

*THE POLITICAL ECONOMY OF FINANCIAL  
REGULATION*

**POLITICS IN SECURITIES ENFORCEMENT**

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## I. INTRODUCTION

American securities enforcement agencies often face charges that they use their enforcement power to further political goals.<sup>1</sup> Most recently, Standard & Poor's credit rating agency claimed that the U.S. Department of Justice unfairly singled it out for prosecution for fraudulent credit ratings after it downgraded U.S. sovereign debt.<sup>2</sup> The U.S. Securities and Exchange Commission (SEC or the Commission), too, has been accused of using its enforcement politically: of bringing enforcement actions to improve its political standing,<sup>3</sup> to punish its detractors,<sup>4</sup> or to deflect attention from negative reports about its activities;<sup>5</sup> and of holding back investigations of politically-connected figures.<sup>6</sup>

While some of these charges may be justified, there is surprisingly little evidence that enforcement agencies, in particular the SEC, select their targets politically.<sup>7</sup> To be fair, the question has been impossible to study empirically without access to relevant data. The SEC deems the first stage of review, called matter under inquiry, or MUI, confidential and destroys all

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<sup>1</sup> See Jonathon R. Macey, *The Distorting Incentives Facing the U.S. Securities and Exchange Commission*, 33 HARV. J.L. & PUB. POL'Y 639, 644 (2010) (suggesting that the SEC carries out its enforcement duties to "maintain a base of support within the Congressional budget process" and to "maximize its appeal to Congress").

<sup>2</sup> Edvard Pettersson, *S&P to Fight for Evidence U.S. Suit Was Political Payback*, BLOOMBERG (Aug. 19, 2013, 12:01 AM), <http://www.bloomberg.com/news/articles/2013-08-19/s-p-to-fight-for-evidence-u-s-suit-was-political-payback>.

<sup>3</sup> See, e.g., Mary L. Schapiro, Chair, SEC, Public Statement on the Independence of the Securities and Exchange Commission (Apr. 21, 2010), <https://www.sec.gov/news/speech/2010/spch042110mls.htm> (asserting that the SEC "will neither bring cases, nor refrain from bringing them, because of political consequences" after allegations to the contrary).

<sup>4</sup> See, e.g., SEC v. McGoff, 647 F.2d 185, 193 (D.C. Cir. 1981) (addressing defendants' claim that the SEC's investigation was "politically motivated").

<sup>5</sup> See, e.g., Edward Wyatt, *Report Finds No Political Motivation in S.E.C.'s Goldman Suit*, N.Y. TIMES (Oct. 13, 2010), [http://www.nytimes.com/2010/10/14/business/14goldman.html?\\_r=0](http://www.nytimes.com/2010/10/14/business/14goldman.html?_r=0) ("The inspector general did not find any evidence that the Goldman suit was filed on the same day that he released a critical report of the S.E.C.'s actions in the R. Allen Stanford case to deflect attention from that news.").

<sup>6</sup> See, e.g., MINORITY STAFF OF S. COMM. ON FIN. & S. COMM. ON THE JUDICIARY, 110TH CONG., THE FIRING OF AN SEC ATTORNEY AND THE INVESTIGATION OF PEQUOT CAPITAL MANAGEMENT 7 (Comm. Print 2007) (investigating "allegations of improper political influence" by the SEC in its investigation of Pequot Capital Management).

<sup>7</sup> For some limited evidence, see discussion *infra* in Part III.C.

evidence gathered during such informal inquiry unless it opens an investigation.<sup>8</sup> While the SEC preserves records from all preliminary and formal investigations for twenty-five years,<sup>9</sup> the only information that it makes publicly available concerns filed enforcement actions—the final step in the process.<sup>10</sup> Despite limited empirical support one way or the other, commentators almost uniformly agree that “there is little corruption at the SEC.”<sup>11</sup>

Yet, while politics is largely irrelevant at the individual case level, political influences do shape enforcement choices at the aggregate level.<sup>12</sup> The main drivers are not political directives or direct pressure from important people in high places. Rather, politics seeps into enforcement choices through close congressional oversight by the U.S. House and Senate committees for banking and financial services<sup>13</sup> and for appropriations.<sup>14</sup> The ultimate

<sup>8</sup> OFFICE OF INSPECTOR GEN., SEC, Case No. OIG-567, REPORT OF INVESTIGATION: DESTRUCTION OF RECORDS RELATED TO MATTERS UNDER INQUIRY AND INCOMPLETE STATEMENTS TO THE NATIONAL ARCHIVES AND RECORDS ADMINISTRATION REGARDING THAT DESTRUCTION BY THE DIVISION OF ENFORCEMENT 2 (2011), <https://www.sec.gov/foia/docs/oig-567.pdf>. The SEC staff closes about 45% of MUIs without opening an investigation. *See id.* (reporting that the staff opened 23,289 MUIs between October 1, 1992 and July 20, 2010, and of those, it closed 10,468 without opening an investigation or another MUI).

<sup>9</sup> *See id.* at 17 (noting the SEC’s records retention schedule requires that “Investigative Case Files,” including preliminary investigation files, be retained for at least twenty-five years).

<sup>10</sup> The SEC publishes a list of all filed enforcement actions annually. *See About the SEC*, SEC, <http://sec.gov/about.shtml> (last modified Oct. 10, 2015) (showing an annually compiled list of all filed enforcement actions). In theory the SEC should disclose information about formal investigations pursuant to a FOIA request, but has refused to do so. *See* William R. McLucas et al., *A Practitioner’s Guide to the SEC’s Investigative and Enforcement Process*, 70 TEMP. L. REV. 53, 79 (1997) (discussing the FOIA exemptions generally relied on by the SEC).

<sup>11</sup> Macey, *supra* note 1, at 642; *see also* Anne C. Flannery, *Time for a Change: A Re-examination of the Settlement Policies of the Securities and Exchange Commission*, 51 WASH. & LEE L. REV. 1015, 1015 (1994) (“The Securities and Exchange Commission (SEC) enjoys a reputation envied by many other regulatory bodies . . .”).

<sup>12</sup> *See* A.C. Pritchard, *The SEC at 70: Time for Retirement?*, 80 NOTRE DAME L. REV. 1073, 1092 (2005) (suggesting that the SEC regulates “in the shadow of potential retaliation from Congress” rather than face direct political pressure on individual cases).

<sup>13</sup> They include the U.S. Senate Committee on Banking, Housing, and Urban Affairs and the U.S. House Committee on Financial Services.

<sup>14</sup> They are the U.S. Senate Committee on Appropriations and the U.S. House Committee on Appropriations.

result of congressional oversight during the last decade is an increase in enforcement targeting strict-liability violations and follow-on cases, obscured almost entirely by meaningless reporting of enforcement results—a result that both Congress and SEC leadership seem to be comfortable with, although it does not improve compliance with the law, and can produce embarrassing enforcement failures like Bernie Madoff’s Ponzi scheme.<sup>15</sup>

This Article discusses the mechanism of political influence over SEC enforcement in Part II. Although the SEC collects significant user fees and monetary penalties, it is funded solely through federal budget appropriations.<sup>16</sup> Congress uses its budget authority to micromanage how the SEC does its business.<sup>17</sup> In Part III, this Article discusses the most significant manifestations of political pressure in securities enforcement, focusing on the disparity between the SEC’s reported performance and its true output. It concludes with limited empirical evidence suggesting that political contributions to influential congressmen can lower a firm’s enforcement risk. In Part IV, this Article proposes to reduce congressional control of the SEC through the budget process. It suggests that the SEC receive five-year budget appropriations rather than having to return to Congress every year. While that would not eliminate congressional control—and it is not obvious whether that would be a good thing—making budgetary fights less frequent should enable the SEC to focus on enforcement with less concern about what Congress might do.

