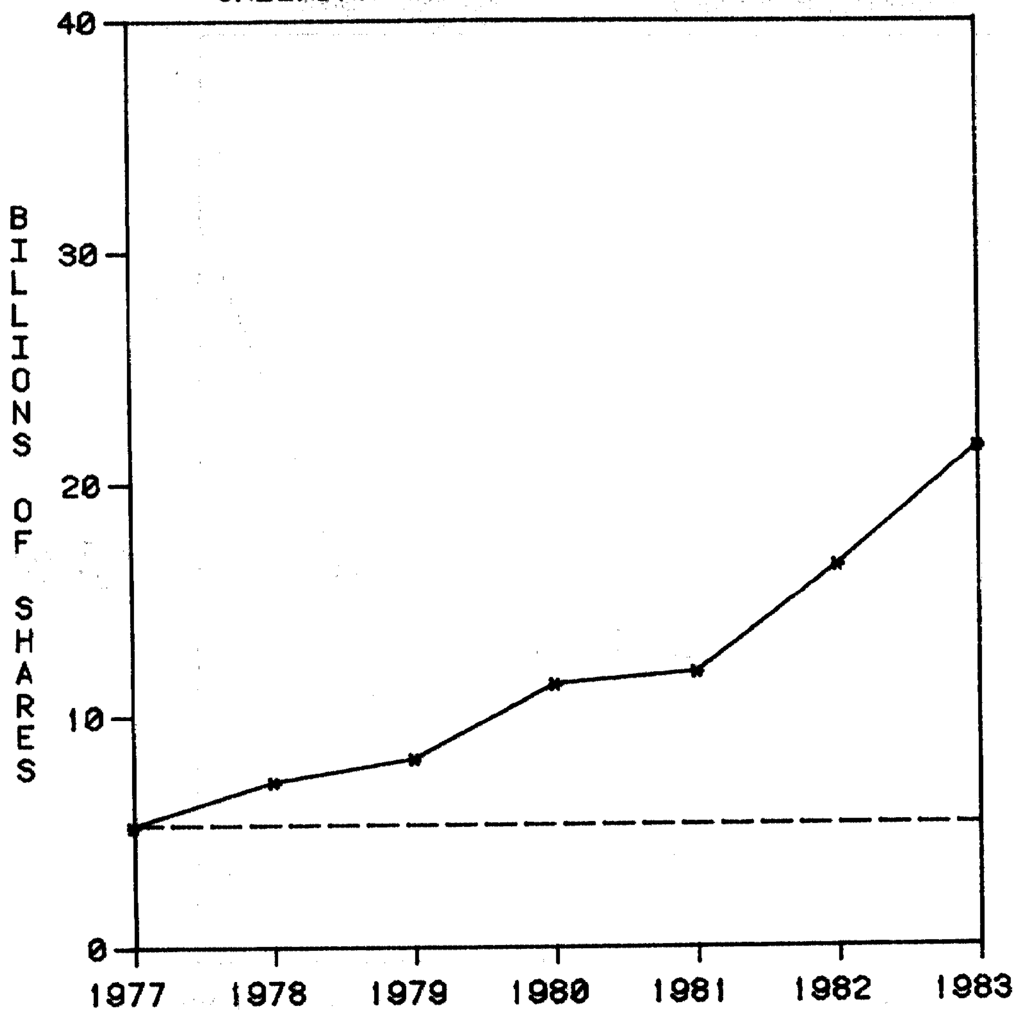
Sincerely yours,

W.J. Anderson

William J. Anderson
Director

GROWTH IN
MARKET ACTIVITY

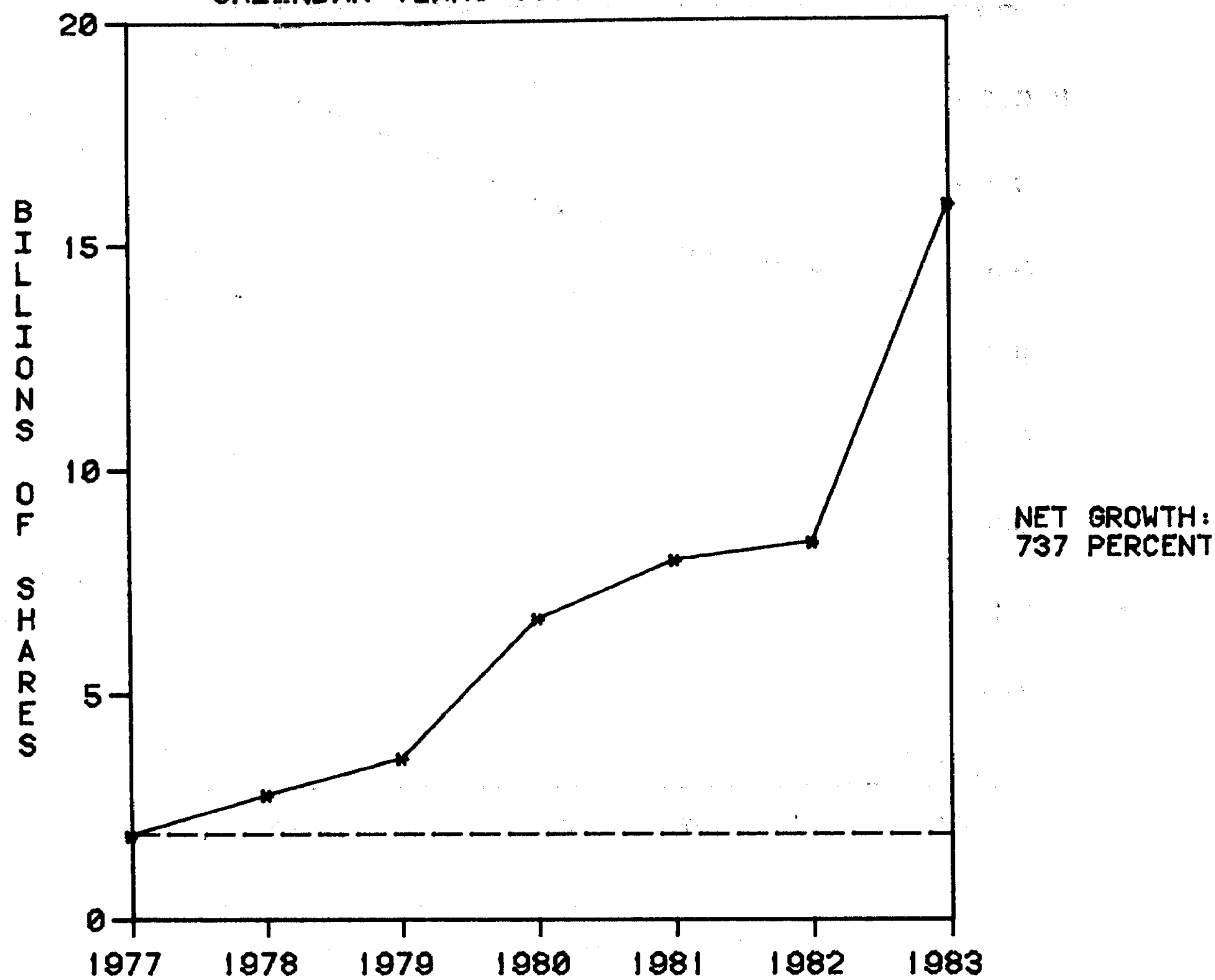
VOLUME OF SHARES TRADED ON THE
NEW YORK STOCK EXCHANGE
(IN BILLIONS)
CALENDAR YEARS 1977 THROUGH 1983



NET GROWTH:
309 PERCENT

SOURCE: New York Stock Exchange Fact Book 1984.

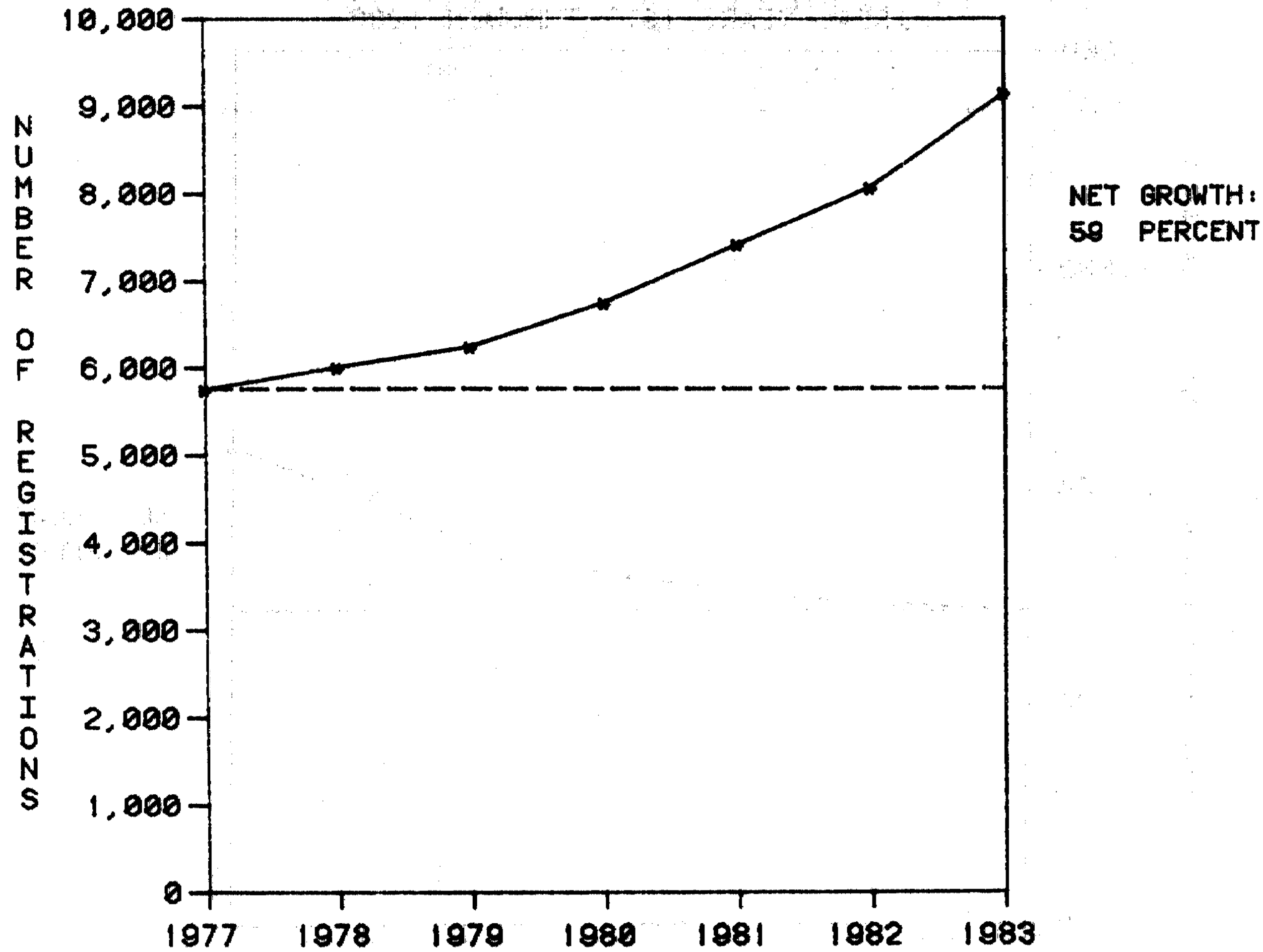
VOLUME OF SHARES TRADED ON THE
NATIONAL ASSOCIATION OF SECURITES DEALERS
AUTOMATED QUOTATION SYSTEM a/
(IN BILLIONS)
CALENDAR YEARS 1977 THROUGH 1983



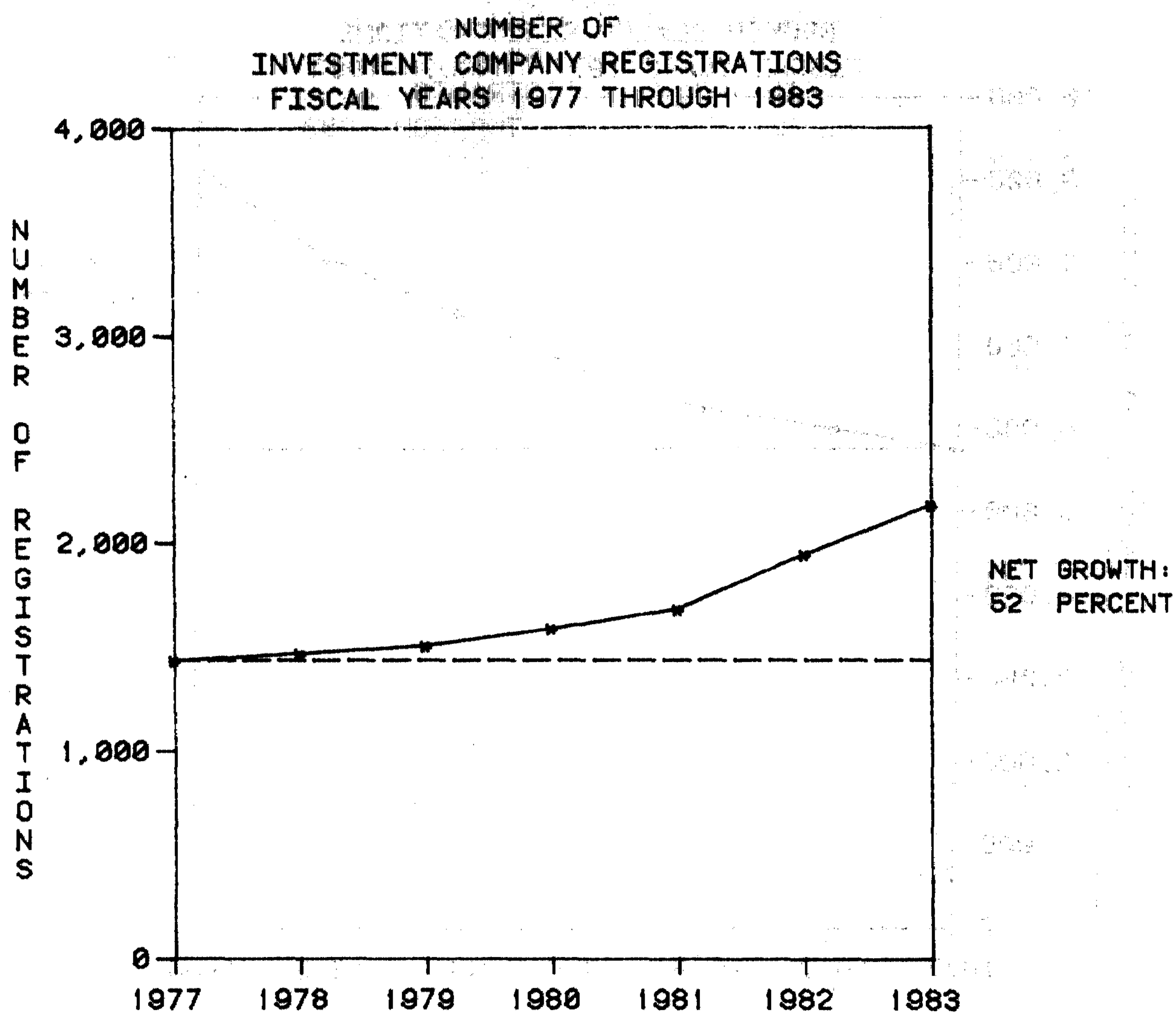
a/ National Association of Securities Dealers Automated Quotation System (NASDAQ) records and reports daily volume and price information of over-the-counter securities trading.

