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

THE CHAIRMAN

May 8, 2009

The Honorable Charles E. Grassley
United States Senate
135 Hart Senate Building
Washington, DC 20510-6200

Re: August 2007 Report by the Minority Staff of the Committee on Finance and the Committee on the Judiciary

Dear Senator Grassley:

Thank you for the opportunity to provide you with the status of the SEC's response to the recommendations contained in the August 2007 Report by the Minority Staff of the Committee on Finance and the Committee on the Judiciary (Senate Report). One of my first priorities as I returned to the Commission this past January was to ensure that the important recommendations contained in this Report are fully implemented. I am pleased to report that this implementation is now complete; detailed descriptions of the SEC's actions are provided below.

1. Standardized Investigative Procedures: The Senate Report recommends that "[t]he SEC should draft and maintain a uniform, comprehensive manual of procedures for conducting enforcement investigations, along the lines of the United States Attorney's Manual. The manual should attempt to address situations or issues likely to recur. It should set a consistent SEC policy where possible and provide general guidance for complex issues that require individual assessment on a case-by-case basis, so that inquiries are handled as uniformly as possible throughout the Enforcement Division." (S.Prt. at p. 7.)

   Action: On October 6, 2008, the SEC's Division of Enforcement published its *Enforcement Manual*, a 122-page document that provides guidelines for SEC enforcement staff. This Manual was the result of a 7-month effort by that Division. To enhance both transparency and accountability, this *Manual* is now posted on the SEC's public website at http://www.sec.gov/divisions/enforce/enforcementmanual.pdf. A copy of the *Manual's* Table of Contents is provided at Attachment A.

2. Directing Resources to Significant and Complex Cases: The Report states that "[t]he SEC currently lacks a set of objective criteria for setting [case] staffing levels and has no mechanism for designating a case as critically important. The SEC should set standards for assessing the size, complexity, and importance of cases to ensure that significant cases receive more resources. The Enforcement Division should develop and apply objective criteria for determining how many attorneys, paralegals, and support personnel should be assigned to a particular case." (S.Prt. at p. 7.)

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Action: The Division of Enforcement began drafting a policy regarding prioritizing investigations and allocating resources in January 2008. After numerous reviews, including by the SEC's OIG, the policy was finalized and incorporated into the *Enforcement Manual* (see §2.1.1, "Ranking Investigations and Allocating Resources") in October 2008. The policy addresses the criteria to be used to assess, on a quarterly basis, the most significant investigations. These factors analyze programmatic impact, magnitude of the potential violation, and resources required. The policy also discusses how resources should be allocated among investigators, stressing the need for flexibility and adaptability as priorities periodically change. A copy of this policy is provided at Attachment B.

3. Transparent and Uniform External Communications: The Report recommends that "[t]he SEC should issue written guidance requiring supervisors to keep complete and reliable records of all outside communications regarding any investigation. [Footnote omitted.] The need for a clear record and transparency is especially acute regarding any communications by supervisors that exclude the staff attorney assigned to the case. The SEC's guidance should generally discourage supervisors from engaging in such communications without the knowledge or participation of the lead staff attorney. The SEC needs to present one, consistent position to parties involved in its investigations." (S.Prt. at p. 7-8.)

   Action: The Division of Enforcement reviewed the Food and Drug Administration's regulations that were cited as illustrative in the Senate Report, and also reviewed comparable policies in other organizations. As a result of this review, the October 2008 *Enforcement Manual* (see §2.1.1, Entitled "External Communications Between Senior Enforcement Officials and Persons Outside the SEC Who Are Involved in Investigations," provided as Attachment C), strongly encourages senior Enforcement officials to include assigned staff members when engaging in material external communications. When such inclusion is not feasible, the senior Enforcement official is directed to memorialize the communication within a reasonable period of time.

4. Greater OIG Independence and More Thorough Investigative Procedures: The Report noted that: "The hallmarks of any good Inspector General are independence and integrity. However, the reputation of the Inspector General within the SEC appears to be that of an office closely aligned with management, lacking independence. In addition to the facts of the Aguirre case, we received numerous complaints about the OIG from both current and former SEC employees. The OIG should develop a plan to ensure independence from SEC management and the General Counsel's Office, and to ensure that its future investigations of allegations against management are thorough, fair, and credible. The SEC needs to implement a directive requiring its Office of Information Technology to provide thorough and timely responses to SEC/OIG document requests. Since the purpose of the OIG is to ensure integrity and efficiency, a document request in connection with an SEC/OIG investigation should be among the highest priorities." (S.Prt. at p. 8.)