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<sup>15</sup> See Macey, *supra* note 1, at 639–40 (suggesting that congressional oversight induces the SEC to pursue only “readily observable objectives,” such as number of cases brought and size of fines collected, resulting in enforcement failures like that involved in Madoff’s Ponzi scheme).

<sup>16</sup> See Andrew Ackerman, *White House Seeks More Money for Wall Street Oversight*, WALL ST. J. (Feb. 2, 2015, 11:30 AM), <http://www.wsj.com/articles/white-house-seeks-more-money-for-wall-street-oversight-1422894603> (noting that while the SEC collects substantial fees, it is still congressionally funded through annual appropriations).

<sup>17</sup> See Sarah N. Lynch, *Senate, House Unveil Dueling Budget Plans for SEC, CFTC*, REUTERS (June 24, 2014, 3:19 PM), <http://www.reuters.com/article/2014/06/24/us-congress-budgets-sec-cftc-idUSKBN0EZ2hb20140624> (discussing a Republican-proposed bill that would severely limit the ways in which the SEC could use the increased funds in its budget).

## II. THE SOURCES OF POLITICAL PRESSURE

That the SEC is subject to intense political pressure might be somewhat surprising given that it is deemed an “independent” agency.<sup>18</sup> “Independence” in administrative law parlance refers to insulation from the President and the executive branch.<sup>19</sup> Presidents have generally stayed away from the Commission.<sup>20</sup> They have refrained from removing Commissioners and have not intervened in enforcement or regulatory matters within the SEC’s purview, other than requesting budget increases on behalf of the agency.<sup>21</sup>

While independent agencies are relatively independent from the President, they are vulnerable to the control and influence of individual members and committees in Congress that oversee their activities and set their budgets.<sup>22</sup> Observers have suggested a causal relationship between agency independence from the President and agencies’ susceptibility to factionalism and capture by well-organized private groups, usually operating through congressional committees and individual influential congressmen.<sup>23</sup>

The most significant source of pressure on the SEC is institutionalized annual reporting to Congress that has been

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<sup>18</sup> The President appoints five Commissioners and can remove them only for good cause. *See, e.g.*, 44 U.S.C. § 3502(5) (2012) (classifying the SEC as an independent agency for purposes of the Paperwork Reduction Act); *SEC v. Blinder, Robinson & Co.*, 855 F.2d 677, 681 (10th Cir. 1988) (“[I]t is commonly understood that the President may remove a commissioner [of the SEC] only for ‘inefficiency, neglect of duty or malfeasance in office.’”). *But see* Note, *The SEC Is Not an Independent Agency*, 126 HARV. L. REV. 781, 782 (2013) (concluding that the SEC is not an independent agency).

<sup>19</sup> *See* Paul R. Verkuil, *The Purposes and Limits of Independent Agencies*, 1988 DUKE L.J. 257, 259–60 (describing different ways in which independent agencies are shielded from executive involvement).

<sup>20</sup> In fact, the complaint of several SEC Chairs has been inadequate access to the President rather than the opposite. *See* JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 631 (3d ed. 2003) (reporting that SEC Chair Arthur Levitt met with President Clinton privately only once during his tenure, much to his chagrin).

<sup>21</sup> *See* Silla Brush & David Michaels, *Obama Seeks More Money for Agencies Enforcing Dodd-Frank Rules*, BLOOMBERG (Feb. 2, 2015, 11:30 AM), <http://www.bloomberg.com/news/articles/2015-02-02/obama-seeks-more-money-for-agencies-enforcing-dodd-frank-rules> (discussing President Obama’s request to increase the SEC’s 2016 budget by 15%).

<sup>22</sup> Cass R. Sunstein, *Paradoxes of the Regulatory State*, 57 U. CHI. L. REV. 407, 427 (1990).

<sup>23</sup> *Id.*

combined with the budget appropriation process.<sup>24</sup> The SEC must report annually to the appropriations committees and the committees overseeing financial markets in both houses of Congress.<sup>25</sup> It must prepare and present a strategic plan once every four years, together with annual performance plans and performance reports.<sup>26</sup> If it fails to meet any of the performance goals it has set for itself, it risks losing funds through the budget appropriation process.<sup>27</sup> As a result, the SEC faces intense pressure to at least meet its performance targets, and to exceed them if possible.

In addition to the SEC, the U.S. Commodities Futures Trading Commission (CFTC), too, must report to Congress annually and depends exclusively on budget appropriations to do its work.<sup>28</sup> The budgets of other federal financial regulators, such as the Federal Reserve, are not set through annual appropriations.<sup>29</sup> The Financial Industry Regulatory Authority (FINRA), a self-regulatory organization of broker-dealers, is funded through membership fees and fines it collects.<sup>30</sup> Although its jurisdiction is much smaller than the SEC's, its budgets in 2013 and 2014 were

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<sup>24</sup> The Government Performance and Results Act of 1993 linked agency performance metrics with the appropriations process. See Pub. L. No. 103-62 § 1115, 107 Stat. 285, 287 (1993) (“[T]he Director of the Office of Management and Budget, shall require each agency to prepare an annual performance plan . . .”). The Results Act was amended in early 2011 by the GPRA Modernization Act of 2010. Pub. L. No. 111-352, § 2, 124 Stat. 3866, 3866–67 (2011).

<sup>25</sup> See Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. (forthcoming 2016) (manuscript at 10), available at <http://ssrn.com/abstract=2654427> (explaining that agencies must report at least annually to the House and Senate Appropriations Committees).

<sup>26</sup> For a more detailed discussion, see generally *id.*

<sup>27</sup> *Id.* (manuscript at 11).

<sup>28</sup> See Ackerman, *supra* note 16 (“The SEC and CFTC have said they lack sufficient resources to police the markets and fully implement dozens of mandates under the 2010 Dodd-Frank financial overhaul law.”).

<sup>29</sup> See *id.* (“[T]he SEC and the CFTC are the only two Wall Street watchdogs that Congress hasn't removed from the federal budget process.”).

<sup>30</sup> See FIN. INDUS. REGULATORY AUTH., FINRA 2014 YEAR IN REVIEW AND ANNUAL FINANCIAL REPORT 17 (2015), available at [https://www.finra.org/sites/default/files/2014\\_YIR\\_AFR.pdf](https://www.finra.org/sites/default/files/2014_YIR_AFR.pdf) (“The increase in FINRA's case ratio was driven by an increase in fines and SEC fees received year over year.”).

larger.<sup>31</sup> As a result, banking regulators and FINRA can operate far more independently than nominally “independent” agencies, with more independence from both the President and Congress.<sup>32</sup>

Not only must the SEC plead in Congress every year for funding, it is regularly under close political scrutiny for reasons other than its budget, even more so than other agencies. For example, in 2012, during the Second Session of the 112th Congress, SEC members and staff were called to testify in Congress fifteen times on matters ranging from the Volcker Rule<sup>33</sup> and cost-benefit analysis in SEC rulemaking,<sup>34</sup> to the collapse of MF Global<sup>35</sup> and the SEC’s settlement practices.<sup>36</sup> The Environmental Protection Agency, an agency with four times as many employees, testified twelve times during the same period.<sup>37</sup>

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<sup>31</sup> See *id.* at 37 (showing FINRA operating revenues of about \$1.3 billion in 2013 and \$1.5 billion in 2014).

<sup>32</sup> See generally Peter Conti-Brown, *The Institutions of Federal Reserve Independence*, 32 YALE J. ON REG. (forthcoming 2015) (Rock Ctr. for Corporate Governance, Working Paper Series No. 139, 2014), available at <http://ssrn.com/abstract=2275759>.

<sup>33</sup> *Examining the Impact of the Volcker Rule on Markets, Businesses, Investors and Job Creation: Hearing Before the Subcomm. on Capital Mkts. and Gov’t Sponsored Enters. and the Subcomm. on Fin. Inst. and Consumer Credit of the H. Comm. on Fin. Servs.*, 112th Congress (2012) (statement of Mary L. Schapiro, Chair, U.S. Securities and Exchange Commission), available at <http://www.sec.gov/News/Testimony/Detail/Testimony/1365171489310>.

