

# Reporting Agency Performance: Behind the SEC's Enforcement Statistics

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*Every October, after the end of its fiscal year, the Securities and Exchange Commission releases its annual enforcement report, detailing its activity for the year. The report boasts record enforcement activity, often showing significant increases over the prior fiscal year in the number of enforcement actions brought and monetary penalties ordered. The numbers suggest that the SEC is ever tougher on securities violators. The SEC includes these statistics in its budget requests; the figures are repeated in congressional testimony, scholarship, policy proposals, and the business press.*

*Yet the SEC's metrics are deeply flawed. The Article reviews fifteen years of enforcement actions and demonstrates that the widely-circulated statistics are invalid because they do not measure what they purport to measure, and unreliable because they can be manipulated all too easily. The SEC double and triple counts many of its cases and overstates the fines it orders. This Article constructs better measures. These measures reveal that the SEC's statistics mask the fact that core enforcement has remained steady since 2002, and obscure a shift in enforcement towards easier-to-prosecute strict-liability violations.*

*The SEC is not alone in using misleading statistics to report its performance. Multiple reporting statutes authorize Congress to cut agencies' budgets for failing to meet performance targets. In response, agencies report flawed metrics to protect their ability to continue enforcing the law. The Article suggests that Congress should not threaten to reduce an agency's budget because of year-to-year fluctuations in enforcement. In addition, to make reported numbers more reliable, non-financial performance measures should not be developed by the agency. Instead, the selection and development of performance indicators should be standardized across agencies, much like financial reporting has already been standardized. Doing so would depoliticize reporting, as well as enable comparisons among agencies, both domestically and internationally.*

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## INTRODUCTION

The year 2014 was a “bumper year” for financial enforcement agencies;<sup>1</sup> the Department of Justice (“DOJ”),<sup>2</sup> the Commodity Futures Trading Commission (“CFTC”)<sup>3</sup> and the Securities and Exchange Commission (“SEC”

1. Madison Marriage, *2014 Was a Bumper Year for Regulators*, FIN. TIMES, May 10, 2015, <http://www.ft.com/cms/s/0/be5231bc-f59d-11e4-bc6d-00144feab7de.html#axzz3al0FRVD9>.

2. See U.S. Dep’t of Just., *Justice Department Recovers Nearly \$6 Billion from False Claims Act Cases in Fiscal 2014* (Nov. 20, 2014), <http://www.justice.gov/opa/pr/justice-department-recovers-nearly-6-billion-false-claims-act-cases-fiscal-year-2014> (reporting that the year set a “record” due to “unprecedented \$3.1 billion from banks and other financial institutions” for mortgage fraud).

3. See U.S. COMMODITY FUTURES TRADING COMMISSION, *FY 2014 ANNUAL PERFORMANCE REPORT, FY 2016 ANNUAL PERFORMANCE PLAN 86* (2015), available at

or “Commission”) all reported record numbers in enforcement. Specifically, the SEC reported that it brought 755 enforcement actions and secured \$4.17 billion in monetary penalties in the fiscal year 2014,<sup>4</sup> setting all-time records for the SEC and posting significant increases over the prior fiscal years. Various news outlets have reported prominently both figures as evidence of a more “severe stance towards wrongdoing in the markets.”<sup>5</sup> The SEC itself celebrated 2014 as a “very strong year for enforcement,” highlighting the aggregate numbers of enforcement actions filed and monetary penalties ordered.<sup>6</sup>

But, was it? Through a close study of SEC enforcement over a 15-year period this Article reveals that the statistics the SEC most commonly uses to assess and report its enforcement performance are flawed.<sup>7</sup> The term “enforcement action” includes all legal proceedings that the SEC brings, including primary enforcement actions, as well as suspensions, bars, and license revocations that are the second or third proceedings against the same defendant for the same misconduct. Between 23% and 34% of SEC enforcement actions brought each year have already been counted at least once.<sup>8</sup> This Article constructs better measures that do not double or triple count. These measures show that core SEC enforcement not increased since 2002. Similarly, the statistic “monetary penalties ordered” overstates the actual figure because it includes disgorgement orders offset by restitution ordered in a parallel criminal prosecution, civil fines imposed by and paid to FINRA or the exchanges, and penalties ordered but waived due to defendant’s financial

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<http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2014apr.pdf> (reporting that the CFTC obtained “a record \$3.27 billion in monetary sanctions” in fiscal 2014).