SOURCE: SEC's Annual Reports and information provided by the Division of Enforcement.

NUMBER OF
BROKER-DEALER REGISTRATIONS
FISCAL YEARS 1977 THROUGH 1983

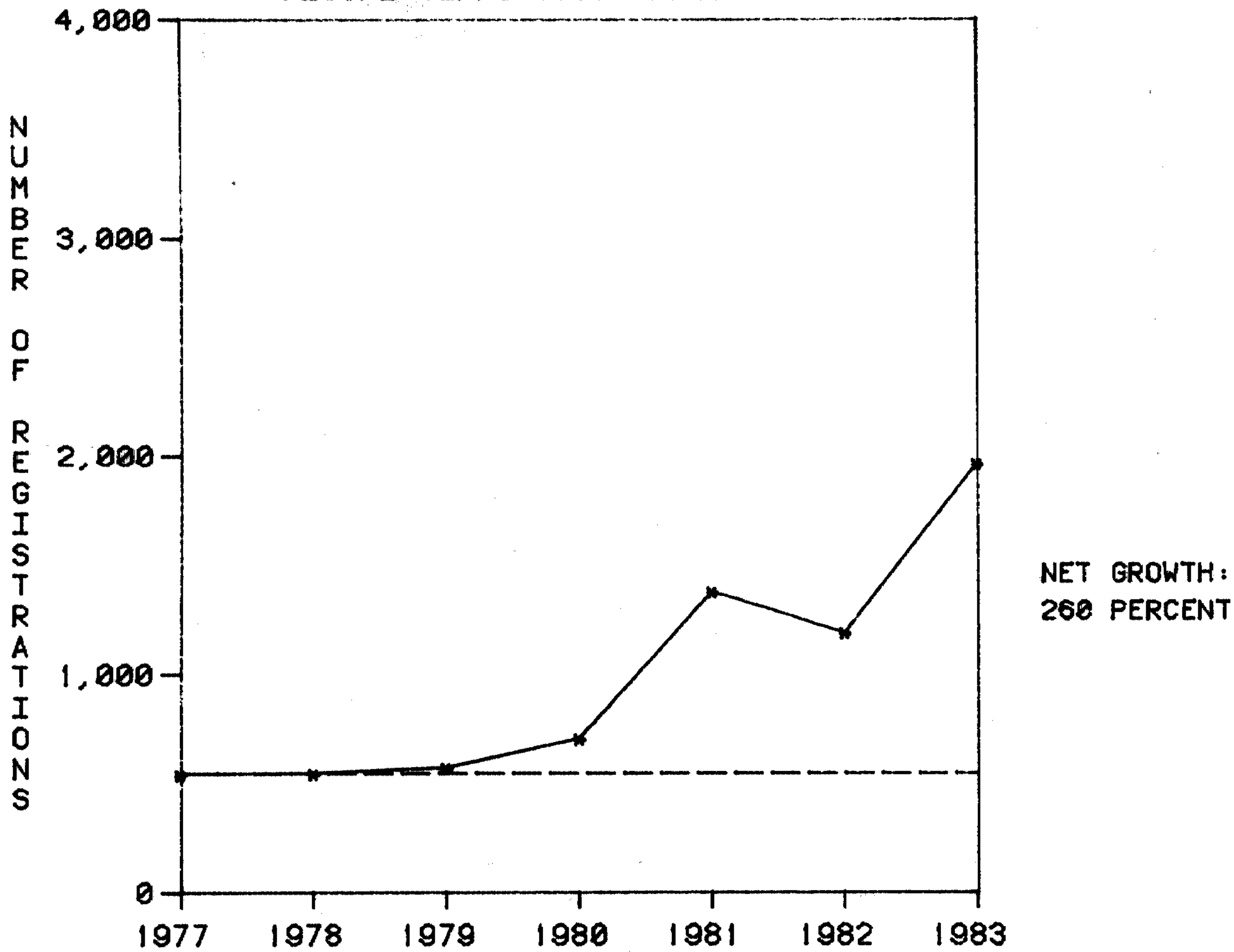


SOURCE: SEC's Annual Reports and information provided by the Division of Enforcement.



SOURCE: SEC's Annual Reports and information provided by the Division of Enforcement.

NUMBER OF REGISTRATION STATEMENTS
FILED BY
FIRST-TIME REGISTRANTS a/
FISCAL YEARS 1977 THROUGH 1983

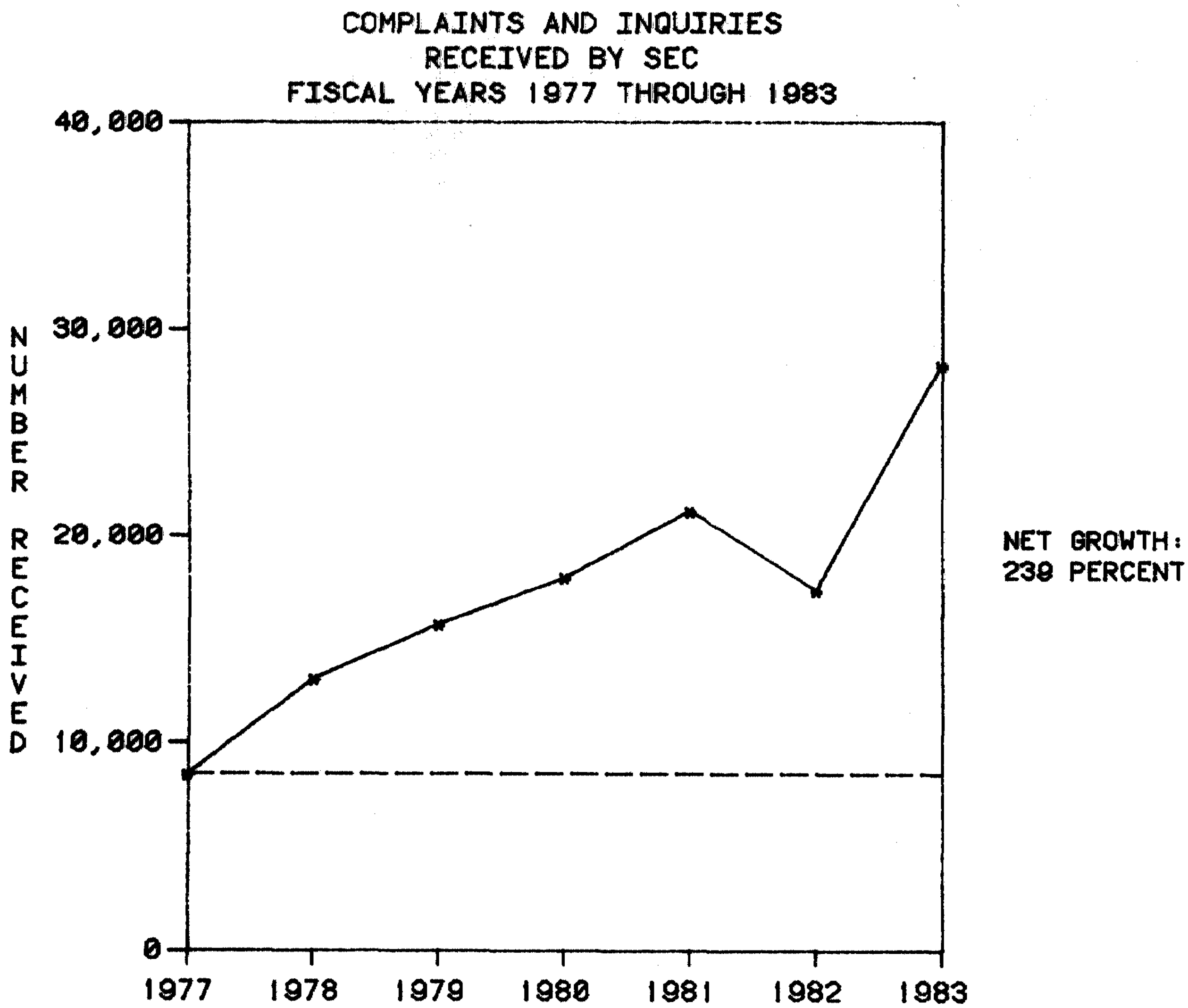


a/ A business' first or initial public offering of a security that meets the requirement to register under the Security Act of 1933.

SOURCE: SEC's Division of Corporation Finance.

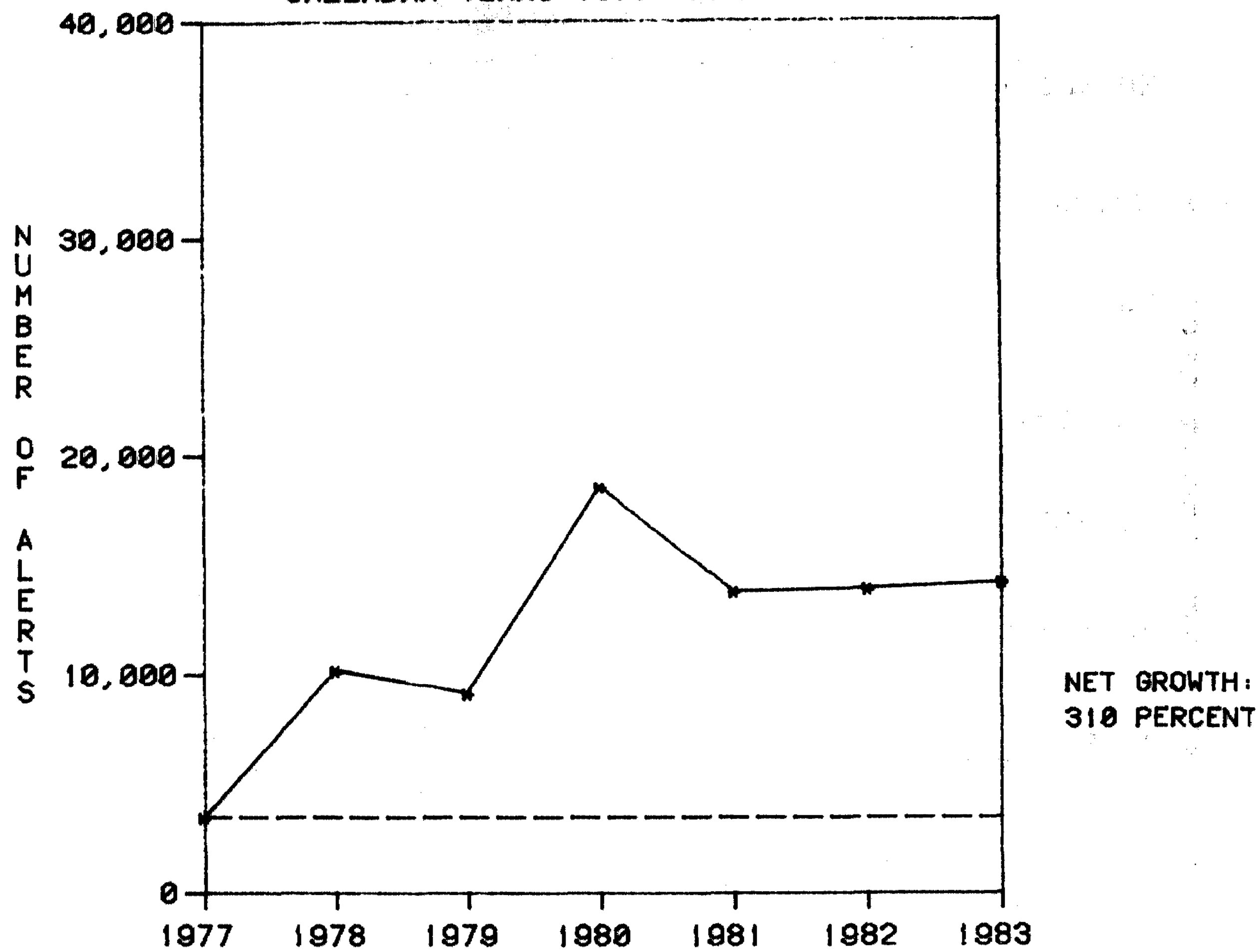
APPENDIX II

GROWTH IN INDICATORS OF FRAUD



SOURCE: SEC's Office of Consumer Affairs and Information Services.

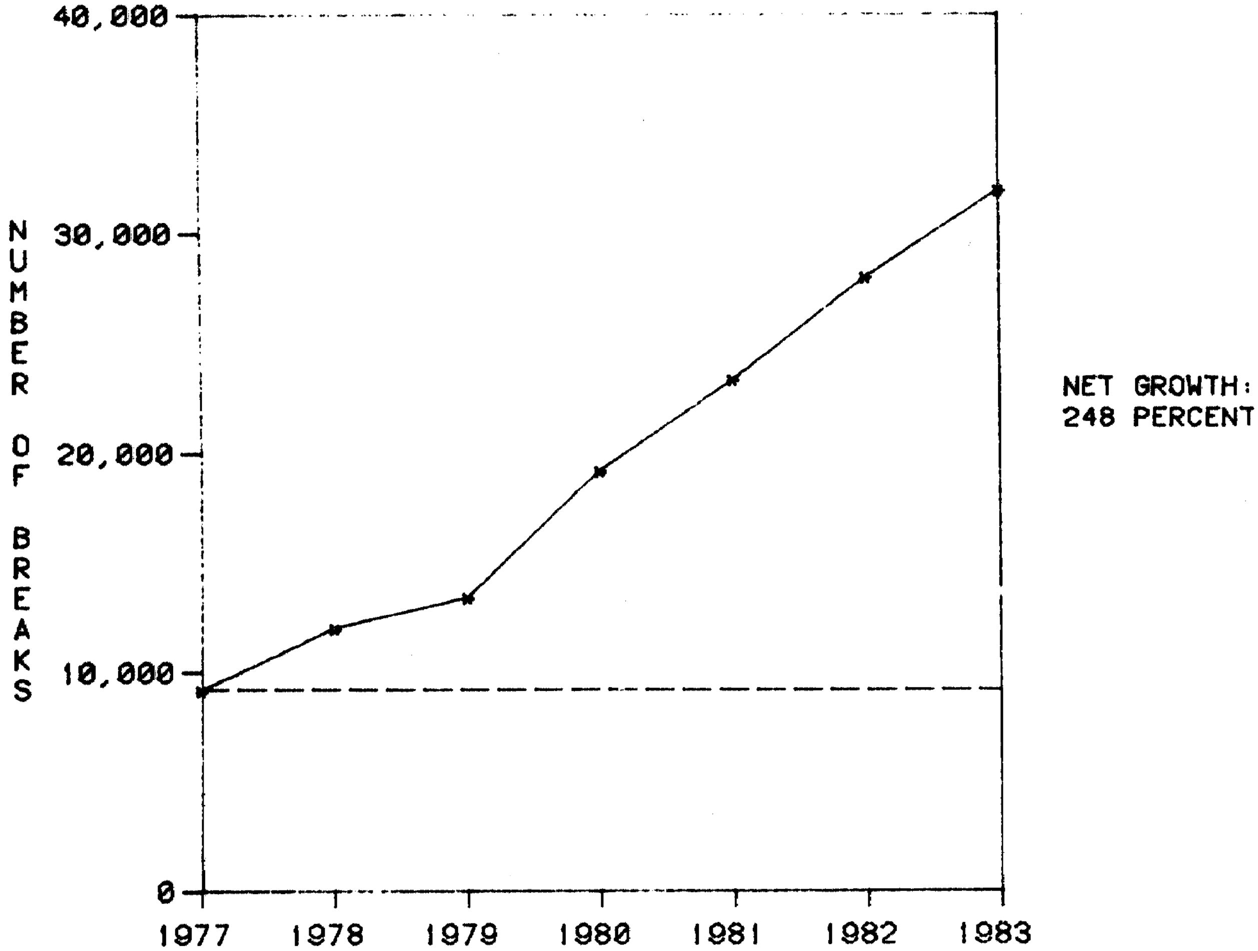
NEW YORK STOCK EXCHANGE
STOCK WATCH ALERTS a/
CALENDAR YEARS 1977 THROUGH 1983



a/ "Stock Watch Alert" is issued when the price and/or volume of a security exceeds a predetermined level on a New York Stock Exchange computerized market surveillance system.