<sup>34</sup> *Economic Analysis in SEC Rulemaking: Hearing Before the Subcomm. on TARP, Fin. Servs. and Bailouts of Pub. and Private Programs of the H. Comm. on Oversight and Gov’t Reform*, 112th Congress (2012) (statement of Mary L. Schapiro, Chair, U.S. Securities and Exchange Commission), available at <http://www.sec.gov/News/Testimony/Detail/Testimony/13651714894000>.

<sup>35</sup> *The Collapse of MF Global: Lessons Learned and Policy Implications: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 112th Congress (2012) (statement of Robert Cook, Director, Division of Trading & Marketing, U.S. Securities and Exchange Commission), available at <http://www.gpo.gov/fdsys/pkg/CHRG-112shrg77222/pdf/CHRG-112shrg77222.pdf>.

<sup>36</sup> *Examining the Settlement Practices of U.S. Financial Regulators: Hearing Before the H. Comm. on Fin. Servs.*, 112th Congress (2012) (statement of Robert Khuzami, Director, Division of Enforcement, U.S. Securities and Exchange Commission), available at <http://www.sec.gov/News/Testimony/Detail/Testimony/1365171489454>.

<sup>37</sup> See *EPA Testimony Statements: Second Session of the 112th Congress*, EPA, <http://www2.epa.gov/ocir/cpa-testimony-statements-112th-congress-2nd-session> (last updated Oct. 16, 2015) (listing each EPA testimony during the period). During the 113th Congress, the SEC testified seventeen times, while the EPA appeared thirty-six times. See *EPA Testimony Statements: First Session of the 113th Congress*, EPA, <http://www2.epa.gov/ocir/epa-testimony-statements-113th-congress-1st-session> (last updated Oct. 15, 2015) (noting that, during the first session of the 113th Congress, the EPA testified twenty-three times); *EPA Testimony Statements: Second Session of the 113th Congress*, EPA, <http://www2.epa.gov>.

The Federal Trade Commission testified ten times, despite considerable public concern about privacy invasions and data breaches that are within the FTC's regulatory purview.<sup>38</sup>

Excessive accountability to Congress has made the SEC vulnerable to the political whims of congressmen.<sup>39</sup> For example, Republican congressmen like to micromanage SEC spending, requiring that any nominal budget increases be spent on pet projects.<sup>40</sup> Other congressmen have responded to the SEC's budget requests by demanding something in return. For instance, one Democratic representative reported asking the SEC Chair during testimony in the U.S. House Committee on Financial Services whether the Commission would change its settlement practices in exchange for a requested budget increase.<sup>41</sup>

The SEC's Division of Enforcement is particularly vulnerable to pressure from congressional committees and their members. Although the SEC has five divisions, the success of the Division of Enforcement drives congressional and public perceptions of the entire Commission.<sup>42</sup> In the words of one former SEC Chair, enforcement is the "bedrock warrant" for the SEC's continued

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gov/ocir/epa-testimony-statements-113th-Congress-2nd-session (last updated Oct. 15, 2015) (noting that, during the Second Session of the 113th Congress, the EPA testified thirteen times); *Testimony*, SEC, <http://www.sec.gov/news/testimony> (last visited Nov. 3, 2015) (showing that the SEC only testified seventeen times during the 113th Congress).

<sup>38</sup> See *Testimony*, FTC, <https://www.ftc.gov/policy/testimony> (last visited Nov. 3, 2015) (documenting all FTC testimony during the second session of the 112th Congress and showing that, during the 113th Congress, the FTC testified twenty-seven times, including several times on net neutrality).

<sup>39</sup> See Lawrence Lessig & Cass R. Sunstein, *The President and the Administration*, 94 COLUM. L. REV. 1, 115 (1994) ("Congress might make agencies independent not to create real independence, but in order to diminish presidential authority over their operations precisely in the interest of subjecting those agencies to the control of congressional committees. Independence, in short, might be a way of increasing legislative power over agencies."); see also Pritchard, *supra* note 12, at 1076 ("The accountability that I believe should be diminished is the SEC's accountability to Congress.").

<sup>40</sup> Republican representatives in the House proposed that any budget increase for the SEC in 2015 be "earmarked for technology projects." Lynch, *supra* note 17.

<sup>41</sup> Telephone interview with anonymous congressional staffer (March 18, 2015).

<sup>42</sup> See Macey, *supra* note 1, at 644 ("[I]t is the activities of the Enforcement Division of the SEC that legitimize the Commission's existence and its federal budget allocation to Congress.").



existence.<sup>43</sup> In the words of another, enforcement is the Commission's "number one priority."<sup>44</sup> Enforcement failures sully the SEC's reputation<sup>45</sup> far more than badly-drafted rules or trading interruptions. There is little that the SEC can do to change that. Enforcement scandals hurt the President and Congress,<sup>46</sup> while regulatory and market problems generally do not unless accompanied by significant recessions. In turn, the SEC, too, is far more sensitive to enforcement failures than to regulatory failures, even though the former are inevitable given its skimpy enforcement budget and the latter much less so.<sup>47</sup> In trying to limit fallout after scandals, the SEC routinely uses its overall enforcement output to defend its performance<sup>48</sup> or to justify budget increases.<sup>49</sup>

Political pressure on SEC enforcement is relatively new. Some thirty years ago, a commentator described the SEC as a "low-

<sup>43</sup> Bevis Longstreth, *The SEC After Fifty Years: An Assessment of Its Past and Future*, 83 COLUM. L. REV. 1593, 1612 (1983) (book review).

<sup>44</sup> *UK and US Differ on Enforcement*, DAILY TELEGRAPH, Dec. 3, 2005, at 30 (quoting SEC Chair Christopher Cox), available at 2005 WLNR 19463408; see also Jonathan G. Katz, *Reviewing the SEC, Reinvigorating the SEC*, 71 U. PITT. L. REV. 489, 509 (2010) (explaining that "[v]irtually every Chairman of the SEC in the past thirty years" believed that the SEC is primarily a law enforcement agency).

<sup>45</sup> See, e.g., David Stout, *Report Details How Madoff's Web Ensnares S.E.C.*, N.Y. TIMES (Sept. 3, 2009), available at [http://www.nytimes.com/2009/09/03/business/03madoff.html?\\_r=0](http://www.nytimes.com/2009/09/03/business/03madoff.html?_r=0) (suggesting that the SEC staff was inexperienced, incompetent, and easily fooled by Madoff).

<sup>46</sup> See Marver H. Bernstein, Book Review, 81 HARV. L. REV. 1886, 1886 (1968) ("[E]ven excellence in administration of the SEC would scarcely help the President much politically but . . . ineffectual administration beset by scandals could hurt that office.").

<sup>47</sup> See *id.* at 1887 (noting Congress's partial blame for the SEC's budget shortfalls).

<sup>48</sup> See, e.g., *The SEC's Failure to Identify the Bernard L. Madoff Ponzi Scheme and How to Improve SEC Performance: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 111th Cong. (2009) (statement of Robert Khuzami, Director, Division of Enforcement, U.S. Securities & Exchange Commission & John Walsh, Acting Director, Office of Compliance Inspections and Examinations, U.S. Securities & Exchange Commission), available at <http://www.sec.gov/news/testimony/2009/ts091009rk-jw.htm> (responding to criticism of handling the Madoff case by reporting overall statistics).