4. The SEC’s fiscal year starts on October 1 of the earlier calendar year and ends on September 30 of that calendar year. The 2014 fiscal year thus runs from October 1, 2013 to September 30, 2014.

5. Marriage, *supra* note 1. See also Jean Eaglesham & Michael Rapoport, *SEC Gets Busy With Accounting Investigations*, WALL ST. J., Jan. 20, 2015, <http://www.wsj.com/articles/sec-gets-busy-with-accounting-investigations-1421797895>; Aruna Viswanatha, *SEC Shifts Focus to Ratings Firms, Fund Valuations as Crisis-Era Cases Fade*, WALL ST. J., Mar. 18, 2015, <http://blogs.wsj.com/moneybeat/2015/03/18/sec-shifts-focus-to-ratings-firms-fund-valuations-as-crisis-era-cases-fade/> (noting that the SEC’s broken window policing has led to “a record 755 cases from the SEC” in FY2014); Andrew Ackerman & Aruna Viwanatha, *SEC Bickering Stalls Mary Jo White’s Agenda*, WALL ST. J., June 3, 2015, <http://www.wsj.com/articles/sec-bickering-derails-whites-agenda-1433374702> (quoting SEC Chair’s statement that 2014 had been as “record year in enforcement”).

6. Press Release, SEC, SEC’s FY 2014 Enforcement Actions Span Securities Industry and Include First-Ever Cases (Oct. 16, 2014), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543184660>.

7. See Jonathan R. Macey, *The Distorting Incentives Facing the U.S. Securities and Exchange Commission*, 33 HARV. J.L. & PUB. POL’Y 639, 639 (2010) (explaining that the “SEC’s performance is measured by Congress and in the court of public opinion on the simplistic basis of how many cases it brings and on the size of the fines it collects”).

8. The distortion in the defendant count is smaller though still large: between 9% (in 2008) and 23% (in 2003) of defendants have already been counted once in the SEC’s statistics.

inability to pay. The figure also obscures the fact that the SEC collects only about half of the total.<sup>9</sup>

These are only two examples of the Commission's problematic reporting. As this Article demonstrates in more detail, the two other enforcement statistics that the SEC highlights, defendant count and subject matter classification, are also distorted. In addition to overstating its enforcement effort, the SEC's reported statistics suggest the presence of bogus trends and obscure actual trends; they reveal non-problems and disguise real problems. In addition, reported statistics conceal whether and where SEC enforcement is lacking, and encourage the agency to bring easy-to-prosecute strict-liability offenses instead of pursuing more serious violations.

The SEC is not the only agency that reports flawed enforcement figures. Other agencies also report figures that are neither useful nor do they accurately reflect the agencies' true activities. The Environmental Protection Agency's ("EPA") reporting suffers from "widespread and persistent data inaccuracy."<sup>10</sup> The Federal Trade Commission's ("FTC") annual reports have become less useful in recent years.<sup>11</sup> The enforcement statistics they do report are internally inconsistent<sup>12</sup> and confusing.<sup>13</sup> Despite a considerable effort to add bite to its enforcement, the CFTC reports very little. The metrics that it does report do not measure what they purport to measure.<sup>14</sup> Even if they did, they would be pretty

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9. Collection rates vary considerably from year to year. Between 2004 and 2014, the SEC was able to collect between 29.8% and 74.2% of ordered monetary penalties. While the SEC ordered more monetary penalties in FY 2014 than in any prior year, it collected less than in FY 2005.