SOURCE: SEC's Division of Enforcement.

NUMBER OF
NATIONAL ASSOCIATION OF SECURITIES DEALERS
AUTOMATED QUOTATION SYSTEM
"PARAMETER BREAKS" a/
CALENDAR YEARS 1977 THROUGH 1983



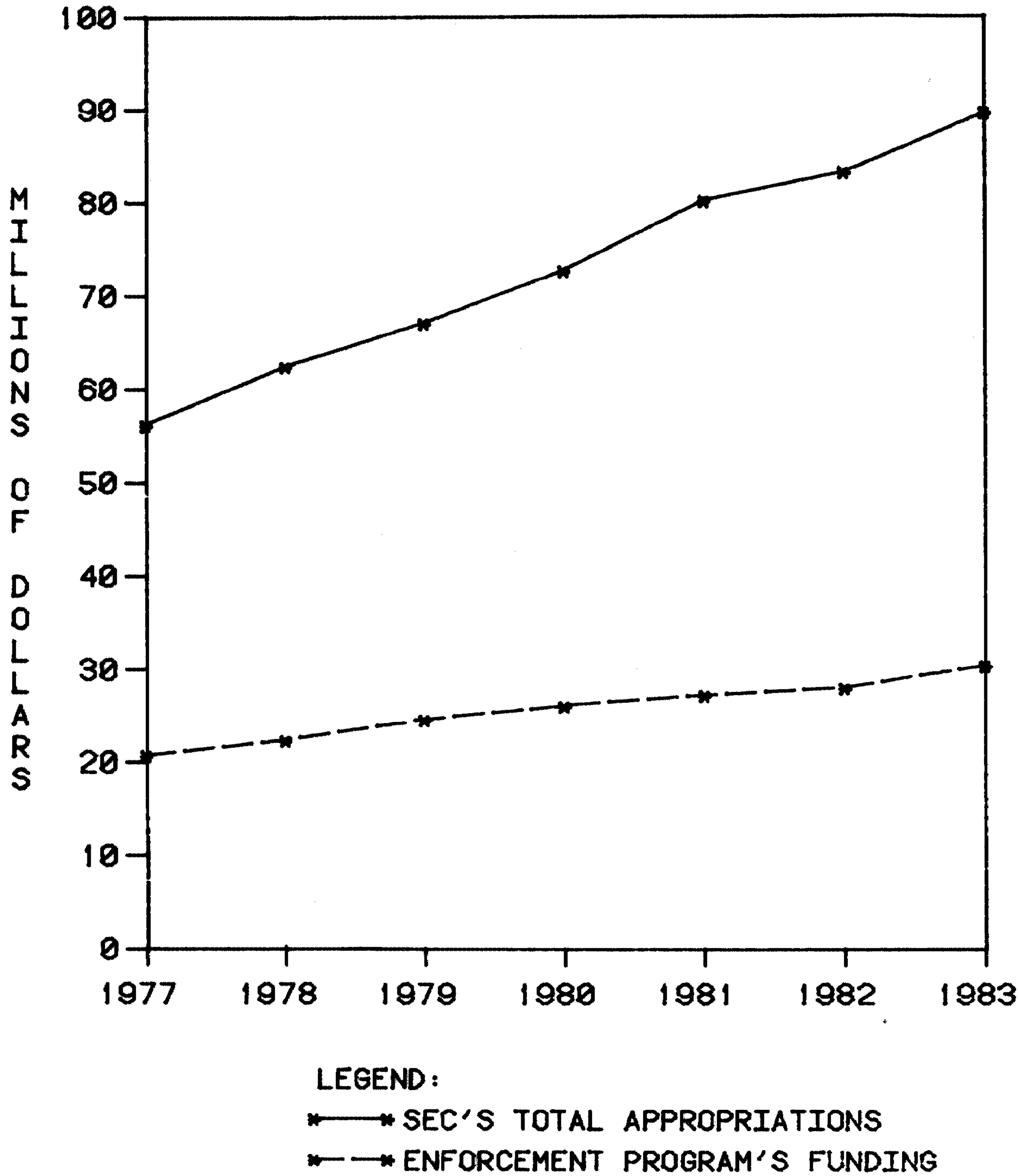
a/ "Parameter Breaks" are automatically triggered by the National Association of Securities Dealers Automated Quotation System (NASDAQ) when trading events, such as price or volume, of a security exceeds a predetermined level.

SOURCE: National Association of Securities Dealers.

APPENDIX III

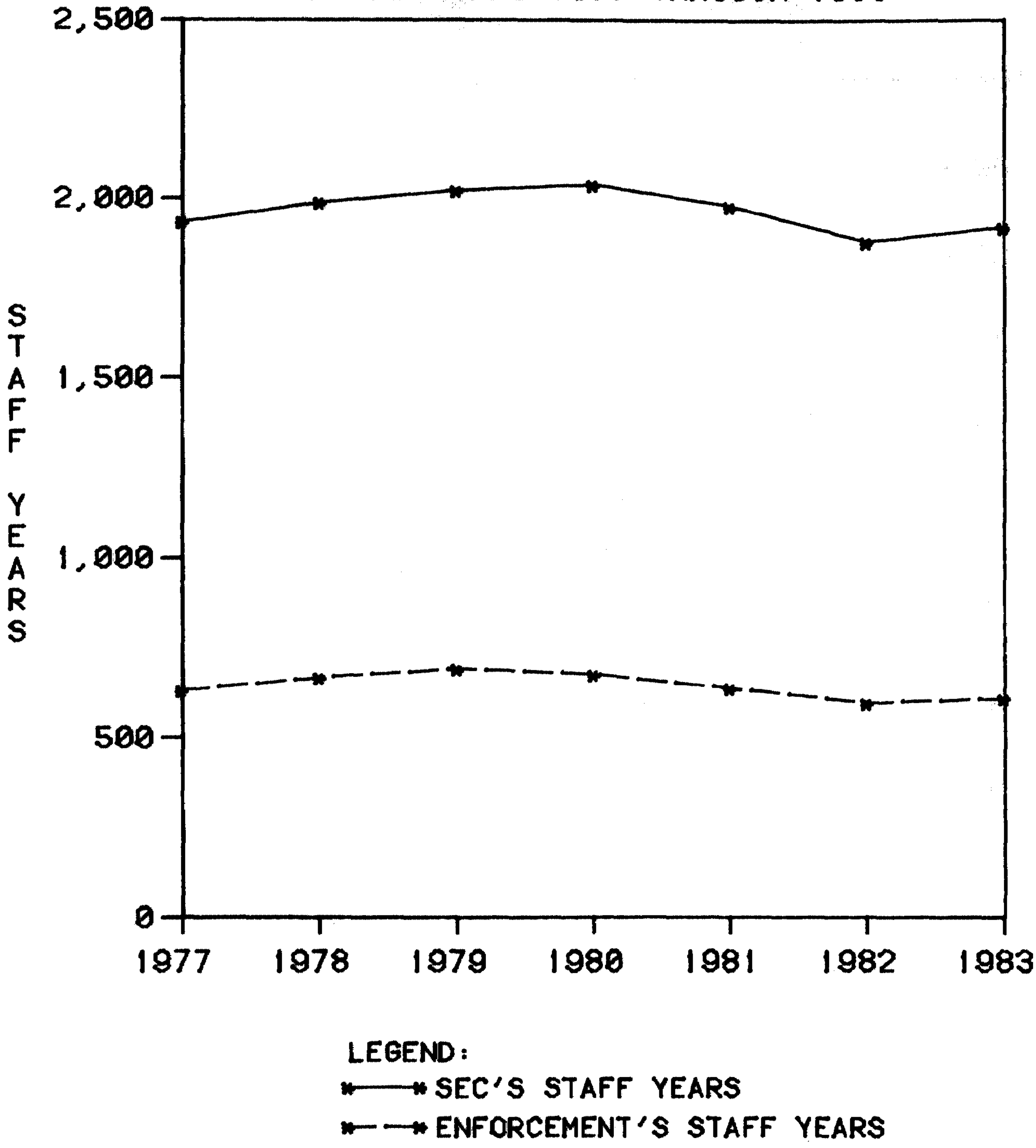
SEC BUDGET AND STAFFING

SEC'S TOTAL APPROPRIATIONS AND
ENFORCEMENT PROGRAM'S FUNDING
FISCAL YEARS 1977 THROUGH 1983



SOURCE: GAO developed data using actual expenditures for fiscal years 1977 through 1983 as shown in fiscal years 1979 through 1985 SEC Budget Estimates.

SEC AND THE ENFORCEMENT PROGRAM'S
STAFF YEARS
FISCAL YEARS 1977 THROUGH 1983

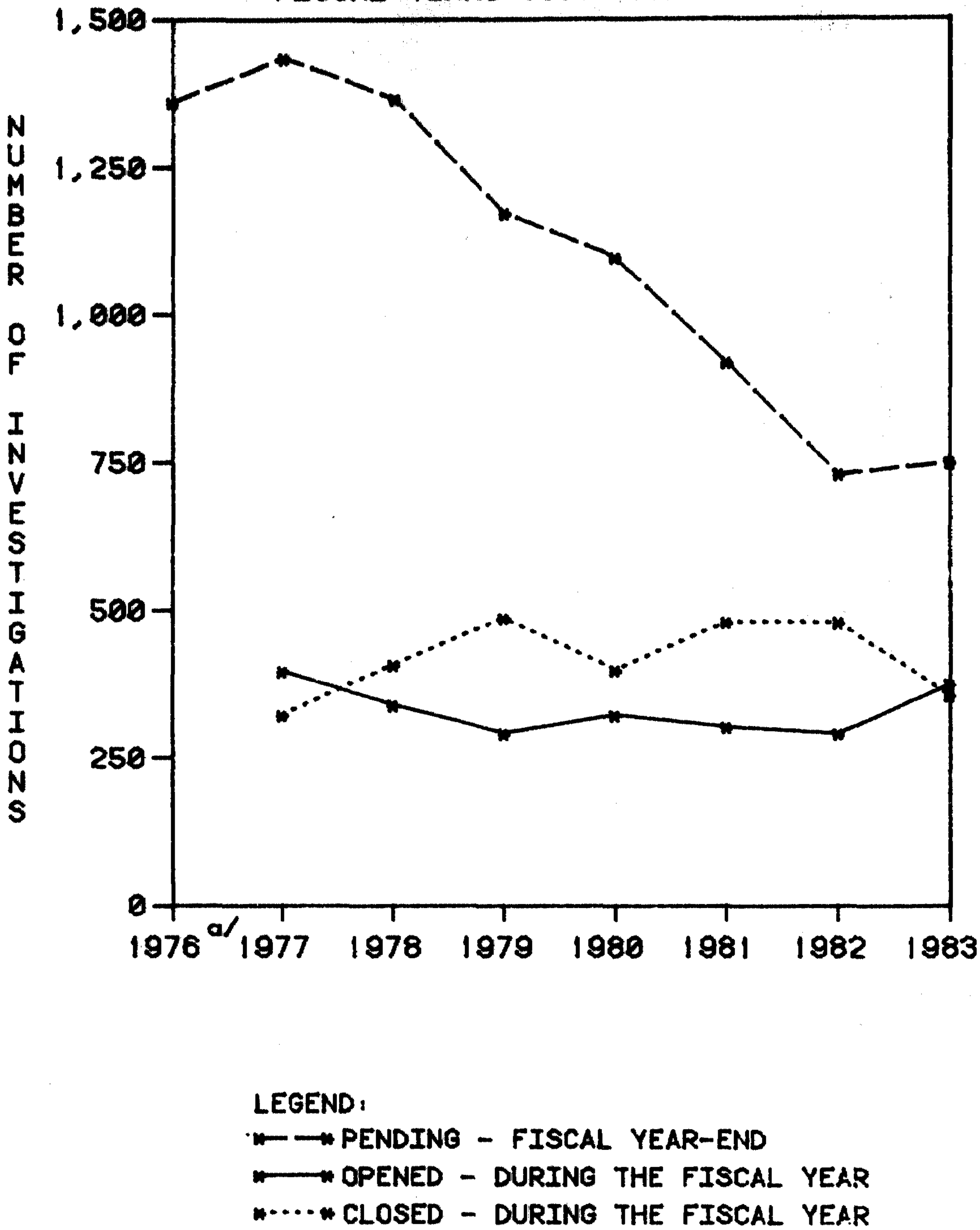


SOURCE: GAO developed using actual staff years for fiscal years 1977 through 1983 as shown in fiscal years 1979 through 1985 SEC Budget Estimates.