<sup>49</sup> See *The Fiscal Year 2016 Budget Request of the U.S. Securities and Exchange Commission: Hearing Before the Subcomm. on Fin. Servs. and Gen. Gov't of the S. Comm. on Appropriations*, 114th Cong. (2015) (statement of Mary Jo White, Chair, U.S. Securities and Exchange Commission), available at <https://www.sec.gov/news/testimony/testimony-fy-2016-sec-budget-request.html> ("The Division of Enforcement continued to achieve significant results, filing 755 enforcement actions and obtaining orders for more than \$4.16 billion in disgorgement and penalties in fiscal year 2014.").

profile agency.”<sup>50</sup> In the early years, the SEC was primarily a regulatory agency.<sup>51</sup> The Division of Enforcement was not created until 1972.<sup>52</sup> Until 1990, when the Remedies Act granted the SEC “robust penalty authority,” the SEC exercised enforcement powers almost exclusively to bar unsavory brokers and investment managers from the securities industry and to stop issuers from selling securities to public investors.<sup>53</sup> Enforcement has risen in prominence since then, in particular in the aftermath of financial scandals.<sup>54</sup> Political and general public attention to securities enforcement has persisted, at least since the dot-com bubble and bust at the turn of the millennium<sup>55</sup> and the accounting scandals.<sup>56</sup>

Constant and intrusive attention can be counterproductive.<sup>57</sup> The following Part discusses three ways in which congressional oversight influences the SEC’s enforcement choices.

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<sup>50</sup> Laura Nader, *Enforcement Strategies and the Catch They Yield at the SEC*, 99 HARV. L. REV. 1362, 1364 (1986) (book review). *But see* John Wheeler, *The SEC: A New American Institution*, 93 YALE L.J. 188, 188 (1983) (book review) (“[T]he SEC is an organization of unusual power, longevity, and responsibility.”).

<sup>51</sup> *See, e.g.*, Walter Werner, *The SEC as a Market Regulator*, 70 VA. L. REV. 755, 755–56 (1984) (explaining that the SEC has two missions: to improve disclosure and to regulate markets).

<sup>52</sup> SEC, THIRTY-EIGHTH ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION, at xxvii (1972), available at [http://www.sechistorical.org/collection/papers/1970/1970\\_0630\\_SECAR.pdf](http://www.sechistorical.org/collection/papers/1970/1970_0630_SECAR.pdf).

<sup>53</sup> Daniel M. Gallagher, Jr., *Lecture: The Securities and Exchange Commission – The Next 80 Years*, 20 FORDHAM J. CORP. & FIN. L. 626, 627–28 (2015).

<sup>54</sup> *See generally id.* (noting the evolution of the SEC enforcement power during the late twentieth century).

<sup>55</sup> *See* David M. Becker, Gen. Counsel & Senior Policy Dir., SEC, Remarks Before the Committee on Federal Regulation of Securities, Section of Business Law, American Bar Association (Nov. 20, 2009), <https://www.sec.gov/news/speech/2009/spch112009dmb.htm> (“With the collapse of the dot com bubble, the Commission found itself an object of intense and sustained public scrutiny.”).

<sup>56</sup> *See id.* (“The world wanted to know why Enron failed and why no one, including the Commission, was aware it was defrauding the public. And the world wanted to know what the Commission . . . was going to do about it.”).

<sup>57</sup> *See generally* Sunstein, *supra* note 22 (describing paradoxes in administrative law); Jacob E. Gersen & Matthew C. Stephenson, *Over-Accountability*, 6 J. LEGAL ANALYSIS 185 (2014) (analyzing various consequences of excessive accountability).

## III. MANIFESTATIONS OF POLITICAL PRESSURE

Political accountability through the congressional committees produces several undesirable consequences. First, the SEC has considerable control over how it reports its performance, in particular the output of the Division of Enforcement. It has used this control to manage its enforcement reporting in order to pander to its congressional overseers. Second, the settled reporting conventions have shifted the Commission's enforcement priorities. For one, the Commission brings more follow-on proceedings than it used to. It has increased the overall number and the share of enforcement actions for strict-liability violations, and it brings many such actions in September, at the end of its fiscal year. Finally, a couple of studies indicate that political contributions and lobbying in Congress tend to reduce the likelihood of enforcement.<sup>58</sup> The studies suggest that reducing the power of Congress to control the SEC could improve its enforcement program.

## A. REPORTING CHOICES

The SEC reports its output to Congress and has done so since the SEC's creation.<sup>59</sup> While financial reporting is standardized across federal agencies, the SEC selects the non-financial metrics that it uses to report on non-financial dimensions itself.<sup>60</sup> As noted in a companion article, over the years the information that the SEC reports has become less useful and more difficult to understand.<sup>61</sup> For example, a long time ago the SEC's annual report included information on remedies that the SEC secured

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<sup>58</sup> See discussion in Part III.C.

<sup>59</sup> Velikonja, *supra* note 25 (manuscript at 5).

<sup>60</sup> *Id.* (manuscript at 11–12).

<sup>61</sup> See *id.* (manuscript at 3) (“[O]ver a 15-year period . . . the statistics the SEC most commonly uses to assess and report its enforcement performance are flawed.”). The Commission used to produce a more detailed classification of enforcement actions than it does now. Compare SEC, SEC 2002 ANNUAL REPORT 144, available at <http://www.sec.gov/pdf/annrep02/ar02full.pdf> (breaking down enforcement actions into eighteen different classifications), with SEC, SELECT SEC AND MARKET DATA: FISCAL 2013, at 3, available at <http://www.sec.gov/about/secstats2013.pdf> (reporting only ten classifications).

against defendants it prosecuted.<sup>62</sup> It now includes only very limited aggregate statistics,<sup>63</sup> and even these aggregate statistics have become less transparent over time.<sup>64</sup>

More problematic than reduced transparency of reported enforcement statistics is that the metrics that the SEC uses most prominently—number of enforcement actions, aggregate monetary penalties, number of defendants, and subject matter categorization—are misleading and can be manipulated quite easily.<sup>65</sup> The SEC’s favorite statistic is the number of enforcement actions filed during a fiscal year. But that statistic is also the most vulnerable to manipulation.<sup>66</sup>

The SEC likes to report that it has increased its enforcement output compared with prior years. To do so, the SEC often brings two or more enforcement actions against the same defendant for the same securities violation based on the same investigation: in one enforcement action it seeks a fine and an injunction, in another a broker-dealer bar, and in a third a professional bar.<sup>67</sup> It counts these as three enforcement actions against three defendants, and thereby skews both statistics.<sup>68</sup> In addition, because over 40% of enforcement actions are settled before legal

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<sup>62</sup> *E.g.*, SEC, FOURTH ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION: FISCAL YEAR ENDED JUNE 30, 1938, at 172–77, available at [http://www.sec.gov/about/annual\\_report/1938.pdf](http://www.sec.gov/about/annual_report/1938.pdf).

<sup>63</sup> *E.g.*, SEC, SELECT SEC AND MARKET DATA: FISCAL 2014, at 2, available at <http://www.sec.gov/about/secstats2014.pdf>.

<sup>64</sup> Until recently, the SEC divided all enforcement actions against broker-dealers into five sub-categories of subject matter, so one could quite easily infer how many cases were follow-on proceedings and how many were not. Now, the report lumps the various actions against broker-dealers under a single heading. Compare SEC 2002 ANNUAL REPORT, *supra* note 61, at 144, with SELECT SEC AND MARKET DATA: FISCAL 2013, *supra* note 61, at 3. The 2013 report breaks out enforcement for municipal offerings under a separate heading, but failure to supervise, fraud against customer, books & records, and other violations by broker-dealers, which were formally set out separately, are reported together.

<sup>65</sup> Velikonja, *supra* note 25 (manuscript at 25).

<sup>66</sup> *See id.* (indicating that “a single investigation may result in multiple separate case filings” and that the SEC’s “stats count all SEC case filings exactly the same”).

<sup>67</sup> *See id.* (manuscript at 20–21) (describing an investigation into accounting fraud at Adelphia).