10. David L. Markell & Robert L. Glickman, *A Holistic Look at Enforcement*, 93 N.C. L. REV. 1, 47 (2014).

11. Annual reports until 2013 reported FTC's success rates in enforcement actions. Subsequent reports omit that measure, but report "consumer savings compared to the amount of FTC resources allocated to consumer protection law." U.S. FED. TRADE COMM'N, FISCAL YEAR 2014 ANNUAL PERFORMANCE REPORT AND ANNUAL PERFORMANCE PLAN FOR FISCAL YEARS 2015 AND 2016, at 51, 63 (2015), available at <https://www.ftc.gov/system/files/documents/reports/1-fy-2015-2016-performance-plan-fy-2014-performance-report/pprfy15-16.pdf>. The document does not explain how the measure was generated.

12. Whereas the 2014 annual report reports that the FTC returned \$38.6 million to consumers, the 2014 Annual Highlights featured prominently on the website report \$66.9 million, a considerably higher figure. *See id.*, *Stats & Data 2014*, FED. TRADE COMMISSION, <https://www.ftc.gov/annual-highlights-2014/stats-data-2014>.

13. For example, in the 2014 annual report, the FTC measures the "amount of money the FTC returned to consumers *and* forwarded to the U.S. Treasury." U.S. FED. TRADE COMM'N, *supra* note 11, at 63 (2015) (emphasis added). Only a close reading of the methodology section reveals that the reported figure (\$65.2 million) combines monies paid to consumers as compensation (\$38.6 million) and amounts that were not distributed to consumers but were remitted to Treasury (\$28.3). *See id.*

14. The CFTC reports only two metrics regarding enforcement. The first metric measures what share of investigations is closed within 12 months of opening. It shows declining performance in recent years and will be changed in the next year to measure investigations closed within 18 months of opening. The second metric shows that the CFTC cooperates with criminal prosecutors and other agencies in 100% of investigations, well above target. But a close reading of the methodology reveals that the CFTC excluded from the denominator all cases that were not

useless because they are so limited. If anything, the SEC's reporting on enforcement is more transparent than reporting by other agencies, making the analysis offered in this Article possible.

Muddled reporting is problematic. Agencies report their activities to Congress during budget appropriation season and repeat them during testimony before congressional oversight committees.<sup>15</sup> In fact, federal agencies are required to report their performance under a series of federal statutes introduced to improve agency reporting and the efficiency of federal programs.<sup>16</sup> The appropriations process, coupled with unreasonable congressional expectations reward agencies that report ever-increasing figures. Flawed performance statistics make it difficult to evaluate how effective is an agency, and to understand whether and how agency effectiveness has changed over time. It makes comparing one agency's performance with that of its domestic and international peers impossible.<sup>17</sup> And it obscures from the agency itself problems that it could identify and perhaps resolve.

The Article contributes to two important debates in law and public policy: the debate about the tools and methods of agency accountability and the debate about the relationship between legal rules, their enforcement, and economic growth. Rulemaking and congressional, presidential, and judicial oversight of rulemaking have attracted a disproportionate share of theoretical and empirical scholarship on agency accountability.<sup>18</sup> By contrast, enforcement remains

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referred. By definition, all other cases were in fact referred, thus showing the CFTC's 100% success. *See* COMMODITY FUTURES TRADING COMMISSION, *supra* note 3, at 53.

15. *See e.g.*, Mary Jo White, Examining the SEC's Agenda, Operations and FY 2016 Budget Request, Testimony before U.S. House Committee on Financial Services, Mar. 24, 2015, <http://www.sec.gov/news/testimony/2015-ts032415mjw.html> (mentioning the SEC's enforcement numbers for 2014 to justify a budget increase for fiscal 2016); Mary Jo White, Oversight of the SEC's Agenda, Operations and FY 2015 Budget Request, Testimony before the Committee on Financial Services, U.S. House of Representatives, Apr. 29, 2014, <http://www.sec.gov/News/Testimony/Detail/Testimony/1370541674457> (noting the SEC's enforcement statistics in fiscal 2013 to justify a budget increase in fiscal 2015).

16. *See* discussion *infra* in Part I.B.

