

COMPLIANCE WEEK

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Deceptive, and Elusive, Metrics for SEC Enforcement

By Bruce Carton — December 8, 2009

For many years, Securities and Exchange Commission statements about the performance of its Enforcement Division have centered on the number of enforcement actions brought during each fiscal year. At the end of fiscal 2008, for example, the SEC issued a press release announcing that the 671 enforcement actions brought that year were the second-highest number of enforcement actions in agency history. The volume of actions brought, the SEC implied, resulted from “the dedicated enforcement staff ... working around the clock to investigate and punish wrongdoing.”

Why the SEC does this is understandable. Unlike so many aspects of its vast enforcement program, the number of cases brought is quantifiable data that is calculated annually (Congress requires the SEC to do so), and that can be used as a point of comparison. And, particularly when the number is high, it is a simple way to argue that the SEC has been hard at work fighting securities fraud.

Simplicity and availability, however, are pretty much the only reasons to use this metric as a measuring stick for the SEC enforcement program; otherwise, it has numerous gaping holes.

First, enforcement volume counts all cases—big, small, important, trivial, difficult, or easy—equally. Second, measuring the Enforcement Division’s success based on a count of how many cases it brings encourages the staff to bring more cases. In many instances, however, the SEC might do better to decline to bring a potential case if the facts or other considerations don’t truly support it.

Third, history shows that the number of actions brought does not climb ever higher each year. Sometimes the number actually goes down, presumably even in years when the SEC is working “around the clock to investigate and punish wrongdoing.” Unlike Garrison Keillor’s fictional Lake Wobegon (where “all the children are above average”), the SEC cannot bring an “above average” number of cases every year to demonstrate its hard work.

In such down years, the SEC has occasionally even floated a different type of spin. In 2004, when the number of cases dropped from 679 the year before to 639, then-Chairman William Donaldson cheerfully stated that the decline was “encouraging” as it showed that the SEC’s crackdown on corporate crime was pressuring executive behavior. (Although, he did allow that it was “too early for the SEC to declare victory in the war on corporate corruption.”)

Current SEC leadership knows that “actions brought” isn’t the ideal barometer of agency enforcement. In May 2009, shortly after he joined the

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SEC as director of enforcement, Robert Khuzami testified before the U.S. Senate that one of the first questions he wanted to address was whether the SEC could “de-emphasize the current quantitative metrics used to evaluate personnel and programs—the number of cases opened and the number of cases filed—in favor of a more qualitative standard, which includes concepts like timeliness, programmatic significance, and deterrent effect of a case.”

Quality Numbers

Apparently, Khuzami and new Chairman Mary Schapiro have already begun the move toward more qualitative metrics. First, although fiscal 2009 ended back in September, the SEC has not issued a press release trumpeting the number of actions it brought that year as it did in 2008. For the record, the SEC brought 664 enforcement actions in fiscal 2009, the third most in its history after 2003 and 2008. But the SEC has barely mentioned the “664” number since fiscal 2009 ended in September.

The only reference I’ve seen to 2009 enforcement actions (and I’ve been looking!) came in an article summarizing comments from Joan McKown, the Enforcement Division’s chief counsel, when she spoke at an American Bar Association meeting in November. She noted that the SEC had brought 664 cases in 2009 and provided a breakdown of those cases. Associate Enforcement Director Cheryl Scarborough then added that the Enforcement Division was expanding its performance metrics to include several “qualitative factors.” These factors, she said, included the timeliness of cases, the mix of cases, whether the cases reflected the stated priorities of the division, the use of SEC resources, and joint efforts with other agencies.

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McKown acknowledged that many of those metrics would be difficult to calculate, but promised that they would nonetheless be “reflected in the statistics that we present to the outside world, [and] certainly something we are using internally as we decide which cases to bring and how to focus our resources going forward.”


Many former SEC enforcement attorneys (and I’m one of them) say that all this makes sense. Russ Ryan, a former assistant director who is now a partner at King & Spalding, says the current fixation by the media and politicians on the ups-and-downs of enforcement numbers creates a “lopsided incentive” for the Commission and staff. Ryan says that often the best thing for investors, particularly in cases involving public companies, “is to take measured action or none at all, or to ratchet down from the last comparable—but it takes an awful lot of courage to go that route in this climate.”

Mike MacPhail, a former deputy assistant director now at Holme Roberts & Owen, says the current tally of actions brought is particularly unhelpful because the SEC’s count includes “throw-away” Section 12(j) proceedings—enforcement actions that many people believe are brought by the SEC at the end of the fiscal year to help it “make its numbers,” as MacPhail puts it. As *the Wall Street Journal* noted last year, the SEC has in recent years brought record numbers of “deregistration” cases under Section 12(j) of the Securities Exchange Act. These cases are simply filed against companies that lack current financial reports, possibly to provide filler on its numbers.

In 2008, around 100 cases, or roughly 15 percent of the 671 actions brought by the SEC, were under Section 12(j). That’s up from 50 such cases in fiscal 2006. Delinquent filing cases made up 14 percent of the cases in

magazine, and other publications on securities-related topics.

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fiscal year 2009, according to a recent SEC report.

Ross Albert, former legal counsel to ex-SEC Commissioner Norman Johnson, believes that the agency's desire to post a high number of actions each year can lead to troublesome conduct. Albert recalls last minute "manipulations" every September as the end of the SEC's fiscal year approached, when certain regional offices "would send up highly dubious cases just to increase their : 'stats:' numbers."

So if "actions brought" is deservedly now in its demise as a metric, what are some better replacements? Here are some suggestions:

- *Duration of investigations from opening to closing.* Timeliness is a major point of emphasis for the Enforcement Division under Khuzami. Currently, a major complaint of parties interested in resolving SEC cases is that the agency has no sense of urgency about them, and cases languish. Ryan believes that tracking the SEC's efforts to accelerate its cases would provide very relevant performance information.
- *Disgorgements ordered and distributed.* Beyond the deterrent effect of its cases, the return of funds to injured investors is, since the passage of Sarbanes-Oxley in 2002, one of the SEC's key missions. Thomas Hanusik, a former senior counsel and now a partner at Crowell & Moring, believes that the amount of disgorgement ordered and distributed is a good indicator of whether the SEC is protecting markets and investors.
- *Statistics on cases opened, cases closed, cases settled, and cases that are tried.* Amy Greer, a former regional trial counsel now a partner at Reed Smith, argues that detailed information on these points, along with a count of the number of actions brought, would shed light on "the movement of work through the agency, the thoughtfulness of the staff in deciding whether to pursue actions, how strong the cases are that they decide to pursue, and whether there are more respondents willing to test the agency's mettle."

Others doubt, however, that any of these metrics can provide a meaningful measure of the SEC's performance. Philip Khinda, a former senior counsel now a partner at Steptoe & Johnson, says that in his view, the SEC's performance is best judged by simply looking at the "cases of lasting impact and enduring message" it has brought that year. Long after people have forgotten how many cases the SEC brought in any particular year, he explains, they will still remember its efforts in milestone matters such as WorldCom, Enron, the market-timing cases, and so on.

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