<sup>68</sup> In addition, when counting defendants the SEC includes relief defendants even though they are not securities violators. *Id.* (manuscript at 35).

proceedings are initiated, the SEC has no incentive to consolidate enforcement actions brought on the basis of the same set of facts.<sup>69</sup> It can, and occasionally does, bring separate actions, thus boosting the overall number. Similarly, aggregate monetary penalties include fines and disgorgements ordered by other financial regulators, as well as disgorgements and fines ordered but waived for defendants' inability to pay.<sup>70</sup>

Prominent enforcement statistics not only overstate the SEC's performance, but they also bias and obscure important trends. Sometimes, the bias is favorable to the Commission. For example, the SEC likes to report increased enforcement overall and as against specific categories, like accounting fraud or insider trading.<sup>71</sup> To show growth, the SEC can boost those figures in various ways.<sup>72</sup> At other times, the Enforcement Division's true output is better than the statistics would suggest. For example, fiscal year 2009 was truly a banner year for enforcement, in particular against Ponzi schemers. Yet measured by the number of enforcement actions, the SEC's enforcement declined in 2009 compared with 2008.<sup>73</sup> Moreover, reported statistics obscure other important facts about enforcement that are frequently misunderstood. For example, contrary to popular belief,<sup>74</sup> the SEC is not more likely to sue firms than it is to go after individuals, at least not in accounting fraud and securities offering cases.<sup>75</sup>

What is odd about the enforcement statistics is that the SEC itself selects the metrics. There are no legal constraints barring the Commission from changing what metrics it uses to report performance or from publishing information in addition to its

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<sup>69</sup> *Id.* (manuscript at 38).

<sup>70</sup> *Id.* (manuscript at 3–4).

<sup>71</sup> *E.g.*, SEC 2002 ANNUAL REPORT, *supra* note 61, at 144.

<sup>72</sup> See Velikonja, *supra* note 25 (manuscript at 25) (noting the ways in which the SEC may manipulate measurements of enforcement activity).

<sup>73</sup> *Year-by-Year SEC Enforcement Statistics*, SEC, <https://www.sec.gov/news/newsroom/images/enfstats.pdf> (last visited Nov. 24, 2015).

<sup>74</sup> Macey, *supra* note 1, at 651.

<sup>75</sup> See Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331, 376, 382 tbl.6 (2015) (noting that third-party defendants are more likely to pay monetary sanctions than are the firms committing fraud).

avored statistics. In fact, the Commission has changed its reporting in various ways over the years. Yet the SEC seems wedded to its “stats” and is unwilling to change them, despite considerable criticism from all directions<sup>76</sup> and despite the fact that it collects data on many other aspects of enforcement. The SEC’s usual retort is that Congress and the press are used to the practice,<sup>77</sup> but that hardly seems convincing. Reporting better metrics along with older figures during the transition period would certainly smooth the shift.

The real reason for using inferior statistics is probably a mix of inertia and the fact that the favored statistics are quite malleable. In an otherwise slow year, the SEC can make up the shortfall in the number of filed enforcement actions by bringing a few dozen follow-on actions in September, just before the end of the fiscal year.<sup>78</sup> “September swell” is a common feature in SEC enforcement and, as shown in Figure 1, below, goes back at least to fiscal year 1999.

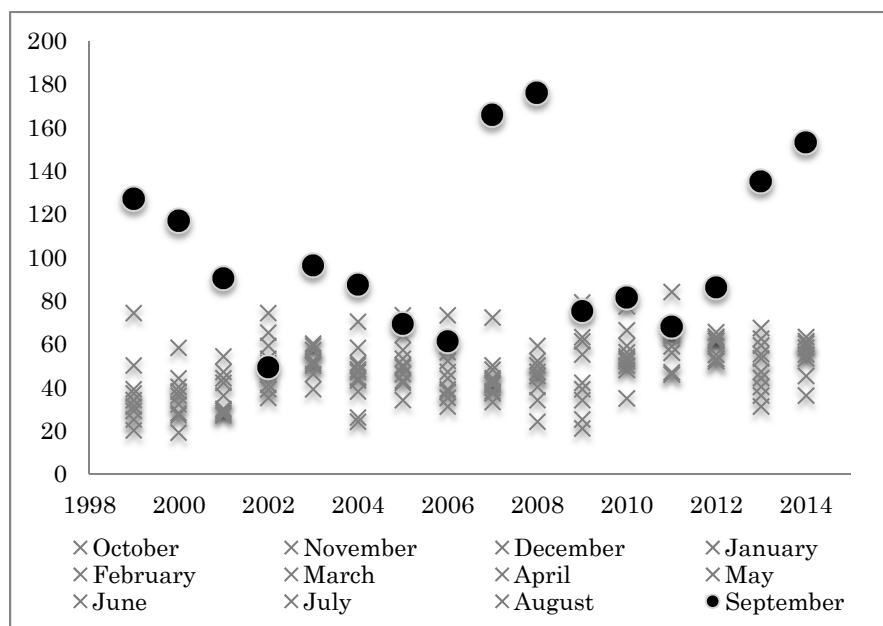
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<sup>76</sup> See, e.g., Jonathan Weil, *The Best SEC Speech Ever*, BLOOMBERG VIEW (Apr. 8, 2014, 2:25 PM), <http://www.bloombergvew.com/articles/2014-04-08/the-best-sec-speech-ever> (quoting an SEC enforcement attorney saying that SEC enforcement statistics are “cancer” and “should be changed”).

<sup>77</sup> See *id.* (quoting an SEC lawyer saying, “one argument against change is that the Press and Congress are welded to [the SEC’s] own anvil”).

<sup>78</sup> See Jean Eaglesham, *SEC Pads Case Tally With Easy Prey*, WALL ST. J. (Oct. 17, 2013, 11:27 PM), <http://www.wsj.com/articles/SB10001424052702304384104579141863675545256> (reporting that in the face of a possible 20% decline in the number of filed enforcement actions in 2013, the SEC brought 128 new enforcement actions in September 2013 to reduce the decline to about 5%).

Figure 1: Monthly Distribution of SEC Enforcement Actions (FY 1999–2014)<sup>79</sup>



The SEC often puts pressure on defendants to either settle by September or face a lawsuit. For example, in addition to its regular menu of enforcement actions, in September 2014 the SEC filed 54 enforcement actions (7.2% of the 2014 total)<sup>80</sup> in two different sweeps for strict-liability violations: 34 enforcement actions for failure to comply with disclosure requirements under Section 16(a) of the Exchange Act<sup>81</sup> and 20 enforcement actions for

<sup>79</sup> For a detailed methodology for the information in Figure 1, see Velikonja, *supra* note 25 (manuscript at 20–24).

<sup>80</sup> See SELECT SEC AND MARKET DATA: FISCAL YEAR 2014, *supra* note 63, at 3 (listing the total number of enforcement actions in fiscal year 2014 at 755).

<sup>81</sup> Press Release, SEC, SEC Announces Charges Against Corporate Insiders for Violating Laws Requiring Prompt Reporting of Transactions and Holdings (Sept. 10, 2014), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542904678>.

violations of Rule 105 of Regulation M.<sup>82</sup> Both investigations had been ongoing for months, and there was no particular reason to wrap up the cases in September, other than to affect the SEC's enforcement statistics.<sup>83</sup>

The ability to exercise control over the dimension of enforcement that is measured enables the SEC to smooth over reported performance and provide cover for the Chair and the Enforcement Division when things do not go as well as hoped. “[T]he SEC wants approval from its congressional overseers and from the general public,” and the enforcement statistics enable it to receive that approval.<sup>84</sup> Such statistics help the SEC meet its own performance targets and thus receive budget increases or, at the very least, avoid budget cuts.<sup>85</sup>

But the blame for misleading reporting does not lie solely with the SEC. Congressional committees overseeing the SEC and its budget also like this state of affairs. The fact that the Commission obligingly strives to report good enforcement numbers obscures that securities enforcement is weaker than reported, and that the SEC is significantly underfunded given the task at hand.<sup>86</sup> Congress holds the purse strings and likes to keep them tight, while at the same time avoiding any blame for enforcement failures that additional funding or less control could have prevented.<sup>87</sup>

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<sup>82</sup> Press Release, SEC, SEC Sanctions 19 Firms and Individual Trader for Short Selling Violations in Advance of Stock Offerings (Sept. 16, 2014), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542963767>.