17. The SEC is an active member of the International Organization of Securities Commissions ("IOSCO"). To demonstrate compliance with international standards, the SEC is required to report to IOSCO. In its report, the SEC must outline its enforcement activities in the various areas of its supervision, including financial reporting, market manipulation, insider trading, and securities offering fraud. *See* UNITED STATES OF AMERICA, DETAILED ASSESSMENT OF IMPLEMENTATION: SELF ASSESSMENT, IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION (2015). The SEC reports its aggregate enforcement figures, which this Article shows to be misleading. The reported figures overstate enforcement activity, sometimes by nearly 50 percent, and show false trends. *See id.* (reporting that the SEC brought 144 enforcement actions related to securities offering violations in FY 2010, yet of those 69 were follow-on cases). *See also* John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 269 (2007) (comparing SEC enforcement actions with similar enforcement actions in the U.K. without adjusting the U.S. figures).

18. *See* Abbe R. Gluck & Lisa Schultz Bressman, *Agency Statutory Interpretation from the Inside—An Empirical Study of Congressional Drafting, Delegation and the Canons, Part I*, 65 STAN. L. REV. 910 (2013); Nestor M. Davidson & Ethan J. Leib, *Regleprudence—At OIRA and Beyond*, 103 GEO. L.J. 259 (2015) (analyzing agency lawmaking); Jennifer Nou, *Agency Self-Insulation Under Presidential Review*, 126 HARV. L. REV. 1755, 1757-58, 1784 (2013) (studying

understudied.<sup>19</sup> While enforcement theory is quite rich,<sup>20</sup> empirical studies of agency performance and enforcement are a rare breed.<sup>21</sup> A handful of recent papers study specific aspects of agency enforcement but none shed light on enforcement generally.<sup>22</sup>

But enforcement is at least as important as the rules that agencies adopt to further their goals. Unlike rulemaking, which happens episodically, enforcement is continuous. The business press closely follows and reports on securities enforcement, which is of particular interest to its readers who may

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presidential review of agency rulemaking); Daniel E. Farber & Anne Joseph O’Connell, *The Lost World of Administrative Law*, 92 TEX. L. REV. 1137 (2014) (describing modern administrative rulemaking); Steven Croley, *White House Review of Agency Rulemaking: An Empirical Investigation*, 70 U. CHI. L. REV. 821 (2003); Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1 (1995).

19. This was true in 1990, when Cass Sunstein complained that “even the most prominent evaluations of the performance of the regulatory state” are “conspicuously silent on the question” of the real-world consequences of agency activities, and remains true today. Cass Sunstein, *Paradoxes of the Regulatory State*, 57 U. CHI. L. REV. 406, 407 (1990).

20. See James J. Park, *Rules, Principles, and the Competition to Enforce Securities Laws*, 100 CALIF. L. REV. 115, 118 (2012) (suggesting that studies of securities enforcement have relied heavily on “economic theories of enforcement” without much empirical grounding). See also Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 207-09 (1968) (developing law and economics model of criminal sanctioning); Louis Kaplow & Steven Shavell, *Optimal Law Enforcement with Self-Reporting of Behavior*, 102 J. POL. ECON. 583, 601-02 (1994); Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 692 (1997); Kate Andrias, *The President’s Enforcement Power*, 88 N.Y.U. L. REV. 1031 (2013).

21. See e.g., Richard A. Posner, *The Behavior of Administrative Agencies*, 1 J. LEGAL STUD. 305 (1972) (studying agency enforcement choices); Catherine L. Fisk & Deborah C. Malamud, *The NLRB in Administrative Law Exile: Problems With its Structure and Function and Suggestions for Reform*, 58 DUKE L.J. 2013, 2028-33 (2009) (studying NLRB’s enforcement over a decade-long period).

