

# COMPLIANCE WEEK

## Keeping Pace, Working Smart: Is The SEC Overextended?

By Susan Schott Karr — August 3, 2004

Last week, *The Wall Street Journal* ran a Page One story on the new role of the Securities and Exchange Commission: policing the world's securities market. But the Commission already has so much to track: public companies, the stock exchanges, brokers-dealers, mutual funds, and now hedge funds... not to mention the myriad minutiae of governance, from MD&A disclosures and insider trades to auditor independence and equity compensation plans. How can they possibly do it all?

When GAO completed a study in 2002 on the SEC's operations, the conclusion was that, for a decade, staff could not keep pace with its workload for filings, applications and examinations.

U.S. securities markets are now even more complex. They're international. They depend on complicated information systems and technology. And they're growing.

In fact, in its 2002 Annual Report, Chairman William Donaldson acknowledged, "This is a critical time for the agency and the way we address the challenges before us will determine not only where we go tomorrow, but for years to come. In many ways, it may be time for the SEC to go through a transition... and evolve into a much more efficient force, becoming quicker, more agile, and more productive."

### Budget and Staff Increases Gain Momentum

Since the scandals at Enron and WorldCom wreaked havoc for investors, Congress has increased the SEC's budget by more than 60 percent.

Although the SEC fell short by \$100 million of spending its \$716.4 million allotted budget in 2003, they still garnered a budget increase for 2004 to the tune of \$811.5 million—and they're closing the variance between this allotment and their spending. This year, according to an agency spokesman and as reported in *The Washington Post*, they will leave just \$20 million on the budget table.

As for staffing, the Commission hired 460 new staff—primarily lawyers and accountants—between September 2003 and June 2004 and anticipated bringing onboard another 130 staff members by fiscal year end.

In total, the SEC consists of five presidentially-appointed commissioners, four divisions, and 18 offices. With approximately 3,100 staff, the SEC is small by federal agency standards.



Cutler

However, its responsibilities and recent activities can hardly be described as "small." In fact, the number of enforcement actions and penalties has skyrocketed over the past 10 years. "We're clearly in the midst of an evolution, if not a revolution, in thinking," noted the Commission's enforcement division director Steve Cutler in an April speech. "In only a decade, we've gone from a regime in which monetary penalties were imposed only rarely to one in which large penalties seem to be part of virtually all significant settlements."

And the kinds of remedies that the Commission has been getting reflect no mere wrist slapping—the price of fraud has gone up. The \$10 million penalty in the Xerox fraud case in April 2002 represented the largest settlement in the SEC's history. But only 15 months later, a federal court approved the largest civil penalty imposed in Commission history: A \$2.25 billion penalty against WorldCom. WorldCom's settlement with the SEC was \$750 million—75 times greater than the Xerox settlement.

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But even with its larger budget, can the SEC meet all of its budget, staffing, and performance objectives?

### Working Smart on the Beat



Sena

According to Joaquin Sena, former assistant chief litigation counsel at the SEC, the Commission at its core is a law enforcement agency. "It's kind of like having a police force out there," notes Sena, now a partner at Chadbourne & Park.. "You can't have a cop on every corner. What you have to do is work smart."

Another SEC veteran, Richard Sauer, agrees with the metaphor: "If viewed as the cop of the beat who is supposed to test every lock and catch every crook, it will be permanently doomed to failure." According to Sauer, now a partner at Vinson & Elkins, there are simply too many laws and individuals with incentives to break them. "Therefore, [the SEC] has to choose wisely which initiatives to announce and cases to bring, often as much for their symbolic, precedential or, bluntly put, PR value, as their underlying merits."



Sauer

As a result, notes Sauer, the Commission may need to focus on the most critical precedent-setting cases that maximize long-term impact. "Accepting the limitations of its resources, the SEC needs to look for those pressure points in the securities markets where well-chosen actions can change perceptions and standards throughout the industry," he says.

"New York Attorney General Eliot Spitzer has shown how this can be done on a hit and run basis." According to Sauer, the issue is made more complex by the Commission's numerous functions in the market. "The SEC ... plays a much more complicated role in the securities markets than any state regulator. It analyzes, mediates, proscribes, and fulfills many other roles beyond just breaking heads of violators. That these functions may often seem in conflict is, at bottom, the biggest source of mismatch between the SEC's resources and its responsibilities."

Sena believes the SEC is big enough as it is. "Recently, with the budget expansion, they can now move people around," he notes. "The SEC's people have to focus on what's coming up and what's hot. At one time it was insider trading. Then it was financial fraud. They've never been able to handle everything."

Are there cracks in the system? Sena says no more so now than ever. "They are always going to be as extended as they can be," he says. "And they're going to get their job done. Even if there were fewer problems out there—even half the number—the SEC still couldn't get to them all. They would still have to pick and choose."

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