<sup>83</sup> Similarly, in September 2013, the SEC filed twenty-three enforcement actions for Rule 105 violations. Press Release, SEC, SEC Charges 23 Firms with Short Selling Violations in Crackdown on Potential Manipulation in Advance of Stock Offerings (Sept. 17, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539804376>.

<sup>84</sup> Macey, *supra* note 1, at 639.

<sup>85</sup> *See id.* at 641 (discussing the SEC's concern with congressional and public opinion due to the effect on its budget).

<sup>86</sup> *See* Donald C. Langevoort, *The SEC and the Madoff Scandal: Three Narratives in Search of a Story* 4–6 (Georgetown Law Faculty Working Papers, Research Paper No. 1475433, 2009), available at <http://ssrn.com/abstract=1475433> (discussing the reasons the SEC obscures its reporting).

<sup>87</sup> *See id.* at 6 (“[T]he budgetary constraint is Congress' choice, and one of the important unwritten rules of being a successful sitting regulator in an independent regulatory agency is never to blame Congress for your problems, even when Congress is very much to blame.”).



## B. SHIFTS IN ENFORCEMENT

The settled reporting conventions have shifted the Commission's enforcement preferences, in particular over the last fifteen years as political and general public scrutiny of the SEC has intensified. Many have observed that after the Sarbanes-Oxley Act, the SEC has increased by an order of magnitude the maximum penalties that it extracts from large entity defendants.<sup>88</sup> Such large fines boost the aggregate monetary penalties that the SEC features in its annual reports. In fiscal years 2011 and 2012, the largest ten settlements yielded 34.5% and 32.3%, respectively, of all monetary penalties ordered.<sup>89</sup> Large settlements with major financial institutions and solvent issuers also improve collection rates (unlike settlements with Ponzi schemers, for example). It does not, however, seem likely that reporting is a significant driver of large financial settlements. Deterrence and possibly investor compensation are the more plausible rationales.

On the other hand, several other trends in enforcement do appear to be driven in significant part by reporting. First, the Commission brings considerably more follow-on proceedings than it used to. Follow-on enforcement actions are brought in administrative proceedings and seek to impose a partial or full

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<sup>88</sup> See, e.g., Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors*, 60 FLA. L. REV. 1103, 1105 n.6 (2008) (explaining that although a \$10 million penalty in 2002 was the highest ever imposed, it "quickly came to seem like small change" in the years following); Barry W. Rashkover, *Reforming Corporations Through Prosecution: Perspectives from an SEC Enforcement Lawyer*, 89 CORNELL L. REV. 535, 542 (2004) (stating that a \$10 million penalty against Xerox "has since been dwarfed by penalties in more recent settlements").

<sup>89</sup> In fiscal year 2011, the largest ten settlements yielded \$968 million, or 34.5% of the total amount of penalties ordered (\$2.806 billion). See ELAINE BUCKBERG, JAMES OVERDAHL & MAX GULKER, NAT'L ECON. RESEARCH ASSOCS., SEC SETTLEMENT TRENDS: 2H11 UPDATE 2 (2012) (listing the ten largest settlements in fiscal year 2011); SEC, FY 2015 CONGRESSIONAL BUDGET JUSTIFICATION, FY 2015 ANNUAL PERFORMANCE PLAN & FY 2013 ANNUAL PERFORMANCE REPORT 36 (2015), <http://www.sec.gov/about/reports/secfy15congbudgjust.pdf> (listing \$2.806 billion as the total amount of penalties ordered in fiscal year 2011). In fiscal year 2012, the largest ten settlements yielded \$1.002.52 billion, or 32.3% of the total amount of penalties ordered (\$3.104 billion). See JORGE BAEZ, JAMES A. OVERDAHL & ELAINE BUCKBERG, NAT'L ECON. RESEARCH ASSOCS., SEC SETTLEMENT TRENDS: 2H12 UPDATE 2 (2013) (listing the ten largest settlements in fiscal year 2012); SEC, *supra*, at 36 (listing \$3.104 billion as the total amount of penalties ordered in fiscal year 2012).

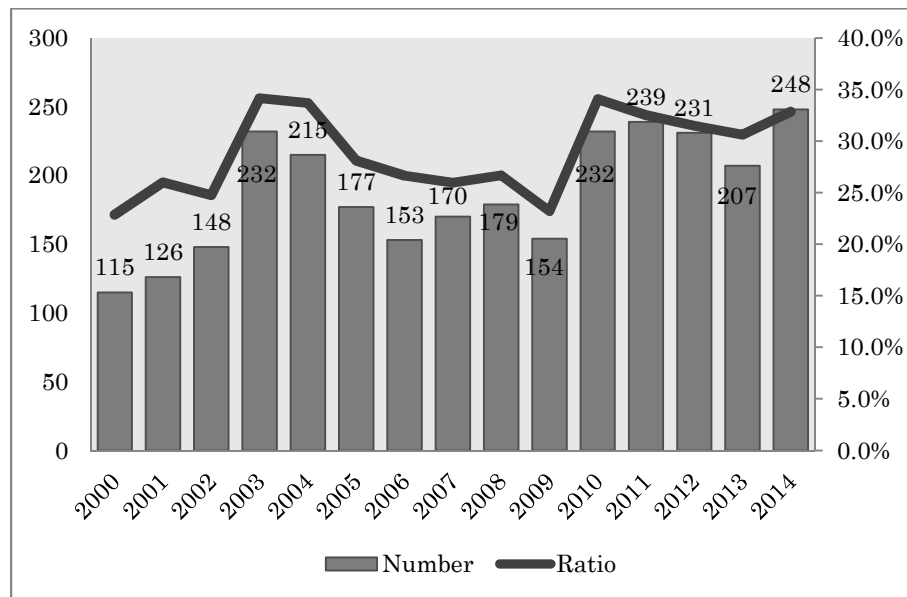
collateral bar under Section 15(b) of the Securities Exchange Act<sup>90</sup> or a professional bar under Rule 102(e) of the SEC Rules of Practice.<sup>91</sup> In all follow-on proceedings, the respondent either already settled an SEC enforcement action (or lost in court or before an administrative law judge), was convicted, or was sanctioned by another federal agency or state securities regulator. Thus, all follow-on actions are *derivative*: they are ordinarily based on an injunction that the SEC imposed against the same offender based on the same set of facts in a primary enforcement action. Many have already been counted in the enforcement tally, often in the same fiscal year. Some have been counted three or more times.<sup>92</sup> As shown in Figure 2, below, in 2000, follow-on cases were 23% of the SEC's enforcement action tally; in 2014, they were 33% of the total.

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<sup>90</sup> Securities Exchange Act of 1934 § 15(b)(6), 15 U.S.C. § 780(6) (2012).

<sup>91</sup> SEC Rules of Practice, 17 C.F.R. § 201.102(e) (2015).