22. See e.g., James D. Cox & Randall S. Thomas with Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737 (2003) (studying concurrent SEC and private enforcement of accounting fraud); Stavros Gadinis, *The SEC and the Financial Industry: Evidence From Enforcement Against Broker-Dealers*, 67 BUS. LAW. 679 (2012) (studying SEC enforcement against broker-dealers); Stephen Choi, Anat Carmy Wiechman & Adam C. Pritchard, *Scandal Enforcement at the SEC: The Arc of the Option Backdating Investigations*, 15 AM. L. & ECON. REV. 542 (2013) (studying the options backdating scandals); Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Value of Foreign Bribery to Bribe Paying Firms* (June 16, 2015), <http://ssrn.com/abstract=1573222> (studying the consequences of DOJ and SEC enforcement for firms caught for bribery). Karpoff, Lee and Martin also published a series of three papers on SEC and DOJ enforcement of financial manipulation.

One recent exception is a forthcoming study by David Zaring. David Zaring, *Enforcement Discretion at the SEC*, 94 TEXAS L. REV. (forthcoming 2016).

advise companies or even be possible offenders themselves.<sup>23</sup> Enforcement is politically significant.<sup>24</sup> The SEC, the focus of this study, is regularly called to testify in Congress after scandals and failures of enforcement.<sup>25</sup> It must annually report on its enforcement performance to Congress and the President, and must “use objective metrics to justify its request for budget increases.”<sup>26</sup> The Government Accountability Office, congressional investigative arm, regularly relies on agencies’ reported figures to assess and propose improvements in agencies’ work.<sup>27</sup> Finally, enforcement is economically significant. The SEC uses its enforcement to communicate to market

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23. The press has closely tracked SEC enforcement for several decades. *See e.g.*, Bruce Ingersoll, *Inundated Agency: Busy SEC Must Let Many Cases, Filings Go Uninvestigated*, WALL ST. J., Dec. 16, 1985 (reporting that a Congressman from Michigan was “especially concerned” about a 10% decline in SEC enforcement actions between 1984 and 1985); Walter Hamilton, *SEC Setting Record Investigation Pace*, L.A. TIMES, Feb. 23, 2002, at 3 (reporting that SEC enforcement had been steadily increasing between 1998 and 2002); Sarah Johnson, *SEC Enforcement Declines 8.9 Percent*, CFO.com, Nov. 3, 2006, <http://ww2.cfo.com/risk-compliance/2006/11/sec-enforcement-declines-8-9-percent/>; Judith Burns & Kara Scannell, *SEC Brings Fewer Enforcement Cases*, WALL ST. J., Oct. 27, 2006, at C3 (reporting on an 8-10% decline in SEC enforcement actions in 2006); Joshua Gallu, *Data: SEC Inflates Enforcement Tally*, WASH. POST, Feb. 23, 2013, at A11 (suggesting that follow-on and delinquent filing cases inflate the overall enforcement tally); Jean Eaglesham, *Easy Prey Pads SEC Numbers*, WALL ST. J., Oct. 18, 2013, at C1 (reporting that the SEC brought several dozen follow-on cases in September 2013, to boost enforcement numbers reported in fiscal 2013).

24. The SEC prominently features enforcement successes in annual reports and budget justifications. *See also SEC Chief on Warpath Against Insider Trading*, THE GLOBE AND MAIL, May 29, 1984 (suggesting that enforcement against insider trading had helped the Regan Administration “that is often accused of favoring business to look more even-handed”); Michael Schroeder, *Bush Defends Pitt Among Calls for Resignation*, WALL ST. J., Oct. 10, 2002, at A6 (quoting President George W. Bush’s press secretary Ari Fleischer as defending the SEC’s successes, in particular the “record number of enforcement actions” brought); Anne Krishnan, *Lead by Example, SEC Chief Tells CEOs*, THE HERALD-SUN (DURHAM), Oct. 23, 2002, at A1 (reporting on Chair Pitt’s speech in which he referenced the SEC’s enforcement figures); Deborah Solomon, *SEC Changes Its Sleuthing, Uses Wider Net*, WALL ST. J., Mar. 18, 2004, at C1 (reporting that SEC “enforcement lawyers were judged on the number of cases they brought”); Amit R. Paley & David S. Hilzenrath, *SEC Chief Defends His Restraint*, WASH. POST, Dec. 24, 2008, at A01 (reporting that Chairman Cox referenced the number of enforcement cases brought under his reign to defend his tenure).