 APPENDIX VI

LEVEL OF INVESTIGATIONS AND ENFORCEMENT EFFORTS

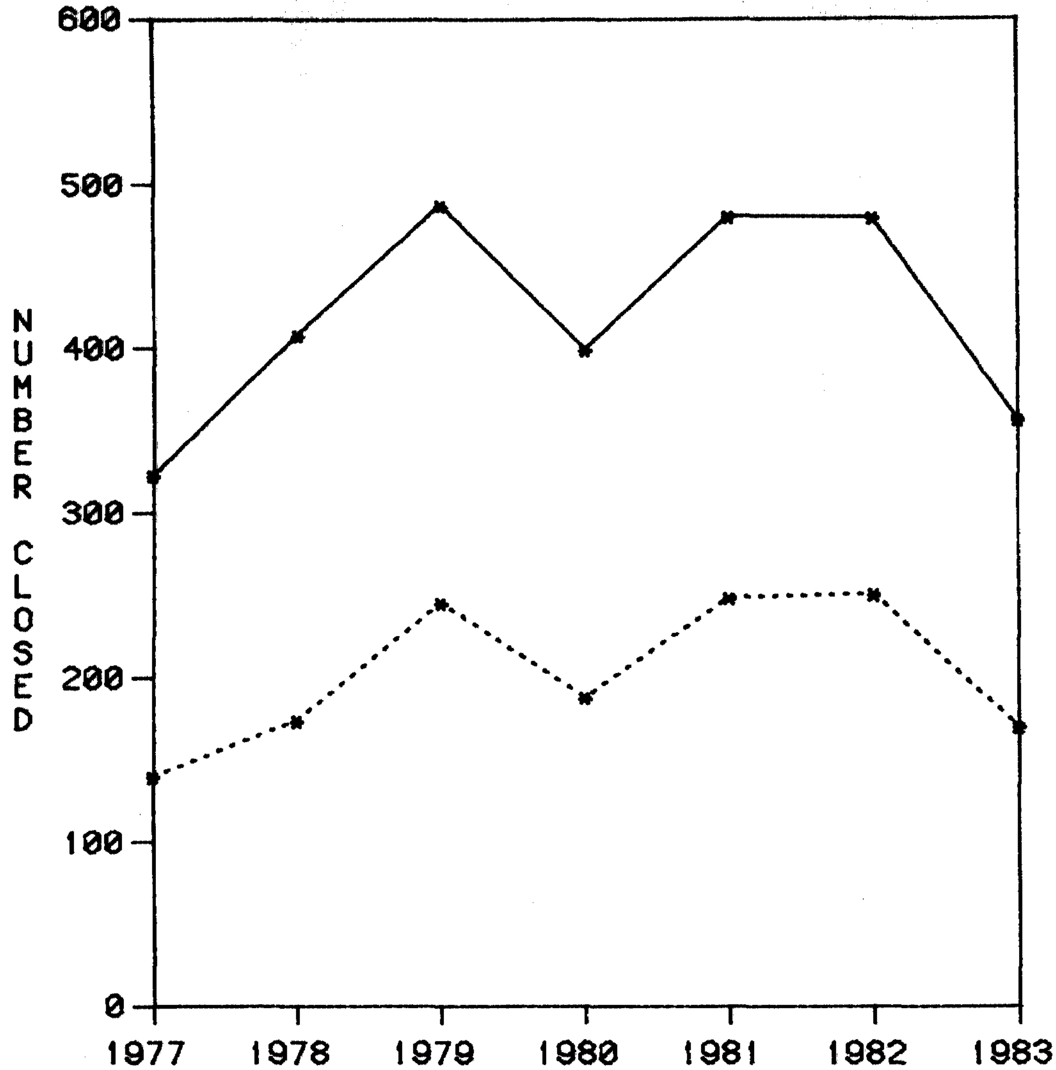
CHANGES IN OPENED, CLOSED, AND PENDING INVESTIGATIONS FISCAL YEARS 1977 THROUGH 1983



a/ Investigations opened and closed during FY76 were not determined.

SOURCE: GAO developed from data extracted from SEC's Name Relationship System.

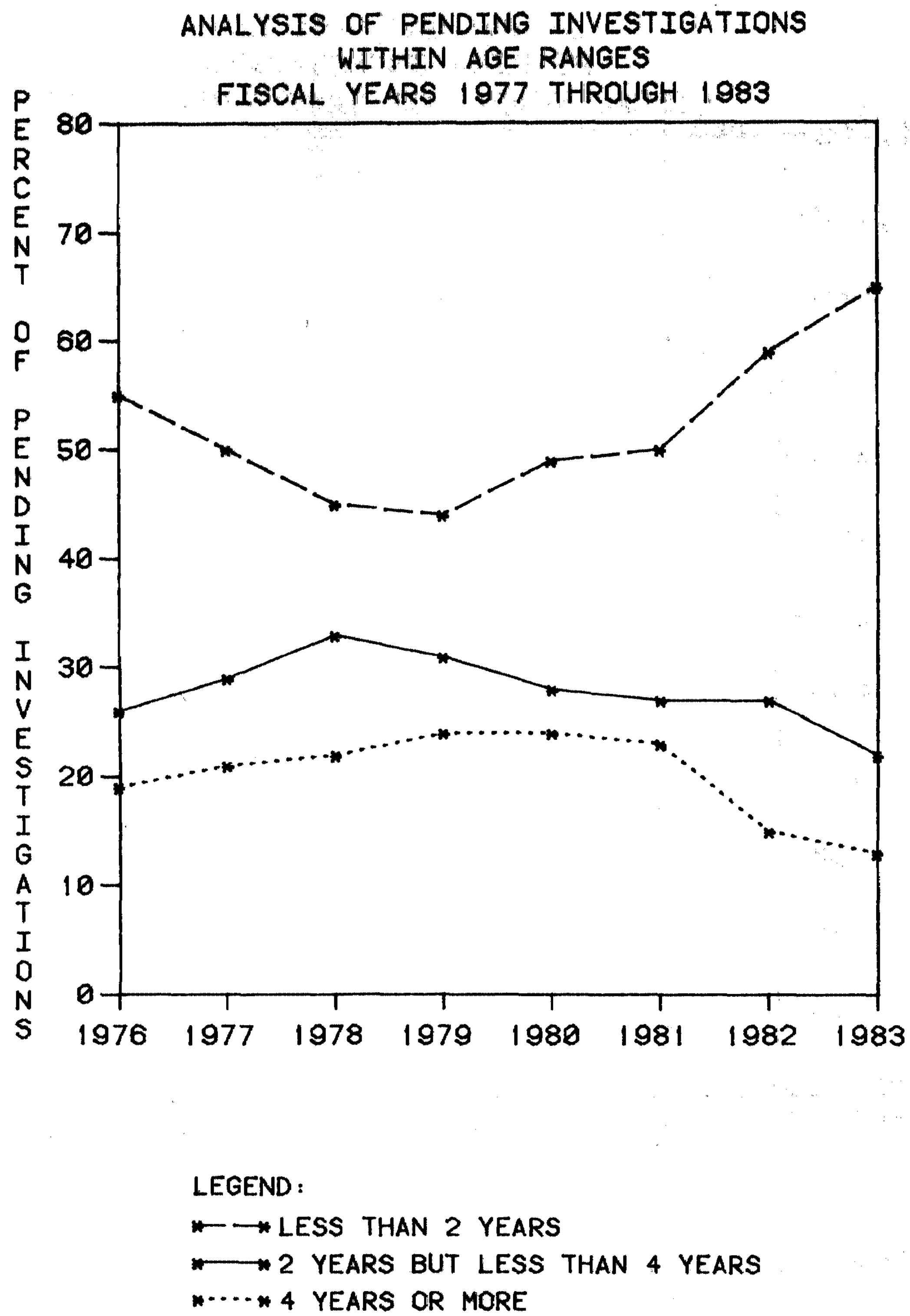
CHANGES IN INVESTIGATIONS CLOSED
WITHOUT ENFORCEMENT ACTION
FISCAL YEARS 1977 THROUGH 1983



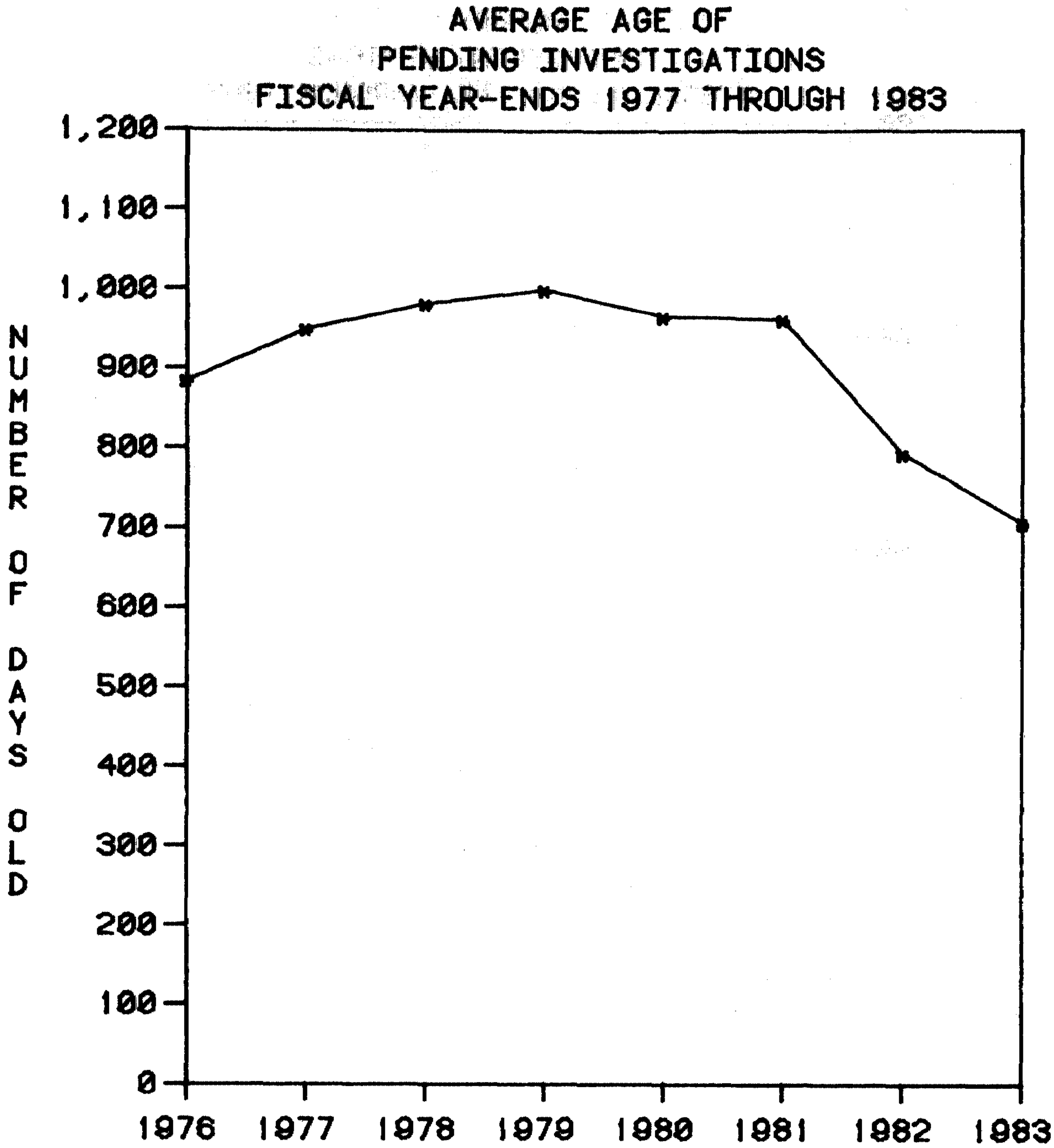
PERCENT CLOSED WITHOUT ACTION	43%	43%	50%	47%	52%	52%	48%

LEGEND:
—— TOTAL NUMBER CLOSED
···· NUMBER CLOSED WITHOUT ACTION

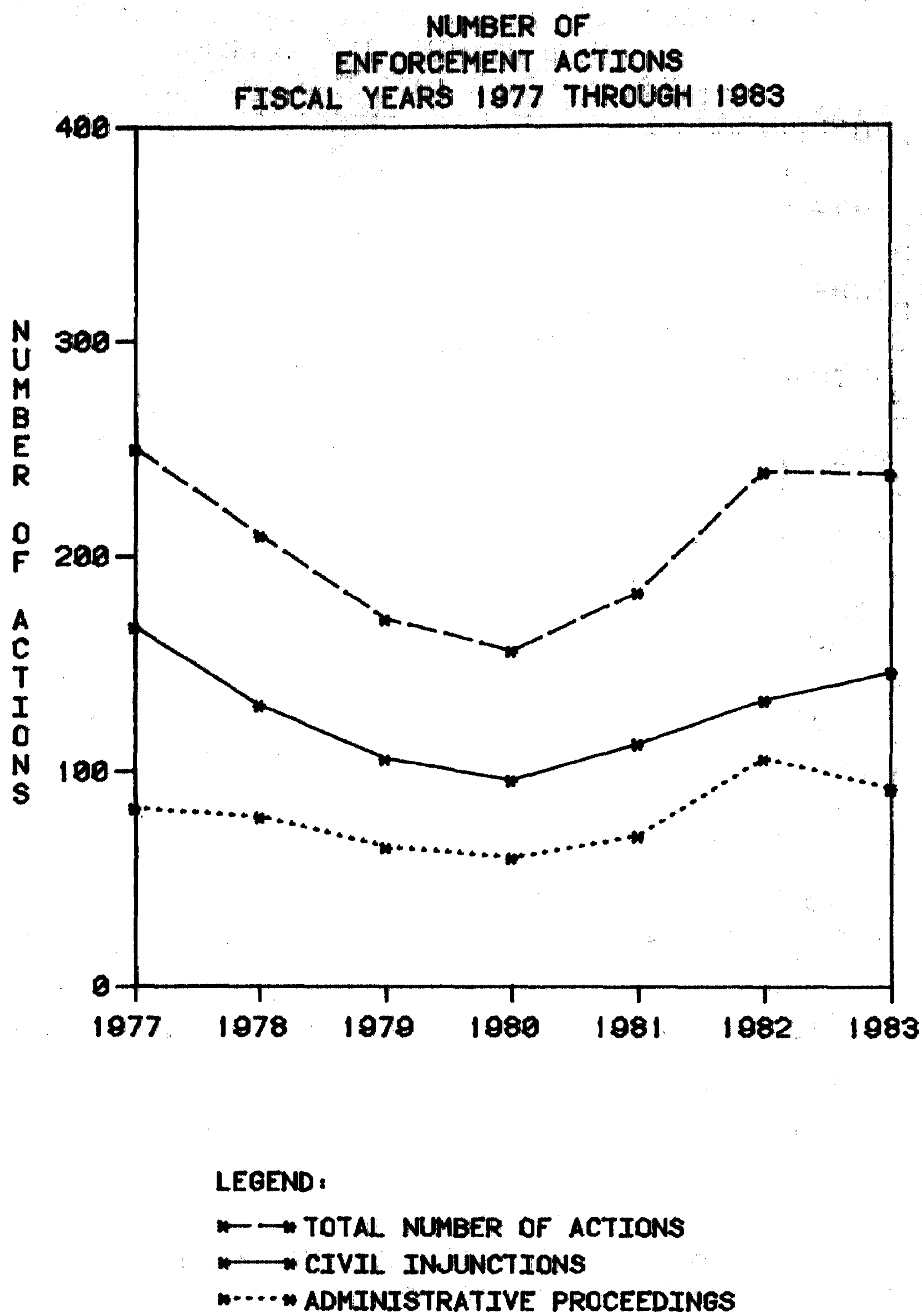
SOURCE: GAO developed using data extracted from SEC's Name Relationship System.



SOURCE: GAO developed from data extracted from SEC's Name Relationship System.