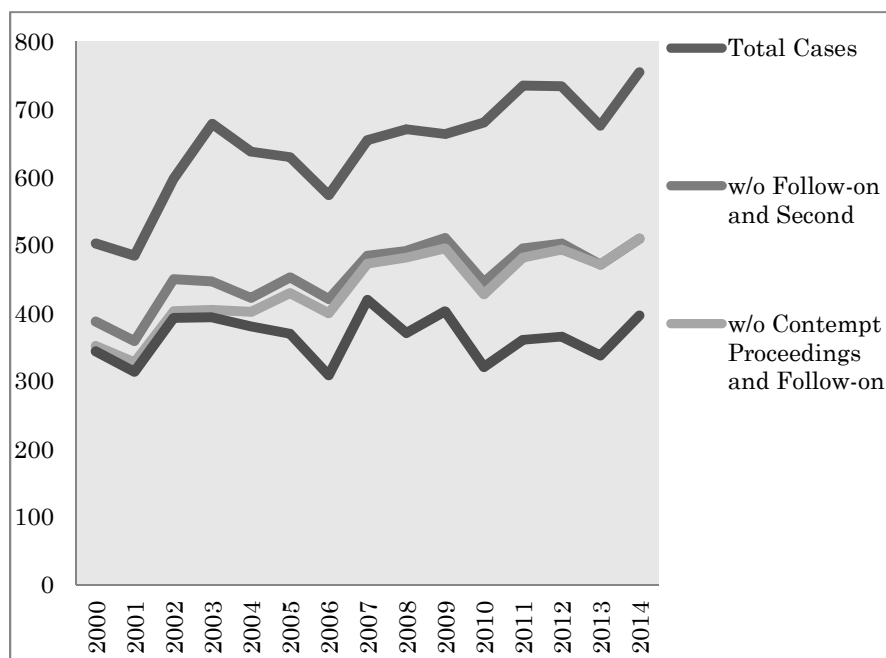
<sup>92</sup> In 2013 alone, the SEC brought three separate enforcement actions for the same violation against James S. Quay and two follow-on actions against Kenneth Ira Starr, whom the SEC first sued in 2010. Quay, Exchange Act Release No. 68,235, 2012 WL 5511037 (Nov. 14, 2014) (bringing an action against James S. Quay); Quay, Exchange Act Release No. 68,234, Accounting and Auditing Enforcement Release No. 3424, 2012 WL 5511036 (Nov. 14, 2012) (bringing two actions against James S. Quay); Starr, Exchange Act Release No. 68,826, Investment Advisers Act Release No. 3544, 2013 WL 428578 (Feb. 5, 2013) (bringing two actions against Kenneth Ira Starr); SEC, Litigation Release No. 21,541 (June 1, 2010), available at <https://www.sec.gov/litigation/litreleases/2010/lr21541.htm> (announcing filing of action against Kenneth Ira Starr for abuse of signatory power by misappropriating client funds for personal purposes).

Figure 2: Number and Share of Follow-on and Second Cases in SEC Enforcement Action Total (2000–2014)<sup>93</sup>

Second, the share of enforcement actions for strict-liability violations has increased during the last ten to fifteen years. Delinquent filing cases—enforcement actions against public companies that fail to file periodic reports with the Commission when there is no other evidence of wrongdoing—have increased from ten in 2002<sup>94</sup> to over one hundred per year since 2010. Excluding follow-on and delinquent filing cases, SEC enforcement has remained level since 2002 as seen in Figure 3, below.

<sup>93</sup> For a detailed methodology for the information in Figure 2, see Velikonja, *supra* note 25 (manuscript at 20–24).

<sup>94</sup> SEC 2002 ANNUAL REPORT, *supra* note 61, at 144 tbl.1.

Figure 3: SEC Enforcement Actions (2000–2014)<sup>95</sup>

In addition, the SEC recently has relied more heavily on “quantitative analytics” to identify violations of strict liability securities laws,<sup>96</sup> advancing its strategy of policing “broken windows” to improve securities compliance.<sup>97</sup> Strict liability rules are often called “technical rules,” and violations are deemed less serious than fraud or violations requiring a showing of negligence.<sup>98</sup> Such violations are also considerably easier to

<sup>95</sup> For a detailed methodology for the information in Figure 3, see Velikonja, *supra* note 25 (manuscript at 20–24).

<sup>96</sup> Press Release, SEC, *supra* note 81.

<sup>97</sup> Mary Jo White, Chair, SEC, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), *available at* <http://www.sec.gov/News/Speech/Detail/Speech/1370539872100>.

<sup>98</sup> See Mary Jo White, Chair, SEC, All-Encompassing Enforcement: The Robust Use of Civil and Criminal Actions to Police the Markets (Mar. 31, 2014), *available at* <http://www.sec.gov/News/Speech/Detail/Speech/1370541342996> (“[The SEC] often bring[s] cases based on negligence, while “most criminal statutes require intent or at least willful blindness.”).

prosecute because the SEC does not have to show scienter or negligence to impose fines and other sanctions.<sup>99</sup>

The Enforcement Division has conducted several sweeps in the last couple of years for strict liability violations. Those sweeps had the happy consequence of boosting overall enforcement figures.<sup>100</sup> Enforcement sweeps are not new to the SEC. But in sweeps brought before the end of 2000, the SEC prosecuted fraudulent sales of securities, not strict liability violations.<sup>101</sup> Given that the SEC's enforcement resources are limited, investigations related to strict liability violations and sweeps displace enforcement actions requiring the showing of scienter. As shown in Figure 3 above, the overall number of enforcement actions has increased since 2000. But once follow-on and contempt proceedings, and strict-liability delinquent filing cases are removed, SEC enforcement has remained level. Since the SEC brought many strict liability enforcement actions in 2013 and 2014, it must have brought fewer enforcement actions requiring the showing of scienter or negligence. It could be either that there are fewer such securities violations today for the SEC to prosecute, or that enforcement actions for strict liability offenses scare all participants in the securities markets into compliance with the law. Whether broken windows policing is effective law enforcement is under dispute. Many commentators, however, seem to agree that it does not

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<sup>99</sup> *See id.* (“[T]he SEC has more flexibility to bring important cases that send a strong message of deterrence when the evidence may not be enough for a criminal case.”).

<sup>100</sup> *See* Andrew Ceresney, Dir., SEC Div. of Enforcement, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 24, 2014), *available at* <http://www.sec.gov/News/Speech/Detail/Speech/1370543515297> (noting that in 2014 the SEC Enforcement Division filed the most actions in the history of the SEC, obtaining 20% more in monetary sanctions than the SEC's previous high).

<sup>101</sup> *E.g.*, Press Release, SEC, SEC Charges 44 Stock Promoters in First Internet Securities Fraud Sweep (Oct. 28, 1998), <http://www.sec.gov/news/headlines/netfraud.htm> (announcing allegations against forty-four individuals and companies consisting of “violations of the anti-fraud provisions and the anti-touting provisions of the federal securities laws”); Press Release, SEC, SEC, State Securities Regulators Announce Promissory Note Enforcement Sweep (June 1, 2000), <http://www.sec.gov/news/headlines/promswp.htm> (announcing “a joint effort” between the SEC and state securities regulators “to combat the fraudulent sale of promissory notes to investors”).

increase compliance with securities laws.<sup>102</sup> If so, it seems plausible that strict-liability policing increased the number of enforcement actions the SEC was able to report in 2013 and 2014, without any increase in deterrence or compliance.

### C. INSULATION FROM ENFORCEMENT

As noted in the beginning of this Article, there is little evidence that the SEC targets defendants to score political points. At the same time, several recent empirical studies suggest that the SEC feels pressured by Congress to go easy on large contributors. For instance, Maria Correia finds that firms that contribute money to congressmen who sit on oversight committees are only about half as likely to be subject to SEC enforcement as those that do not.<sup>103</sup> And if they are targeted, firms that contribute to politicians pay lower penalties.<sup>104</sup> This phenomenon is not unique to the SEC. The Nuclear Regulatory Commission, too, may be less likely to investigate firms that make contributions to their political action committees.<sup>105</sup>

Frank Yu and Xiaoyun Yu find that firms that spend more on lobbying have a significantly lower rate of fraud detection than those that do not.<sup>106</sup> Significantly, while they are committing

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<sup>102</sup> See, e.g., Sarah N. Lynch, *U.S. SEC's Piowar Takes a Swing at 'Broken Windows' Enforcement Policy*, REUTERS (Oct. 14, 2014, 9:55 AM), <http://www.reuters.com/article/2014/10/14/sec-enforcement-piowar-idUSL2N0S90PW20141014> (“[T]he ‘broken windows’ enforcement strategy . . . hinders the agency’s ability to set priorities and have robust, healthy markets.”); Andrew Stoltmann, *The SEC’s ‘Broken Windows’ Strategy is Misguided*, PENSIONS & INVESTMENTS (Dec. 22, 2014), <http://www.pionline.com/article/20141222/PRIN T/312229993/the-secs-broken-windows-strategy-is-misguided> (noting that the SEC’s broken windows strategy is “fundamentally flawed” and does not lead to greater compliance).