25. For an analysis of political forces that shape securities enforcement, see Urska Velikonja, *Politics in Securities Enforcement*, 50 GA. L. REV. \_ (2016) (forthcoming) [hereinafter Velikonja, *Politics in Securities Enforcement*].

26. John C. Coffee Jr., *SEC Enforcement: What Has Gone Wrong?*, THE CLS BLUE SKY BLOG (Jan. 2, 2013), <http://clsbluesky.law.columbia.edu/2013/01/02/sec-enforcement-what-has-gone-wrong/>. *See also* Bruce Carton, *SEC’ White Squares Off With Senate Committee Over FY 2016 Budget*, COMPLIANCE WEEK, May 8, 2015, <https://www.complianceweek.com/blogs/enforcement-action/secs-white-squares-off-with-senate-committee-over-fy-2016-budget#.VZ7C0caqqk0> (reporting that Chair White requested a 15% increase in the SEC’s budget for 2016).

27. *See e.g.*, U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-09-358, SECURITIES AND EXCHANGE COMMISSION: GREATER ATTENTION NEEDED TO ENHANCE COMMUNICATION AND UTILIZATION OF RESOURCES IN THE DIVISION OF ENFORCEMENT 2 (2009) (reporting that the GAO obtained data from the SEC on, among other things, the number of enforcement actions brought, the distribution of enforcement actions by cases type, and annual amounts in penalties and disgorgements ordered).

participants what is appropriate behavior.<sup>28</sup> Legal academics routinely rely on reported enforcement statistics to offer their assessments of the SEC's performance and propose changes to enforcement practices.<sup>29</sup> Law firms regularly issue reports using the SEC's enforcement statistics to warn clients about future legal risks.<sup>30</sup> Flawed reporting thus has the potential to lead agencies to implement changes that are unnecessary and obscure real problems that ought to be addressed.<sup>31</sup> This Article pulls back the curtain on the problems with agency reporting of their enforcement performance.

The second area of research to which this Article contributes is the study of the relationship between legal rules and their enforcement, and economic growth. Using cross-country comparisons, a vibrant debate is ongoing in the financial and legal circles about whether and how legal rules or enforcement contribute to the development of financial markets. The first set of studies suggested that the "law on the books" mattered more than enforcement,<sup>32</sup> spurring significant investment in studying and developing efficient rules to support capital market development.<sup>33</sup> Subsequent studies argued that such conclusions were not supported by the data<sup>34</sup> nor warranted.<sup>35</sup> Studies of enforcement emerged, first looking at formal rules regarding enforcement agencies,<sup>36</sup> followed by studies analyzing resources dedicated to enforcement,<sup>37</sup>

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28. See Jonathan G. Katz, *Reviewing the SEC, Reinvigorating the SEC*, 71 U. PITT. L. REV. 489, 491 (2009) (describing that in the 1950s the SEC began using enforcement actions "to guide and instruct market professionals").

29. See e.g., Coffee, Jr., *supra* note 17, at 262 (comparing SEC-reported statistics with those in the U.K. and Germany); Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. ON REG. 253, 280, 283 (2007) [hereinafter Jackson, *Variation*] (using the SEC's data on enforcement actions without adjustment, thus overstating SEC enforcement by 200 actions per year); Howell E. Jackson, *Regulatory Intensity in the Regulation of Capital Markets: A Preliminary Comparison of Canadian and U.S. Approaches* 113, 120 fig. 5 (2006), available at [http://www.tfmsl.ca/docs/V6\(2\)%20Jackson.pdf](http://www.tfmsl.ca/docs/V6(2)%20Jackson.pdf) [hereinafter Jackson, *Regulatory Intensity*] (same).

30. See *infra* note 211.

31. The Veterans Health Administration reporting scandal is an example of how manipulated results obscured a real problem in the VA. See Richard A. Opper Jr. & Michael D. Shear, *Severe Report Finds V.A. Hid Waiting Lists at Hospitals*, N.Y. TIMES, May 28, 2014, at A1.