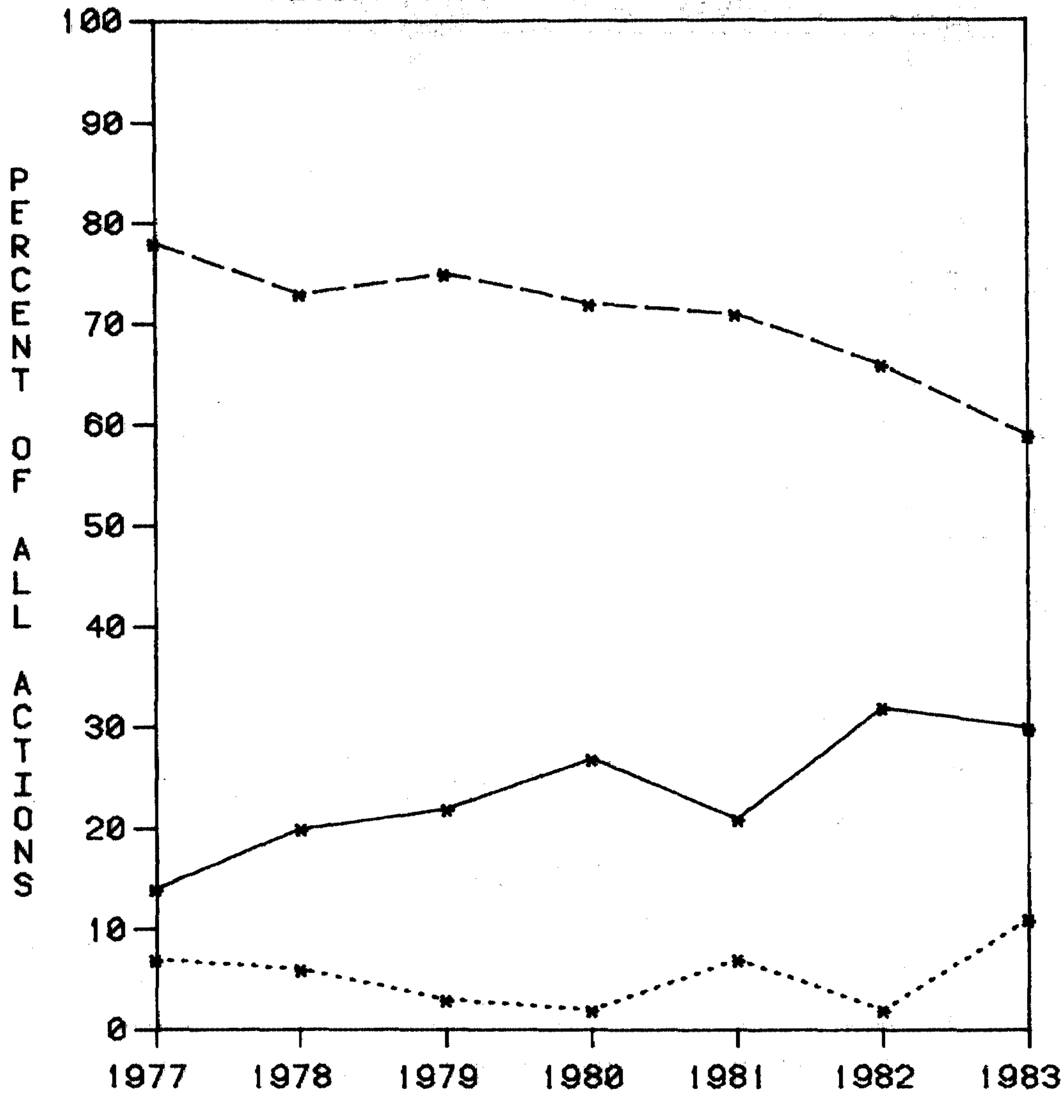


SOURCE: GAO developed using data extracted from SEC's Name Relationship System.



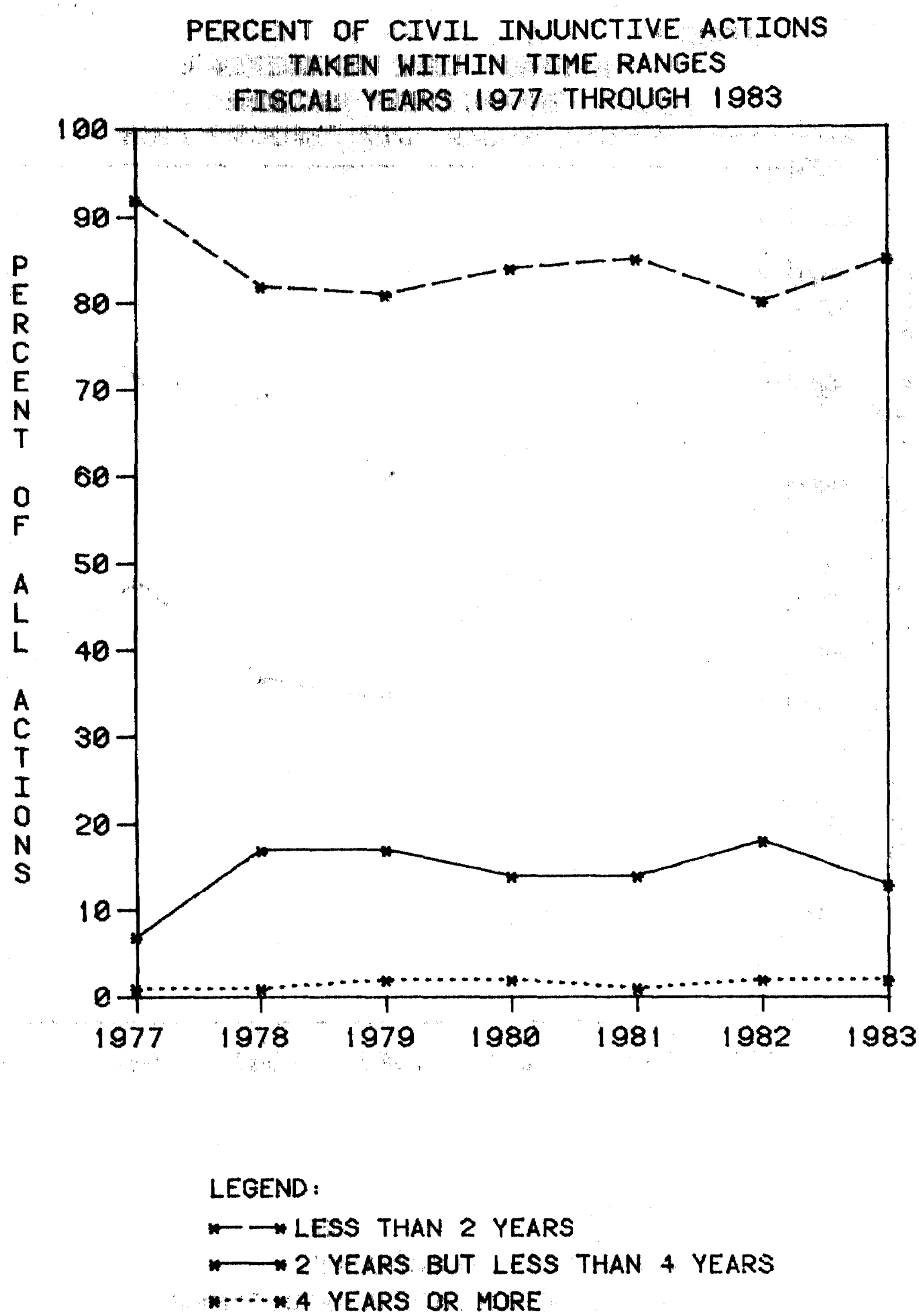
SOURCE: GAO developed using data extracted from SEC's Name Relationship System.

PERCENT OF ADMINISTRATIVE PROCEEDINGS
TAKEN WITHIN TIME RANGES
FISCAL YEARS 1977 THROUGH 1983

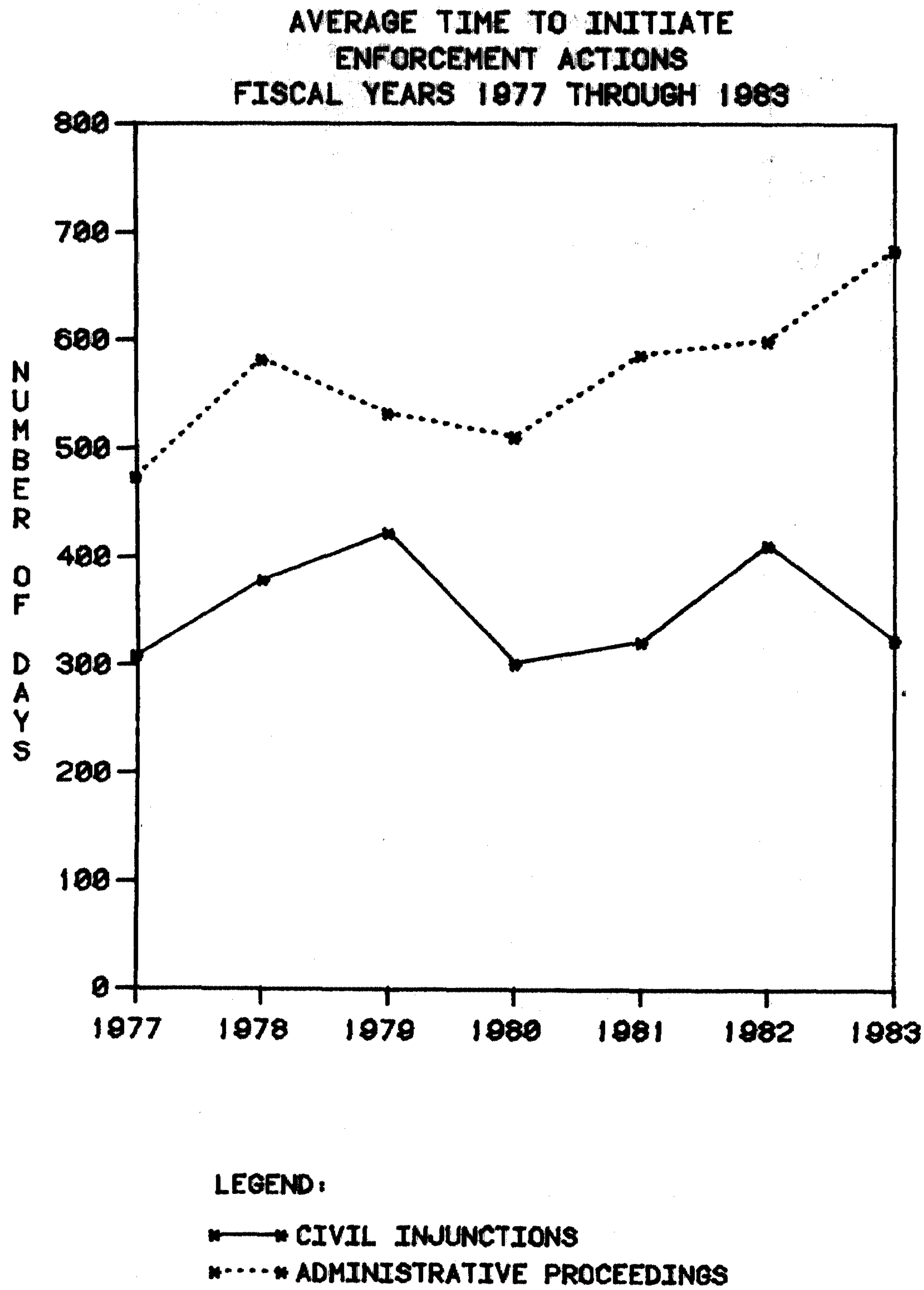


LEGEND:
LESS THAN 2 YEARS
2 YEARS BUT LESS THAN 4 YEARS
4 YEARS OR MORE

SOURCE: GAO developed from data extracted from SEC's Name Relationship System.



SOURCE: GAO developed from data extracted from SEC's Name Relationship System.



SOURCE: GAO developed using data extracted from SEC's Name Relationship System.

APPENDIX V

MOST COMMON VIOLATIONS

MOST COMMON VIOLATIONS

During the period covered by our review, the most frequently alleged security law violations were for sections and related rules of the Securities Act of 1933 and the Securities Exchange Act of 1934. These acts give SEC the authority to regulate companies that issue securities to the public.

The Securities Act of 1933 prohibits the offer and sale of securities to the public that are not registered with SEC, subject to certain exemptions. This act also sets forth specific procedures and disclosure requirements and prohibits fraudulent or deceptive practices in a public offering.

The Securities Exchange Act of 1934 provides for the full and fair disclosure in the trading of securities that are already distributed to the public. In addition, the 34 act regulates not only publicly held companies but also brokers and dealers, the national securities exchanges, clearing agencies, transfer agents, and security information processors. This act imposes specific disclosure, reporting, and registration requirements and other regulatory standards on these distinct groups. The act also prohibits various "manipulative or deceptive devices or contrivances" in connection with the purchase or sale of any security.

The following is a description of the securities laws sections and SEC rules most often pursued in formal investigations and cited in civil injunctions and administrative proceedings during fiscal years 1977, 1980, and 1983.

Description of Those Sections Of The Securities Laws And SEC Rules Cited In 15 Percent Or More Of Formal Orders and Enforcement Actions

Section/Rule	Description
PROGRAM AREA: ANTI-FRAUD PROVISIONS	
33 §17a:	Prohibits fraud in connection with offer or sale of securities in interstate commerce.
34 §10b:	Prohibits fraud in connection with purchase or sale of any security by use of interstate commerce or any facility of any national securities exchange.
34 §14a:	Prohibits solicitation of proxies in contravention of Commission rules in respect to any security registered under section 12.
34 R14a-9:	Prohibits proxy solicitations containing false or misleading statements or omissions or material facts.
PROGRAM AREA: REGULATION OF ENTITIES AND ASSOCIATED PERSONS	
34 §15c-3:	Prohibits broker-dealer transactions in contravention of Commission rules prescribing financial responsibility standards.
34 §17a:	Requires securities exchanges, brokers, dealers, clearing agencies, transfer agents, and others to make and keep books and records as prescribed by Commission rule.
34 17a-3:	Requires broker-dealers to maintain and keep current books and records in order to accurately reflect, among other things, their financial condition.
PROGRAM AREA: REGISTRATION OF SECURITIES	
33 §5a:	Prohibits sale of a security through means of interstate commerce unless a registration statement is in effect.

