June 21, 2018

The Honorable Jay Clayton
Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chair Clayton:

I write to stress the importance of a strong, comprehensive Securities and Exchange Commission (SEC) enforcement program that strives for meaningful accountability even at the largest firms. You have now been Chair for one year, and I am concerned that developments over that time signal a retreat from holding the biggest Wall Street firms and executives meaningfully accountable for violating the law.

To begin, I am concerned about certain changes to SEC policies and procedures that are likely to reduce accountability. Three trends in particular stand out. First, the SEC’s mutual fund share class initiative, which effectively grants amnesty to Wall Street firms that have overcharged their customers, raises questions about the SEC’s commitment to imposing meaningful penalties. Under this initiative, the Division of Enforcement (Enforcement) recommends no civil monetary penalties for Wall Street firms that self-report violations and return ill-gotten gains to investors. For example, in the Ameriprise settlement reached last February, the SEC assessed a penalty of only $230,000, even though Ameriprise had overcharged customers by $1,778,592. When wrongdoers can get away with violating the law by simply returning illicit profits and paying a small penalty, this provides little deterrence to prevent future violations.

If the SEC made up for these low corporate penalties with meaningful accountability for the individuals responsible, that might mitigate this loss in deterrence. The SEC’s record under your tenure, however, does not create the sense that the SEC will hold Wall Street executives meaningfully accountable. For example, in the Bank of America customer protection rule case, which the SEC settled with the company for $415 million under Chair White, the SEC last fall

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imposed no sanctions on the bank’s head of regulatory reporting except a cease-and-desist order, and it failed to charge any of the traders or other individuals responsible for the misconduct. Overall, since you became Chair, there appears to have been only one significant case involving a major Wall Street financial institution, excluding accounting firms, where the SEC meaningfully sanctioned a high-ranking executive employed by the institution.

The second concerning trend is the apparent lack of admissions of wrongdoing under your tenure. Instead, the SEC has obtained settlements in which the wrongdoer “neither admits nor denies” the misconduct. As U.S. District Court Judge Jed Rakoff has explained, the business community often views these settlements without admissions as merely “a cost of doing business.”

I became concerned that the SEC might have categorically returned to this practice last fall, based on remarks by Enforcement Co-Director Steven Peikin. The SEC’s record under your tenure so far nearly bears this out: I am aware of only one admission in a case filed and settled since you became Chair.

The SEC’s recently settled securities fraud charges against Theranos, Inc. and its former CEO, Elizabeth Holmes, are an illustrative example of such a lack of an admission. In its complaint, the SEC alleged that Ms. Holmes repeatedly and brazenly lied to investors about the company’s business, cheating them out of over $700 million. Among other things, Ms. Holmes had allegedly provided investors with financial statements that “bore no resemblance” to the company’s actual financial performance, for example by misrepresenting the company’s annual revenue as $108 million when it was actually only $100,000. Although the SEC’s use of a rather unconventional penalty suggests that the SEC recognized the seriousness of these violations, the SEC did not obtain an admission of wrongdoing from either Holmes or Theranos. This failure is particularly striking in light of the criminal indictment filed by the Department of Justice against Ms. Holmes and the company’s former number-two executive.

The third trend relates to changes to internal procedures governing the Division of Enforcement. Last fall, you stated that you would accept Commissioner Piwowar’s decision as Acting Chair to reverse prior policy and deny certain senior SEC officials comprehensive investigative powers, such as the authority to subpoena documents and testimony without first obtaining the Director’s approval. By adding another obstacle to the investigative process, this decision could impede...

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9 Id. ¶¶ 85–86.
Enforcement’s ability to initiate, conduct, and conclude enforcement actions in a way that maximizes accountability and investor protection. Indeed, a Government Accountability Office (GAO) report found that before and during the financial crisis, a cumbersome internal-review process had this very effect.  

In addition to these concerns about changed policies and procedures, I am also worried that a combination of resource constraints and changed priorities may create additional impediments to holding Wall Street accountable. Last fall, Mr. Peikin reportedly indicated that Enforcement might lose a significant number of investigators and supervisors through attrition. Asked about these reports in February, you acknowledged that personnel is your “biggest challenge at the moment” and said you “could use more people in enforcement,” adding that this is one of two areas where “the American people would get the greatest return for additional bodies.” You then assured that your “fiscal year 2019 request reflects the sentiment I have expressed today.” But the SEC’s FY 2019 budget request provides for fewer full-time equivalent (FTE) staff in Enforcement. Compared to FY 2017, total FTE positions would decrease from 4,616 to 4,457, including a loss of 45 FTE positions in Enforcement. 

We have seen this story before. The GAO report mentioned above also found that before and during the financial crisis, a reduced number of Enforcement investigative attorneys was undermining the SEC’s enforcement capacity. 

These resource constraints could have an especially big impact in light of the new demands created by initial coin offerings and the SEC’s shift toward retail fraud enforcement. Although I agree that it is important to target these types of violations, a shift in resources toward these areas, combined with reduced headcount overall, can be expected to reduce the resources available to fight the sorts of Wall Street frauds and abuses that escalated into the financial crisis.