32. See Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1149 (1997) (concluding that legal rules and enforcement impact the size and extent of a country's financial market); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998) (same).

33. See generally WORLD BANK, INSTITUTIONAL FOUNDATIONS FOR FINANCIAL MARKETS 1 (2006) (concluding that "private monitoring and enforcement drive development more than public enforcement measures"), <http://siteresources.worldbank.org/INTTOPACCFINISER/Resources/Institutional.pdf>.

34. Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.'s "Anti-Director Rights Index" Under Consistent Coding* 68 (John M. Olin Ctr. for Law, Econ. & Bus. Fellows' Discussion Paper Series, Discussion Paper No. 7, 2006), available at [http://www.law.harvard.edu/programs/olin\\_center/fellows\\_papers/pdf/Spamann\\_7.pdf](http://www.law.harvard.edu/programs/olin_center/fellows_papers/pdf/Spamann_7.pdf).

35. See Coffee, *supra* note 17, at 247-48 n. 39 (explaining that La Porta et al. methodology attracted considerable criticism).

36. See La Porta et al., *What Works in Securities Laws?*, 61 J. FIN. 1, 27 (2006).

and finally by studies comparing enforcement outputs.<sup>38</sup> Prominent academics have suggested that comparing enforcement efforts across nations is difficult because enforcement agencies have different jurisdictions, different priorities and different rates of misconduct.<sup>39</sup> This Article proposes that the list of challenges is incomplete: different jurisdictions also measure their enforcement activities differently.<sup>40</sup> High quality data collection on enforcement output must be the first priority in any effort to compare enforcement intensity across nations, as well as within nations across various industries. This Article is a step in that direction.

The Article proceeds in five parts. Part I provides an overview of agency reporting, the legal requirements for agency reporting, and the challenges of reporting on non-financial measures related to agency performance. Part II provides details on the SEC's reporting requirements, and explains how the data was collected and analyzed. Parts III and IV are the substantive core of the study. By studying the SEC's reporting practices from fiscal years 2000 to 2014, Part III exposes significant problems with validity and reliability of the metrics that Congress, the SEC, the press, and legal commentators widely use to evaluate the SEC's enforcement. By recoding enforcement figures to more accurately reflect actual performance, Part IV suggests some of the consequences of biased reporting, including overstatement of the enforcement effort, metrics that suggest false trends and non-existent problems, as well as obscure real problems, performance indicators that do not measure what they set out to measure, and distorted enforcement priorities. In Part V, the Article finally proposes several steps to improve agency reporting of their enforcement output. Agencies like the SEC are under considerable pressure from Congress to increase their enforcement output year after year without additional appropriations, so perhaps it should come as no surprise that agencies sometimes fudge the numbers to meet unreasonable expectations. There are two possible solutions: reduce the pressure on agencies by decoupling the budget process from reported enforcement output, and standardize reporting conventions. Finally, the Article proposes that agencies share more liberally data on enforcement. Doing so would add credibility to their reporting and, indirectly, to their enforcement programs.

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37. See Jackson, *Variation*, *supra* note 29, at 280, 283 (2007) (using the SEC's data on enforcement actions without adjustment, thus overstating SEC enforcement by 200 actions per year); Jackson, *Regulatory Intensity* *supra* note 29, at 281-13, 120 fig. 5 (same).

38. See Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-based Evidence*, 93 J. FIN. ECON. 207, 237 (2009) (proposing that the World Bank or another agency begin collecting data on enforcement activity, including the number of cases filed); Coffee, *supra* note 17, at 262 (comparing enforcement statistics between Germany, the U.K. and the U.S.).

39. Coffee, Jr., *supra* note 17, at 263 ("securities regulators have very different jurisdictions and may have different priorities in terms of what they wish to prosecute").

40. See Holger Spamann, *Empirical Comparative Law*, 11 ANNUAL REV. OF L. & SOC. SCI. (2015) (forthcoming), available at <http://papers.ssrn.com/abstract=2577350> (suggesting that collecting data of high quality is crucially important for cross-country comparative work).