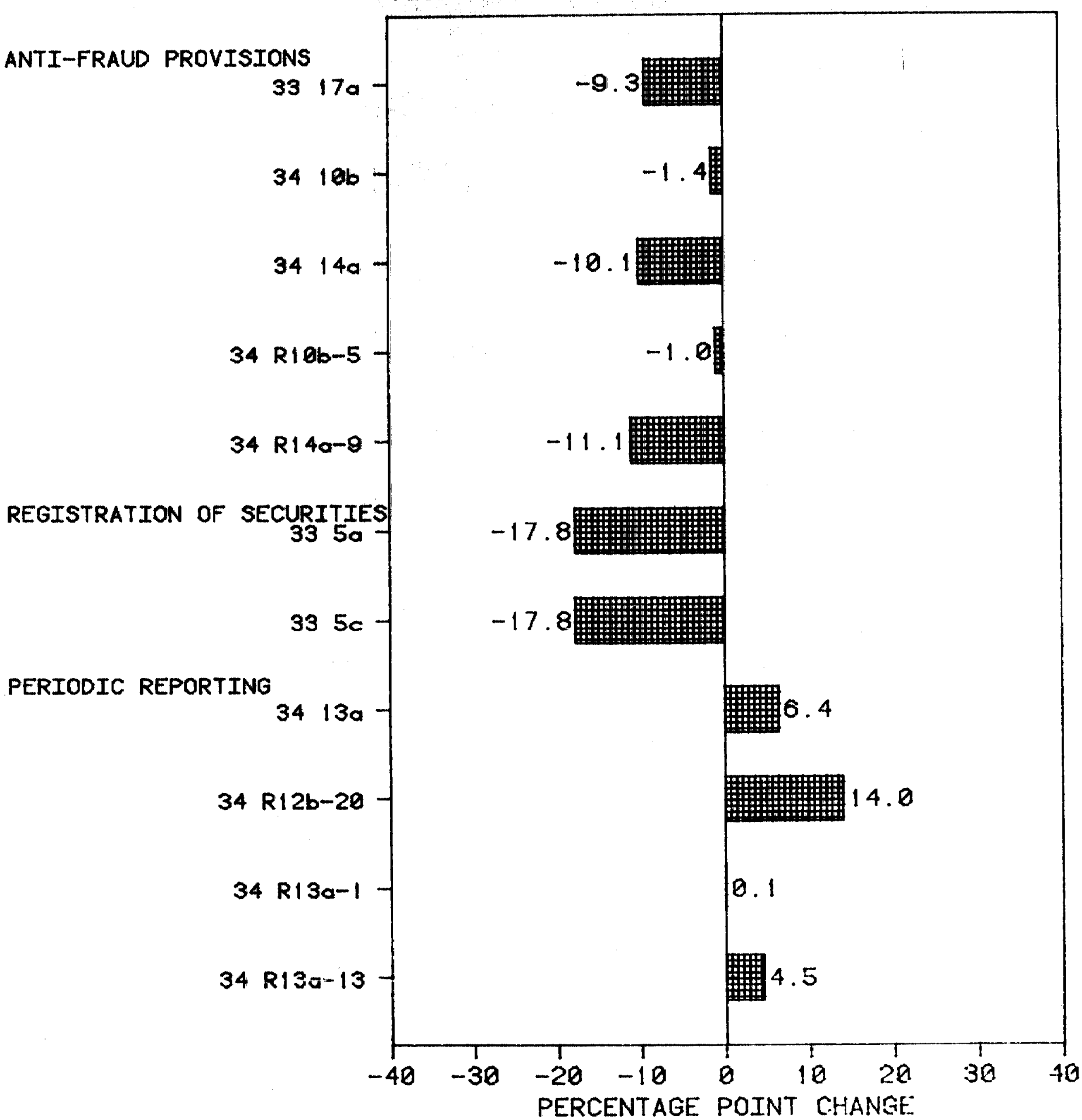
[1] 33 refers to the Securities Act of 1933 and 34 refers to the Securities Exchange Act of 1934. "R" identifies a rule promulgated under the applicable securities law.

33 §5c:	Prohibits offers to sell or buy a security through means of interstate commerce unless a registration statement has been filed.

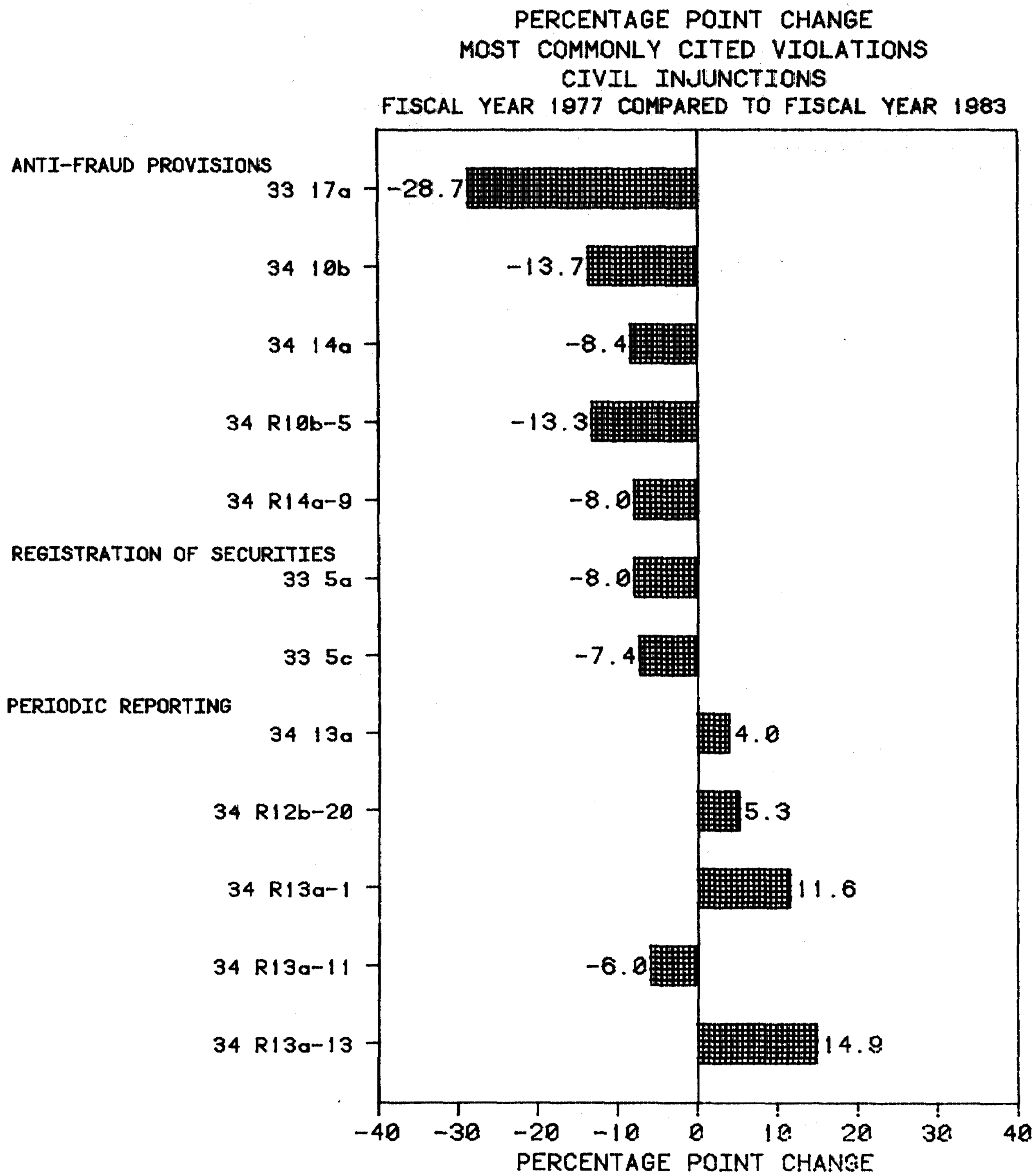
PROGRAM AREA: PERIODIC REPORTING REQUIREMENTS

34 §13a:	Requires every company with securities registered under Section 12 to file, among other things, such annual and quarterly reports as the Commission may require.
34 R13a-1:	Requires companies with securities registered under Section 12 to file an annual report on Form 10-K.
34 R13a-11:	Requires companies required to file an annual report on Form 10-K to also file reports on Form 8-K for any month in which certain specified events occur.
34 R13a-13:	Requires companies required to file an annual report on Form 10-K to also file quarterly reports on Form 10-Q.
34 R12b-20:	Requires, in addition to information expressly required to be included in reports, the addition of such further information necessary to make the required statements not misleading.

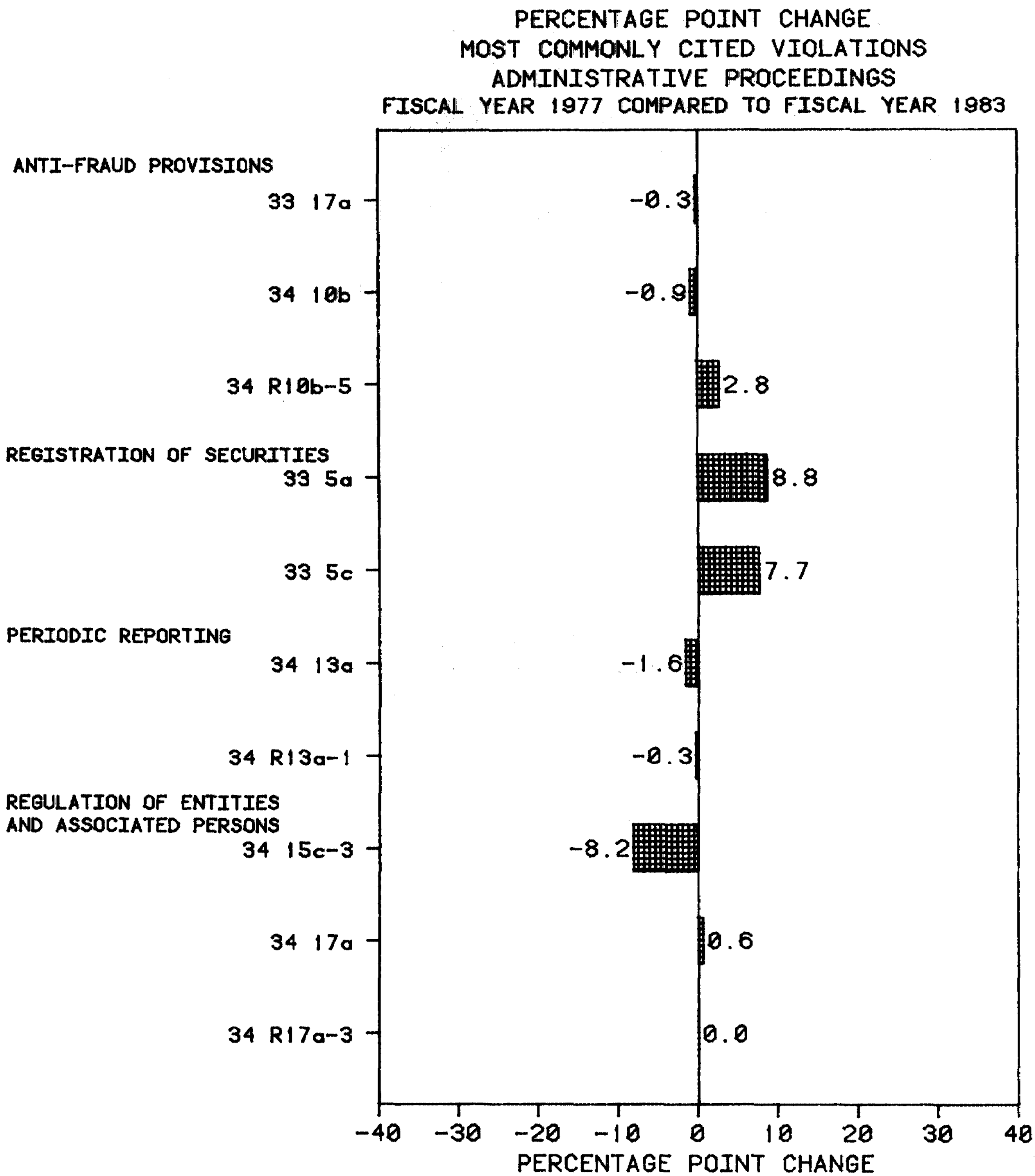
PERCENTAGE POINT CHANGE
MOST COMMONLY CITED VIOLATIONS
FORMAL INVESTIGATIONS
FISCAL YEAR 1977 COMPARED TO FISCAL YEAR 1983



SOURCE: GAO developed using information published in the SEC Docket.



SOURCE: GAO developed using information published in the SEC Docket.

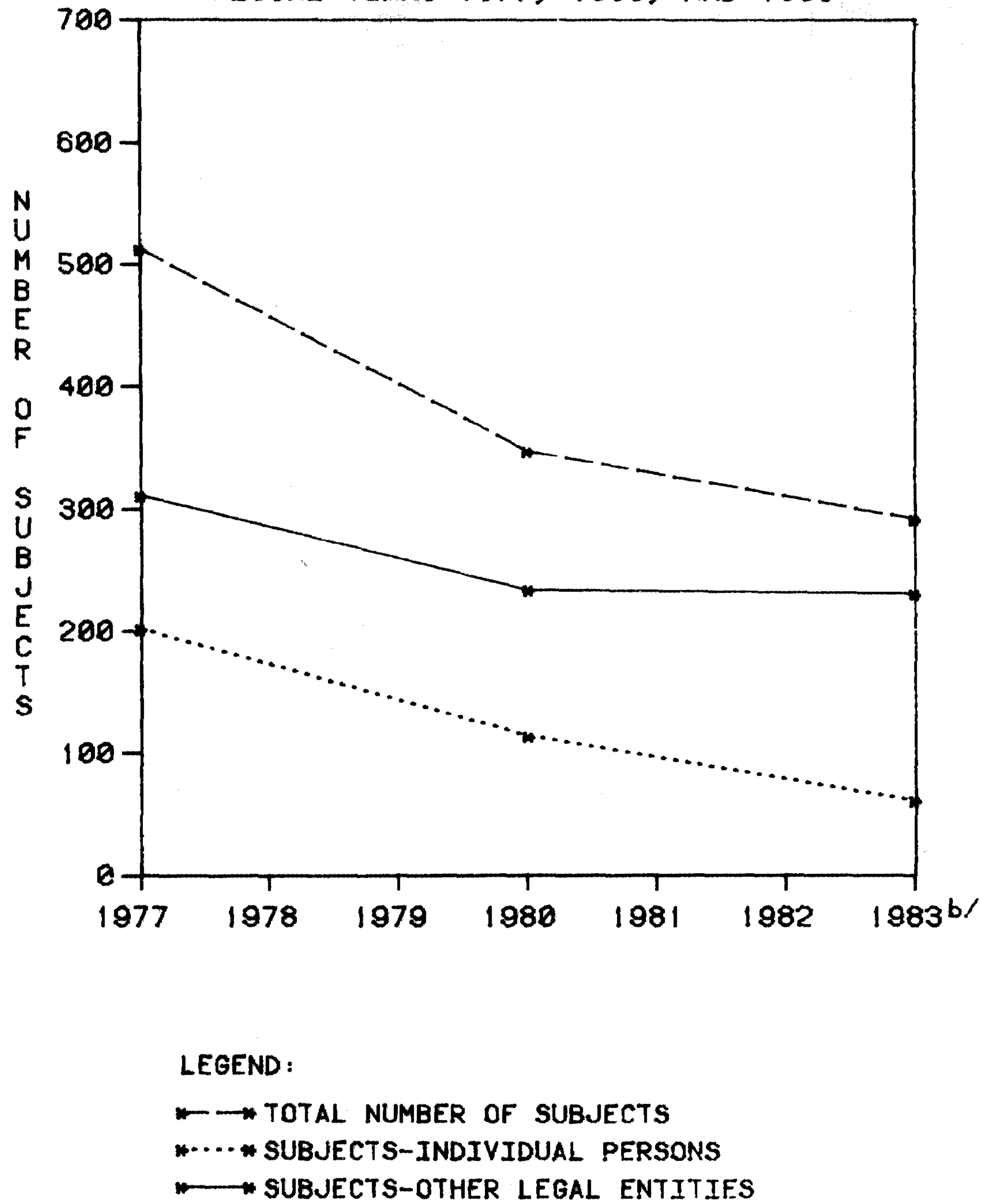


SOURCE: GAO developed using information published in the SEC Docket.