Actions: On December 5, 2007, the Commission announced the hiring of a new Inspector General, David Kotz. On February 13, 2009, Inspector General Kotz announced a series of directives regarding OIG investigative and audit procedures, all designed to ensure the office's independence and credibility. As I understand, Inspector General Kotz has separately informed you of these initiatives, which include:

- In all new investigations, the complainant must be interviewed first and on the record whenever feasible and in light of the particular circumstances (e.g., except in the occasion of an anonymous complainant);
- All significant interviews of complainants, subjects and critical witnesses are to be conducted under oath and on the record with a full transcript;
- Investigators must give assurances of confidentiality to potential witnesses who have expressed reluctance to come forward in an official investigation;
- Perjury warnings will be provided to subjects and/or witnesses being interviewed where there is any possibility or indication that full and truthful testimony might not be provided;
- Witnesses and/or subjects will not be allowed to have an SEC attorney represent them in an OIG investigation;
- Reports of Investigation will include specific findings and recommendations, including whether the OIG believes disciplinary action should be taken; and
- The OIG now requests that management inform it of the disciplinary action taken in response to a Report of Investigation within 45 days of the issuance of the report and the OIG follows-up with management both prior to and at the 45-day mark.

In addition, on May 15, 2008, the OIG completed its re-investigation into the matter that was also the subject of the Senate Report. The resulting 191-page Report of Investigation, together with a five-volume appendix, was shared with your office on September 30, 2008. I am sure that you can confirm from reading this Report of Investigation, the OIG is independent of SEC management.

The second part of this recommendation concerns the responsiveness of the SEC's Office of Information Technology (OIT) to OIG requests. On February 27, 2008, OIT and OIG entered into a memorandum of understanding designed to facilitate prompt responses to OIG requests for email. OIT also established a prioritization system that classifies all OIG requests as "time-sensitive," and established a site on the SEC intranet to allow OIG to track OIT's progress in responding to its email retrieval requests.

5. Timely and Transparent Recusals: The Report recommends that "[t]he SEC should review its guidance to employees regarding their obligations to recuse themselves immediately from any

matter involving a potential employer with whom the employee has had contact, either directly or indirectly through an agent. Recusals should be communicated in writing to all SEC staff who have official contact with the recused individual, and a record of the recusals should be centrally maintained by a designated ethics officer. The appearance created by having undisclosed contacts with potential employers while still participating in an enforcement matter involving that potential employer undermines public confidence in the fairness and impartiality of the SEC." (S.Prt. at p. 8.)

Action: As recommended, the SEC's Ethics Office reviewed its existing guidance on recusals involving potential employment, the scope of training around this guidance, and the process for communicating and maintaining recusals. As a result, on February 20, 2008, the Ethics Office sent new guidance to all SEC employees (see *"Ethics NewsGram: Seeking a New Job"*, a copy of which is provided as Attachment D[1]). Between January and May 15, 2008, all Senior Officers received one hour of mandatory in-person training focused on this guidance. This guidance was repeated in the mandatory ethics training for Senior Officers that was conducted in November and December of 2008. The Ethics Office also established an information technology system within the SEC's intranet, through which employees submit information about their potential-employment recusals. This site allows employees to note the date on which recusal notice was given, to whom (by name and title), and the name of the potential employer; the information is submitted to the Ethics Office, and allows the employee to self-track. This new site has been active since March 18, 2009.

6. Standardized Evaluation Procedures: The Report notes that "[e]mployee evaluations should be submitted in a timely manner, according to an established schedule. Evaluations should not be prepared outside or apart from the established procedure. Although it is appropriate to document performance issues and to discuss them with the employee as the issues arise, submitting a re-evaluation with substantive changes after the regularly scheduled evaluation is submitted can raise questions. Where the re-evaluation occurs just after an employee reports alleged wrongdoing by a supervisor, it tends to suggest that retaliation is driving the process rather than an honest attempt to evaluate employee performance." (S.Prt. at p. 8.)