<sup>103</sup> See Maria M. Correia, *Political Connections and SEC Enforcement*, 57 J. ACCT. & ECON. 241, 255 (2014) (“An increase of \$4 million in long-term lobbying by a restatement firm is estimated to reduce the probability of enforcement from 8.12% to 4.01%.”).

<sup>104</sup> See *id.* at 258 (finding that a “\$100,000 increase in PAC contributions over the last five years is associated with an 11% decrease in monetary penalties” and a 12.9% decrease in the probability of an officer and director bar).

<sup>105</sup> Sanford C. Gordon & Catherine Hafer, *Flexing Muscle: Corporate Political Expenditures as Signals to the Bureaucracy*, 99 AM. POL. SCI. REV. 245, 258 (2005).

<sup>106</sup> Frank Yu & Xiaoyun Yu, *Corporate Lobbying and Fraud Detection*, 46 J. FIN. & QUANTITATIVE ANALYSIS 1865, 1866 (2011) (finding that lobbying firms avoid detection of

fraud, firms spend more to lobby congressmen, which in turn delays detection of their accounting manipulations.<sup>107</sup> Again, the effect is not limited to the SEC. Brian Richter and his collaborators found that firms that lobby face lower effective tax rates than those that do not.<sup>108</sup>

Finally, Jonas Hesse reports that the SEC is less likely to prosecute large employers, in particular during presidential election years if the firms are headquartered in politically important states.<sup>109</sup> In addition, large employers are less likely to be subject to SEC enforcement if the incumbent congressman serves on one of the oversight committees.<sup>110</sup>

The three studies together suggest that congressional oversight has significant negative consequences. Whether it outweighs its benefits requires further study.

#### IV. REDUCING THE INFLUENCE OF POLITICS

All the collected evidence suggests that congressional oversight as practiced today engenders several negative consequences for securities enforcement. It shifts enforcement priorities, possibly deflects prosecution away from politically-connected firms, and leads the SEC to report statistics to obscure rather than to illuminate.

It seems plausible that less congressional oversight would yield better results, while more congressional oversight would be counterproductive. Rather than shifting securities enforcement to the Department of Justice to reduce congressional control (as

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fraud longer than non-lobbying firms and are considerably less likely to face enforcement actions).

<sup>107</sup> See *id.* at 1869 (“[L]obbying can potentially make fraud more difficult to uncover.”).

<sup>108</sup> See Brian Kelleher Richter, Krislert Samphantharak & Jeffrey F. Timmons, *Lobbying and Taxes*, 53 AM. J. POL. SCI. 893, 898 (2009) (“[H]igher lobbying spending reduces firms’ effective tax rates in the following year.”).

<sup>109</sup> See Jonas Hesse, *Government Preferences and SEC Enforcement* 32 (Harvard Bus. Sch. Accounting & Mgmt. Unit, Working Paper No. 15-054, 2015), available at <http://ssrn.com/so13/abstract=2542242> (“[T]he political influence on the SEC is directed to electoral-vote rich states that are tightly contested to enhance the presidential reelection prospects . . .”).

<sup>110</sup> See *id.* at 33 (“[T]he SEC only acts in line with House members’ preference for local employment if these congressmen serve on committees that oversee the SEC.”).

Adam Pritchard has proposed)<sup>111</sup> or making the SEC self-funding (as former SEC Chair Arthur Levitt has proposed),<sup>112</sup> this Article proposes reducing the frequency of budget approval from annually to once every four or five years.

This proposal would reduce the frequency of congressional meddling and would enable the SEC to plan several years in advance, rather than face the “binge-purge approach” to its budget that has been common in the post-World War II period.<sup>113</sup> Annual changes in SEC output are mostly noise, yet they command an inordinate amount of attention and hand-wringing. Constant pressure on SEC leadership and, in turn, staff lowers morale and leads to short-term focus. Longer-term financial security would enable the Chair to plan accordingly and pursue longer-term goals, and permit the Commission to shift resources from year to year.

Section 991 of the Dodd-Frank Act, in fact, includes longer-term budget planning for the SEC. It authorizes an annual budget of \$1.3 billion in 2011, increasing to \$2.25 billion in 2015.<sup>114</sup> Actual appropriations, however, have lagged those in the Dodd-Frank Act: in 2012, the actual budget was \$179 million less (12%) than instructed by Dodd-Frank; in 2013 it was \$429 million (24.5%) less; in 2014 it was \$650 million (32.5%) less; and in 2015 it was \$750 million (33.3%) less.<sup>115</sup>

Any change to SEC oversight would necessarily produce unexpected consequences, good and bad. Given that fact, a change that is more easily reversed should be preferred to one that is not.

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<sup>111</sup> Pritchard, *supra* note 12, at 1096–97 (“The Justice Department has many lawyers and investigators who are proficient at prosecuting securities fraud. . .”).

<sup>112</sup> See Joel Seligman, *Tyrell Williams Lecture: Key Implications of the Dodd-Frank Act for Independent Regulatory Agencies*, 89 WASH. U. L. REV. 1, 23 (2011) (discussing Arthur Levitt’s belief that self-funding, similar to that operating at the Federal Reserve Board, is the answer to boom-bust budgeting); see also Amitai Aviram, *Allocating Regulatory Resources*, 37 J. CORP. L. 739, 763 (2012) (suggesting that a self-funding SEC would be a more effective enforcer during economic booms).

<sup>113</sup> Seligman, *supra* note 112, at 22.

<sup>114</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 991, 124 Stat. 1376, 1954 (2010) (codified at 15 U.S.C. § 78kk).

<sup>115</sup> See Frequently Requested FOIA Document: Budget History—BA vs. Actual Obligations (\$ in 000s), SEC, <https://www.sec.gov/foia/docs/budgetact.htm> (last modified Mar. 26, 2015) (listing the actual budget authorizations for the SEC in fiscal years 2012–2015 as \$1.321 billion, \$1.321 billion, \$1.35 billion, and \$1.5 billion, respectively).



Shifting securities enforcement to the Department of Justice would be costly, and reversing track would be even costlier. If a self-funded SEC were ineffective, it would be relatively easy to put the SEC back on a budget, in theory. In reality, however, doing so would make congressmen and the President who re-proposed to put the SEC on a budget subject to criticism of going easy on fraudsters and Wall Street corruption. It would be much easier and cheaper to reverse five-year budget appropriations to annual appropriations if they turned out to be worse than the system we have.

#### V. CONCLUSION

Despite considerable political and public interest in securities enforcement, the SEC has remained surprisingly apolitical. Yet its overall enforcement program shows evidence of responding to pressure by Congress, the chief oversight body for the SEC. The SEC battles annually with congressional appropriations committees for additional resources and is usually asked in return to demonstrate that it can do more with less. The Commission has responded to pressure by shifting to enforcing cheaper-to-prosecute strict liability violations and further sanctioning defendants who have already been sanctioned—to report better enforcement output than in the previous year. No SEC Chair to date has been able to break the vicious cycle.

This short contribution sheds light on how congressional control over the SEC distorts its enforcement program. It ultimately proposes longer-term budgetary planning to reduce Congress's opportunity to influence the Commission's operations. Five-year budgeting is not necessarily optimal if one were designing the SEC from a clean slate. But this Article offers many reasons to believe that it would be an improvement over the current state of affairs.