APPENDIX VI

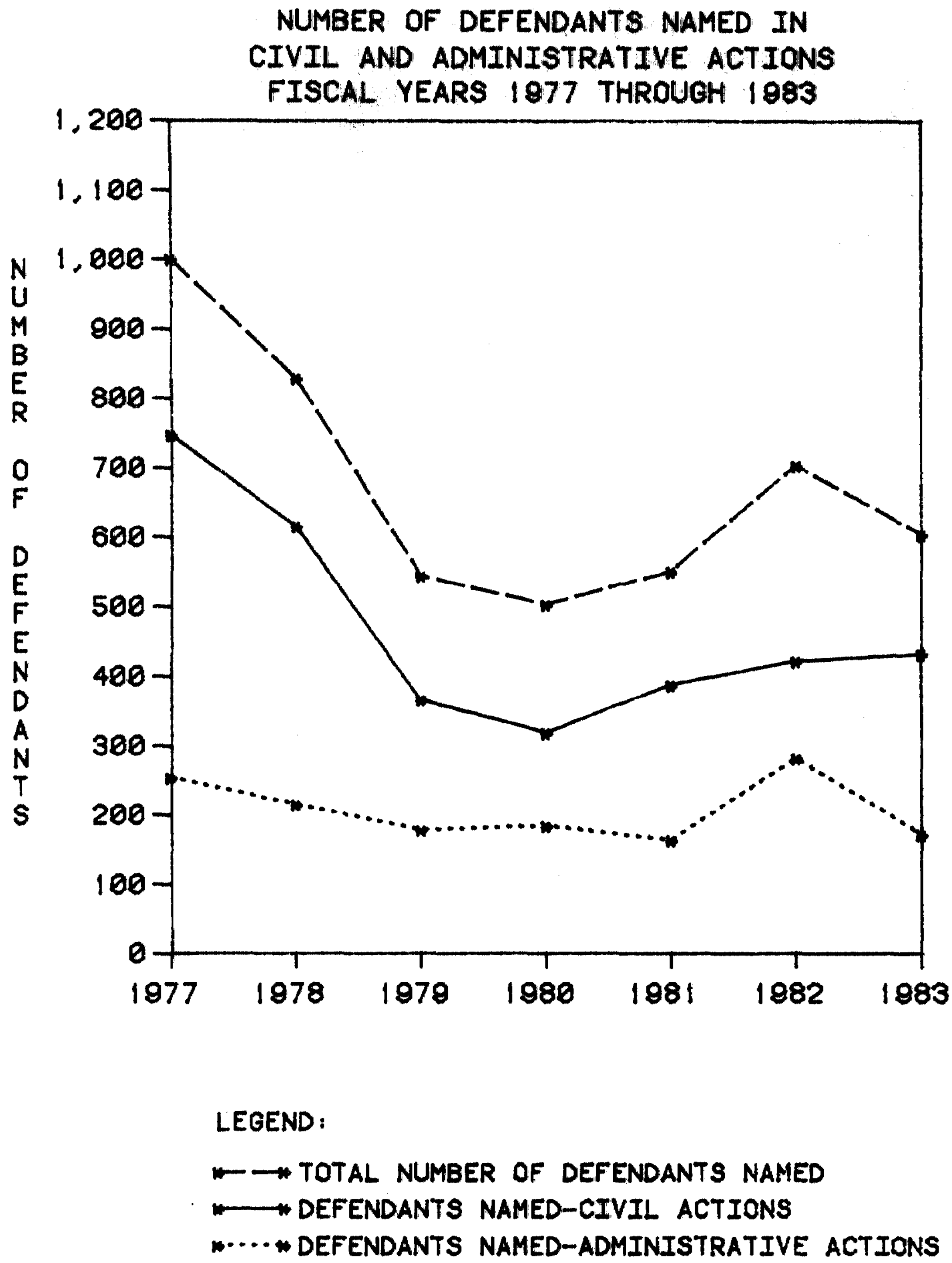
NUMBER AND TYPE OF
SUBJECTS AND DEFENDANTS

NUMBER AND TYPE OF SUBJECTS
IDENTIFIED IN FORMAL INVESTIGATIONS a/
FISCAL YEARS 1977, 1980, AND 1983



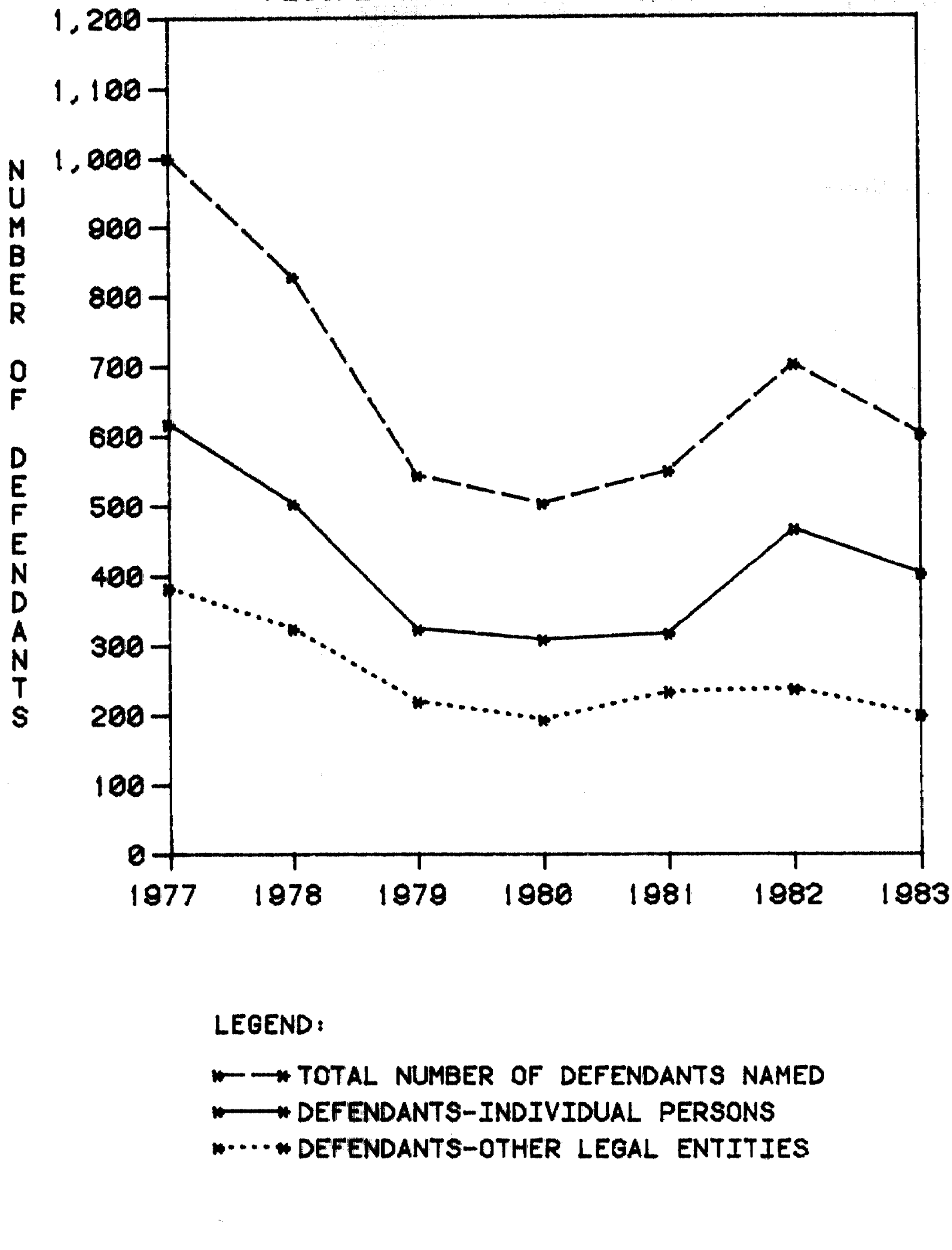
a/ Not all formal orders identified a subject(s).
b/ Does not include one formal investigation in which 87 entities were identified.

SOURCE: GAO developed using documents obtained from SEC's Office of the Secretary.

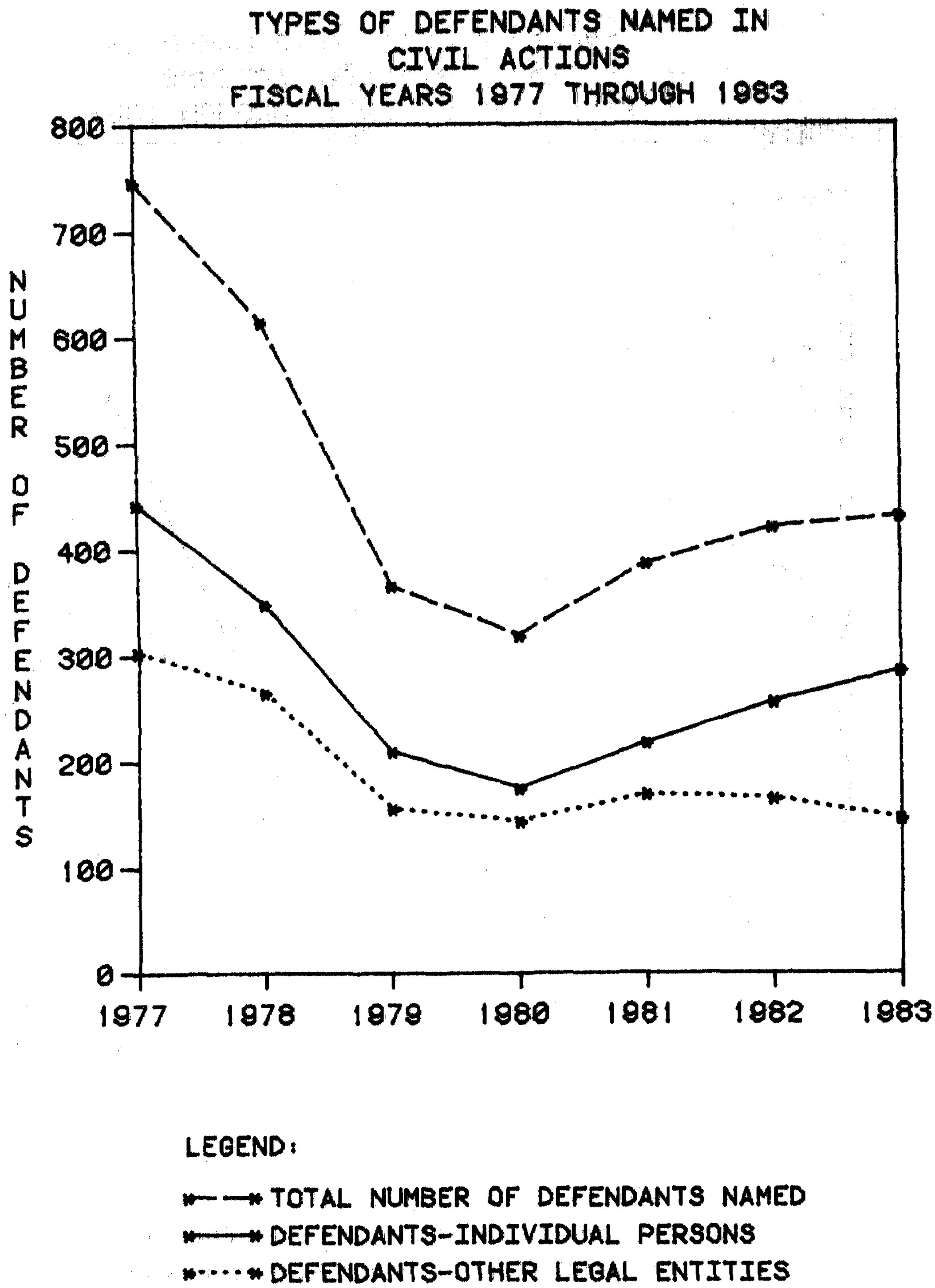


SOURCE: GAO developed using data extracted from SEC's Name Relationship System.

TYPES OF DEFENDANTS NAMED IN
CIVIL AND ADMINISTRATIVE ACTIONS
FISCAL YEARS 1977 THROUGH 1983

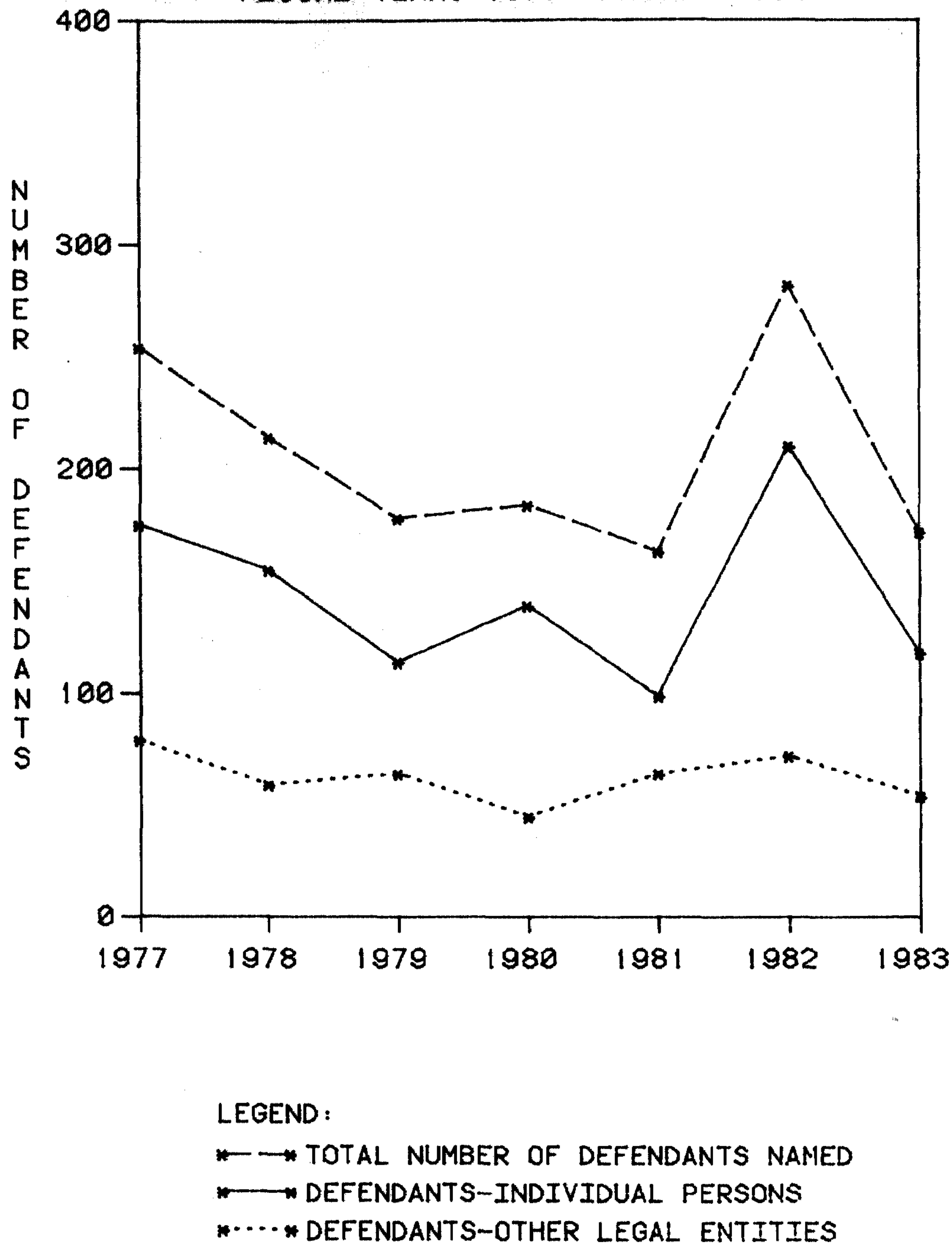


SOURCE: GAO developed using data extracted from SEC's Name Relationship System.