Action: The SEC's performance management cycle for non-manager/non-supervisory employees ended on April 30, 2009. On May 1, 2009, the SEC's Office of Human Resources (OHR) issued guidance to all employees regarding the system for tracking performance management responsibilities. (This system was implemented in 2008 for senior managers.) Under this system, specific dates are established and announced to the agency for each step of the performance review process. (See Attachment E for a copy of the steps and timeline applicable to the 2009 review process; this calendar was communicated to all SEC employees by email on May 1, 2009, and is posted on the SEC's intranet.) Under this system, evaluations and ratings will be finalized strictly according to the published dates, and managers are not permitted to alter, amend or supplement the rating after the fact.

[1] This guidance is also maintained on the Ethics Office's page within the SEC's intranet.

7. Clear, Written Whistleblower Protections: Although not contained in the "recommendations" section of the Report, the Report also suggests that "the SEC should adopt clear, written whistleblower protections to safeguard all employees against adverse personnel actions in retaliation for reasonable good faith allegations or disclosures of perceived wrongdoing, even when done in the context of an employee's assigned duties. A fair hearing without fear of retaliation for internal complaints could not only increase morale and resolve disputes earlier—it could also assist the SEC in its mission by identifying problems that need attention and action from senior management." (S.Prt. at p. 81.)

   Action: On April 2, 2008, former Chairman Cox emailed a memo (which was drafted with the assistance of the SEC's OIG) to all SEC employees, outlining their rights under the whistleblower laws. While this memo has since been consistently posted on the SEC's intranet, I have recently determined that its placement did not have sufficient prominence to ensure full awareness by all employees. Therefore, the Cox memo has been re-crafted as employee guidance; a new "Whistleblower Rights" page has been created, accessible though links from both the Human Resources and New Employees pages of the intranet. This page provides links to both the general law in this area, and the re-crafted guidance (a copy is provided as Attachment F). Employee whistleblower rights are also highlighted in mandatory new-employee on-line video training; this video features the SEC's Inspector General, who specifically reminds employees of his office's role in protecting employees from retaliation for reporting wrongdoing.

8. Careful Adherence to Established Procedures for Terminating Probationary Employees: The Report also cautioned that, "when dealing with an investigator or attorney who is responsible for a major investigation, careful adherence to established procedures is necessary to ensure that the SEC considers all relevant information and avoids the appearance of impropriety. Even if the agency is not legally required to show cause for the action, as may be the case with a probationary employee or an employee who resigns, standard written procedures are needed to ensure public confidence in the integrity of the SEC's operations." (S.Prt. at p. 81.)

   Action: On December 18, 2007, the SEC's OHR revised our Performance Management Policy to, among other things, clarify procedures and establish criteria for addressing unacceptable performance by probationary employees. As I prepared this status summary to you, however, I learned that these provisions were not widely known throughout the organization, and therefore directed that this information be provided on the OHR page of the SEC's intranet. As of today, I can confirm that this has been done. A copy of these provisions is provided as Attachment G.

9. Clear, Written Guidance for Handling Employee Complaints: Lastly, the Report also suggested that "the SEC should adopt clear, written guidance establishing alternate, confidential channels of communication to resolve potential issues early and without public controversy. The SEC should encourage employees to use such procedures to raise serious issues that they cannot resolve with their managers. Complaints should be taken seriously and considered independently, not merely referred back to the complainant's supervisor." (S.Prt. at p. 81-82.)

   Action: Former Chairman Cox's April 2, 2008 memo to all employees also addressed this issue. As described in Appendix E, the OIG represents an alternative channel for communicating

potential wrongdoing, for employees who are uncomfortable reporting through the chain of command. In addition, since assuming my Chairmanship in January, I have repeatedly expressed the importance of open lines of communication throughout the organization.

I take very seriously the charge that I have been given to restore the SEC's reputation and credibility as the investors' watchdog. I also know that this can only occur if this organization is managed in such a way that employees are supported in the work that they do, are engaged toward a clear and common mission, and accept the need for transparency and accountability that is part of public service. I am optimistic that we have made great strides in the past 4 months. I appreciate your continued interest in the SEC.

Sincerely,

Mary L. Schapiro
Chairman

Attachments
A. Enforcement Manual Table of Contents
B. Enforcement Manual §2.1.1
C. Enforcement Manual §3.1.1
D. EthicsGram: Seeking a New Job
E. 2009 Performance Management Steps and Timeline
F. Whistleblower Rights
G. Probationary Employees