When the SEC broadly targets misconduct, a diverse mix of Americans benefit from the SEC’s actions. For example, in the SEC’s 2010 and 2011 municipal bond bid-rigging cases against several large banks, the SEC recovered compensation for a wide variety of local governments and nonprofit organizations, ranging from $1,075,988 for Clinton County, Ohio, to $225,101 for

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12 Cf. GAO, Securities and Exchange Commission: Greater Attention Needed to Enhance Communication and Utilization of Resources in the Division of Enforcement 27–31 (2009), https://www.gao.gov/assets/290/288156.pdf. Although a Director-approval requirement is somewhat less burdensome than the Commission-approval requirement in place during the Bush administration, it is still a significant departure from your predecessors’ policies and could divert resources from other, productive uses.


16 Id. at 17.
the Children’s Hospital of Alabama.\textsuperscript{17} In addition, the crisis taught us that misconduct in the financial markets can have systemic consequences, including for ordinary Americans who do not directly invest in the financial markets, but who stand to lose their jobs or homes.\textsuperscript{18} Independent research shows that my concerns are well placed. As reported by the \textit{Wall Street Journal}, a study by Georgetown University law professor Urska Velikonja finds that SEC fines and enforcement actions for FY 2017 fell significantly compared to the previous year.\textsuperscript{19} According to Professor Velikonja’s data, this decline occurred primarily under your, and to a lesser extent then–Acting Chair Piwowar’s, watch.\textsuperscript{20} A study by NYU’s Pollack Center for Law & Business and Cornerstone Research similarly finds that “[t]otal monetary settlements against public company–related defendants . . . declined from the first half of FY 2017 to the second half, from $1 billion to $196 million,” timing that “corresponds with leadership changes at the SEC.”\textsuperscript{21}

Moreover, Professor Velikonja’s findings regarding broker-dealer and investment-adviser enforcement provide empirical support for my concerns that the SEC has taken a more relaxed approach toward Wall Street in particular. “In the second half of 2017,” she notes, “the SEC has continued to pursue relatively small establishments for various violations, but virtually stopped enforcement actions against large entities, often referred to as Wall Street firms.”\textsuperscript{22} Ultimately, she finds a nearly 70% decrease in penalties against these “Wall Street firms” from the first to second half of FY 2017.

According to additional data provided by Professor Velikonja, the FY 2018 numbers so far have been even lower. In the first half of FY 2018, the SEC assessed only $102 million in aggregate monetary penalties and disgorgement in settled cases. That reflects a 93% drop compared to the $1.4 billion that the SEC levied in the first half of FY 2017, and it is the lowest first-half-year total since at least 2007, the first year for which Professor Velikonja has data. Updated figures from NYU and Cornerstone tell a similar story, with monetary settlements in public company


\textsuperscript{22} Velikonja, supra.
and subsidiary actions declining to $65 million in first-half FY 2018, the lowest semiannual total in the study’s research sample from FY 2010 onwards.\textsuperscript{23}

In sum, I am concerned that various developments over the past year signal a less forceful approach toward Wall Street enforcement at the SEC. In light of these concerns, I ask you to provide answers to the following questions by July 13, 2018:

1. Have there been plans or discussions at the SEC about the possibility of another initiative similar to the mutual fund share class initiative? If so, please describe the nature of these plans or discussions.

2. In connection with the SEC’s 2015 municipalities continuing disclosure cooperation initiative, certain charged firms agreed to retain an independent consultant to review their policies and procedures on due diligence for municipal securities underwriting.\textsuperscript{24} Such arrangements help to ensure that the firms comply with the law going forward. Is the SEC considering or planning to require any similar arrangements for the mutual fund share class initiative? If not, why?

3. Did the SEC or its staff conduct any economic analyses in connection with the SEC’s or Enforcement’s decision to impose or recommend low corporate penalties in the mutual fund share class initiative (or impose low penalties in general)? If so, please provide copies of any such analyses.

4. Please explain the factors that the SEC will use in determining whether to seek an admission of wrongdoing. If the SEC or its staff conducted any economic analyses in connection with a decision to discontinue admissions or seek them less frequently, please provide copies of any such analyses.

5. Please describe any changes to the SEC’s internal policies or procedures related to enforcement in addition to the rescission of certain officials’ comprehensive investigative powers. For example, please describe any additional steps added to Enforcement’s internal-review process and any changes in policies or procedures related to settlements, such as the institution of a requirement that Enforcement staff obtain Commission approval of a penalty range before beginning settlement negotiations. If there have been any such changes, please state whether the SEC or its staff conducted any economic analyses in connection with the decisions; and if so, please provide copies of any such analysis.


6. Please describe how the SEC will pursue individual accountability for executives at even the largest financial institutions.

7. Given the SEC’s limited resources, please explain how the SEC’s retail fraud initiative and actions in the virtual-currency space will not detract from the SEC’s efforts to hold Wall Street and large corporations accountable for traditional securities law violations.

Thank you for your attention to these matters. I look forward to your response and expect that you will continue to closely monitor financial firms for fraud and misconduct wherever it appears.

Sincerely,

[Signature]

Sherrod Brown
United States Senator