SOURCE: GAO developed using data extracted from SEC's Name Relationship System.

TYPES OF DEFENDANTS NAMED IN
ADMINISTRATIVE ACTIONS
FISCAL YEARS 1977 THROUGH 1983



SOURCE: GAO developed from data extracted from SEC's Name Relationship System.

APPENDIX VII

SCOPE AND METHODOLOGY

SCOPE AND METHODOLOGY

To gain an understanding of how the enforcement process works, we interviewed SEC Washington officials in the divisions of Enforcement, Corporation Finance, and Market Regulation and in the offices of the Secretary, General Counsel, Executive Director, Chief Accountant, and Consumer Affairs and Information Services. We also interviewed officials in SEC's New York City; Washington, D.C.; Chicago; Boston; and Los Angeles regional offices.[1] These regions were selected because of geographic location throughout the United States and the relative size of the enforcement effort as measured by case load activity. We also reviewed SEC documents, including statements of enforcement policies and procedures.

We obtained, analyzed, and summarized information on the enforcement activities carried out by the Division of Enforcement and SEC's nine regional offices. We identified changes in the number of investigations and enforcement actions and determined the age of pending investigations at the end of each fiscal year. We also identified the number and types (individual or other legal entity) of defendants against which enforcement actions were brought. For each formal investigation (see p. 5) authorized during fiscal years 1977, 1980, and 1983, we identified the number and type of entities whose activities were subject to investigation. We refer to these individuals or other legal entities as "subjects." We limited our analyses to these years because of the extensive amount of resources required to analyze the data.

For each civil injunction and administrative proceeding (the primary enforcement actions brought by SEC) initiated during fiscal year 1977 through 1983, we determined the length of time it took SEC to bring the action. We calculated that time by identifying the number of days between the date the investigation was opened and the date the official action was filed with a federal district court or administrative law judge.

We also identified the sections of the federal securities laws and SEC rules most often pursued in formal investigations and cited in civil injunctions and administrative proceedings during fiscal years 1977, 1980, and 1983. We limited our analyses to these years because of the extensive amount of

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[1]SEC has nine regional offices. The other four are Atlanta, Denver, Fort Worth, and Seattle.

resources required to analyze the data. Since there were over 100 sections/rules--many cited in a small percentage of the investigations and enforcement actions--we performed comparative analyses of only those sections/rules cited in 15 percent or more of the formal investigations and enforcement actions.

Because of the large amount of enforcement data, much of our analyses were performed through computer assistance. We utilized SEC's Name Relationship System (NRS) to develop much of our information. The NRS is a reference system that identifies parties involved in past and current SEC investigations. Although NRS is not an official record-keeping system, it contains information on SEC's enforcement cases. While we did not review controls over the input or processing of data, we did perform extensive tests of the data recorded in the system by comparing them to official SEC source documents.

Our work was conducted between December 1983 and October 1984.

DIVISION OF ENFORCEMENT

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

January 17, 1985

William J. Anderson
Director
General Government Division
U.S. General Accounting Office
Washington, D. C. 20548

Re: General Accounting Office draft report entitled "Statistics on SEC's Enforcement Program"

Dear Mr. Anderson:

I am responding to your November 21 letter in which you invited the Commission to comment on the above-captioned draft report.

While the report attempts to report statistics on the enforcement program for 1977 to 1983 without venturing judgments on the effectiveness of the program or otherwise interpreting the data, the choice of data and their characterization may mislead those who read the report casually or do not have a good grounding in the operations of the SEC. We therefore ask that the report be changed to reflect the following important considerations.

SEC and Enforcement Staffing

The report states in its second paragraph that "statistics indicate that the SEC has reduced both the level of resources devoted to the enforcement program and pending (ongoing) investigations." While both parts of this statement are, by themselves, supported by the data, they incorrectly imply that the SEC is not supportive of its enforcement program. This is the absolute reverse of Commission policy: direct enforcement activities -- particularly the Enforcement Division -- have been consciously protected from SEC budget reductions that have thus fallen more heavily on other program areas. At the level of aggregation chosen for the report, however, this is not obvious.

This problem stems in part from not addressing the important differences between the headquarters and field operations of the SEC's enforcement program in the report's section "How the Enforcement Process Works," beginning on page 4. The mission of the Enforcement Division, which is located in Washington and is managed by the Director of Enforcement, is national in scope and its staff is committed to one program -- enforcement. The Director provides guidance to -- rather than direct supervision of -- the field operations.

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Enforcement in the field, on the other hand, is directed by regional administrators who manage staffs engaged in both enforcement and regulatory matters. The regional administrator enjoys some latitude in applying his resources to items of regional importance, allowing the SEC to maintain a balance between national and more local concerns. Field offices are smaller than the headquarter's operation and less specialized in their different functions. Regional staff are also more fungible: while some staff are assigned solely to enforcement work, a significant number who may spend part of their time on enforcement matters, including accountants, securities examiners, clerical and supervisory staff, are primarily assigned or may also work in the regulatory area when required by the important, immediate concerns of the day. The staff years cited in the GAO report, which lump headquarters and field operations together, reflect variations caused by responding to such concerns, and not the overall program priority that enforcement enjoys in the SEC. These headquarters/field differences make the Enforcement Division's staffing a better indicator of the SEC's emphasis on its enforcement program. As shown by the table below, the Enforcement Division's staffing has been reduced less than a third than the SEC as a whole.

Another important distinction ignored by the report involves support staff versus those actually involved in bringing enforcement actions. Within the headquarters, a significant number of staff in the Office of Applications and Reports Services, the Office of Consumer Affairs and Information Services, and the Office of Information Systems Management contribute to the enforcement effort and are thus included in that program. Disproportionate cuts in this headquarters support between 1977 and 1983 reduced the size of the enforcement program without cutting into direct enforcement activities.

The table below shows that the main decrease in the enforcement staff from 1977 to 1983 stems from reductions in the regions and support, and not in the Enforcement Division. Controlling for both regional and support reductions shows clearly the SEC's priority on enforcement. While the total enforcement program reduction for the period was 3.6%, direct enforcement activities (which includes the Division as well as the regions) declined 3.3% and the Enforcement Division itself slipped only 1%. The regions, on the other hand, dropped 4.4% and headquarters support fell 10.5%. This trend is even more pronounced in the 1981-1983 period. Although the enforcement program reduction for the period was 4.7%, direct enforcement activities declined 3.8%, and the Enforcement Division itself slipped again only 1%. Again, the regions and headquarters support fell much more rapidly, dropping at 5% and 23.2%, respectively.

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SEC/Enforcement Staff Changes, 1977 through 1983

SEC/Enforcement Staff Years

	1977	1978	1979	1980	1981	1982	1983
Enforcement Division	184.3	184.4	195.1	199.4	184.4	171.2	182.5
Regional Enforcement	423.2	454.1	469.7	450.2	425.8	403.1	404.7
Subtotal, Direct Enforcement Activities	607.5	658.5	664.8	644.6	610.2	514.3	587.2
Headquarter Support *	25.6	28.6	29.3	28.5	24.8	23.6	22.9
Total Enforcement Program	633.1	667.1	694.1	678.1	640	597.9	610.1
Total SEC	1934	1989	2023	2041	1982	1882	1921

Percent Changes in Staff Years

	1977-83	1981-83
Enforcement Division	-1.0%	-1.0%
Regional Enforcement	-4.4%	-5.0%
Direct Enforcement Activities	-3.3%	-3.8%
Headquarters Support	-10.5%	-23.2%
Total Enforcement Program	-3.6%	-4.7%
Total SEC	-.7%	-3.1%

SEC and Enforcement Funding

The report's comparison of total SEC funding, as compared with enforcement resources, on pages 9 and 23 implies that the aggregate division of the agency's appropriation accurately reflects program priorities. Funding may vary for many reasons, however, only one of which is the program's relative priority.

A number of items contributed to the variations in funding over the 1977 to 1983 period. Program costs contain a mix of overhead expenses, some directly

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* Office of Applications and Reports Services, Office of Consumer Affairs and Information Services, and Office of Information Systems Management.

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related to enforcement activities and others that are shared pro rata by all programs, such as rent, utilities, and overall agency overhead. Expenses directly related to each program include travel, stenographic reporting costs, salary and related personnel benefit expenses, and special projects or activities. Two major, directly-related enforcement expenses are stenographic reporting and transcript purchases. Fiscal 1977 expenses of $1,045,000 for these two items were reduced 28% by fiscal 1983 through SEC management initiatives, which resulted in reduced enforcement program funding with no impact on enforcement priorities.

Major projects costs assigned to program areas other than enforcement also affect enforcement's share of the SEC budget. Examples are two special projects were mandated by Congress between 1977 and 1983, the Market Oversight and Surveillance System, required by the Securities Acts Amendments of 1975, and the Government-Business Forums, established by the Small Business Investment Incentive Act of 1980. The costs of these two projects were arbitrarily assigned to other programs. These project costs were net increases to total SEC appropriations. Because they did not cause a pro rata increase in funding to all agency programs, they resulted in a relative decrease in the enforcement program's share of the Commission's budget -- without any reduction in its level of effort or relative priority.

For these reasons, we see funding as too unreliable a measure of a program's relative importance to the agency to be included in the report. Staffing, as qualified above, is much less susceptible to non-relevant changes and is thus a better measure of the SEC's program priorities.

Enforcement Productivity

The assertion in the first page of the report that resources have dropped implies, absent further explanation, that enforcement actions have also dropped. The report states "the overall effectiveness of the [enforcement] program is difficult to measure, because there is no reliable method for estimating the amount of violative conduct SEC has prevented." Nonetheless, the program's efficiency, in terms of output for input, is not. That efficiency mirrors the trend shown in the report's findings on page 9 that enforcement actions dropped from 1977 to 1980 but rose from 1981 to 1983. In fact, as the table below shows, actions per staff year have risen in 1984 to their 1977 levels in spite of the much more complex environment (see discussion below) in which we must now bring cases. These increases in productivity mitigate decreases in enforcement resources that may have occurred over the period, especially from 1981 to 1984.

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Enforcement Actions Per Staff Year

	1977	1978	1979	1980	1981	1982	1983	1984
Total Actions *	308	257	189	177	187	242	245	293
Staff Years	633.1	667.1	694.1	678.1	640.0	597.6	610.1	599.7
Actions Per Staff Year	.49	.39	.27	.26	.29	.40	.40	.49

Backlog Reduction

We have stated above why we think that the first half of the statement on page 1 that "the SEC has reduced both the level of resources devoted to the enforcement program and the number of pending (ongoing) investigations" conveys the impression that the SEC is cutting back on enforcement. We think that negative implication is furthered by the second half of the statement, regarding the reduction of ongoing investigations. The reduction of pending investigations is, however, an important improvement in the enforcement program. The report's findings on the enforcement program's reduction in its backlog of pending actions, as well as the reduction in the average age of actions, shows the improved efficiency of an enforcement program that promptly closes unproductive investigations.

Environmental Changes

During the period covered by the report, several developments had a substantial impact upon the Commission's enforcement program. Those developments included changes in the nation's economic climate, the nation's securities markets, and the legal environment in which the Commission carries out its enforcement responsibilities. As examples, since 1977:

the volume of trading on the New York Stock Exchange increased approximately 300 percent;

initial public offerings by Commission registrants increased 250 percent;

broker-dealer and investment company registrants with the Commission increased by more than 50 percent each;

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* Excludes criminal and civil contempt proceedings.

purchases of corporate stocks and bonds in the United States by foreign persons or financial institutions increased from \$23.6 billion to \$79.8 billion from 1978 to 1983; 2/ and

total foreign investment in the United States increased from \$42.4 billion in 1978 to \$133.5 billion in 1983; 3/ and

In addition to the foregoing, the Commission's enforcement efforts were subjected to more stringent legal requirements. 4/

The cumulative effect of these factors has been a substantial increase in (1) the complexity of matters requiring the Commission's enforcement attention; (2) the difficulty of conducting investigations, especially those involving banks or international securities trading; and (3) the evidentiary standards which the Commission must meet in proceedings resulting from those investigations. Because this complexity heavily impacts on enforcement efforts, it should be addressed in the report.

Improved Management

The report reflects the efforts made by the SEC to establish and improve case management procedures and techniques. For example, during the period covered by the report the Commission emphasized the need to concentrate its

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2/ Bureau of Governmental Financial Operations, Office of the Secretary, U.S. Department of the Treasury, Treasury Bulletin, Winter Issue, 1st Qtr. 1983, at 106; Spring Issue, 2nd Qtr. 1984 at 55.

3/ Id.

4/ The requirements were a result of both judicial and legislative developments. Notable and representative of judicial developments were such cases as: Dirks v. SEC, 103 S.Ct. 3255 (1983) (restricting application of the antifraud provisions to insider trading); Aaron v. SEC, 446 U.S. 680 (1980) (requiring proof of scienter to establish violations of Section 17(a)(1) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934); and SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d 90 (2d Cir. 1978) (reflecting more stringent standards for the issuance of injunctions).

The principal legislative development adversely impacting the Commission's enforcement process was the enactment of the Right to Financial Privacy Act of 1978, 12 U.S.C. §3401 et seq. Compliance with that act imposes major burdens on Commission enforcement efforts. See Statement by John M. Fedders, Director of the Division of Enforcement, Securities and Exchange Commission, before the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations, May 2, 1984.

efforts upon significant violators of the Federal securities laws. The Commission thereby made its enforcement actions more efficient by directing its limited resources at "core", rather than peripheral, violators. This enabled the Commission to increase the cost/benefit ratio of its actions and avoid protracted litigation, particularly in light of the judicial developments described in note 4. The Commission's success in this regard is noted in the report at page 10: "[o]ur analysis showed a decline in the number of . . . defendants named in enforcement actions."

The Commission also made greater use of technological means for improving case management, market surveillance, case development, and reporting of enforcement-related information. Notable in this regard were:

- the Commission's establishment of the computerized Case Activity Tracking System, which commenced operations in 1980; and

- the improvements to the Commission's, and self-regulatory organizations', capabilities to detect questionable market activity.

Finally, the Commission emphasized its oversight responsibilities and, correspondingly, placed greater reliance upon the self-regulatory process. 5/

As shown by the report, the Commission's direct case management efforts resulted in a 45 percent reduction in pending investigations and a 21 percent reduction in the average age of investigations. 6/ Normally, consistent with these figures, one would expect that the total of actions brought would have been substantially reduced. Yet, as the report shows, the total of actions brought in 1983 approximately equals the number brought in 1977. 7/ These figures demonstrate a more effective enforcement process and underscore the excellent productivity achievements of the Commission's enforcement management.

* * * *

We believe that the report reflects the continued effectiveness and productivity of the Commission's enforcement program despite ample cause for a reduction in those measures. We therefore ask that the report be modified to include the important changes regarding staffing, funding, productivity, backlog, environment, and management that we present above.

5/ Reflective of these efforts is the fact that self-regulatory disciplinary proceedings increased from 531 in 1977 to 865 in 1983 -- a 63 percent increase.

6/ Report at p. 9.

7/ Report at p. 30.

APPENDIX VIII

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Chairman Shad has requested that I convey his gratitude for the opportunity to provide these comments.

Very truly yours,

John M. Fedders

John M. Fedders
Director

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