## I. AGENCY REPORTING

*A. Why Report*

You cannot manage what you cannot measure. Reporting systems are thus put in place to monitor how well an organization and individuals within it are pursuing their “mission.”<sup>41</sup> Without reporting, the organization does not know whether and to what extent it accomplished what it set out to do, and when to change course.<sup>42</sup> Companies report to enable managers and investors to evaluate how well the company is meeting its goals. Reporting is at least as important for government agencies. Reporting is a precondition for deploying other accountability measures, including evaluating whether government officials, be they legislators, bureaucrats, or judges, act in the citizens’ interests, ensuring that administrative agencies enforce policy consistent with legislative and presidential priorities, and, ultimately, replacing agents that do not perform.<sup>43</sup>

Despite its obvious importance, reporting is controversial. What is measured is managed and rewarded, often to the exclusion of qualities that cannot be measured.<sup>44</sup> Also, people often believe that statistics are more accurate than they are,<sup>45</sup> and attribute greater significance to flawed numerical reporting than to an accurate narrative.

*B. The Legal Foundations of Agency Reporting*

Agencies generally do not have the choice whether to report. Federal agencies’ organic acts require that they prepare annual reports and present them to authorizing congressional committees that oversee their work.<sup>46</sup> Such reports are to include “whatever information, data, and recommendations for further legislation” that the agency considers relevant.<sup>47</sup> In addition, many federal agencies must report at least annually to the House Committee on Appropriations and the Senate Committee on Appropriations.<sup>48</sup> The executive,

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41. S.K. Bhattacharyya, *Management Reporting Systems: Structure and Design*, ECON. & POL. WEEKLY, Vol. 6, No. 22, p. M-67 (May 29, 1971),

42. *See id.*

43. Jacob E. Gersen & Matthew C. Stephenson, *Over-Accountability*, 6 J. LEGAL ANAL. 185, 186 (2014).

44. *See infra* Part I.C.

45. *See* Jordan Ellenberg, *How Not to Be Misled by Data*, WALL ST. J., June 26, 2015, <http://www.wsj.com/articles/how-not-to-be-misled-by-data-1435258933>.

46. *See e.g.*, 15 U.S.C. §78w(b)(1) (requiring the SEC, the Federal Reserve, the Comptroller of the Currency, the Federal Deposit Insurance Corporation to report annually to Congress); 15 U.S.C. §46(f) (authorizing the Federal Trade Commission to report annually to Congress).

47. 15 U.S.C. §78w(b)(1).

48. *See* Nancy Staudt, *Redundant Tax and Spending Programs*, 100 NW. U. L. REV. 1197, 1223-24 (2006). Of financial enforcement agencies, only the SEC and the CFTC must report to the appropriations committees. Other financial enforcement agencies, including FINRA, the Fed, the FDIC, the OCC, etc. are not funded with budget appropriations and thus do not appear before congressional appropriations committees. *See* Velikonja, *Politics in Securities Enforcement*, *supra* note 25, at [].

agency heads, and spending committees submit reports, assessments, and views of existing programs and expected costs. Based on submitted information, each Appropriations Committee adopts a budget resolution, which is then translated into committee allocations and ultimately delivered to authorizing congressional committees.<sup>49</sup>

The adoption of the Government Performance and Results Act of 1993 (the “Results Act”) reinforced agency reporting. The Results Act was one in a series of statutes designed to improve government performance by reducing “waste and inefficiency” and by “holding Federal agencies accountable for achieving program results.”<sup>50</sup> Influenced by private-sector management practices,<sup>51</sup> it requires agencies to set performance goals,<sup>52</sup> measure performance results, and to report the results annually to the President and Congress.<sup>53</sup> The goals are to be expressed in “objective, quantifiable, and measurable form,” and agencies are instructed to develop performance indicators that are to be used in measuring and assessing agency output and the outcomes of their activities.<sup>54</sup> If an agency misses a performance target, it must report its failure to the Office of Management and Budget (“OMB”) and submit an improvement plan.<sup>55</sup> If an agency misses a performance target two years in a row, it must submit to Congress what it plans to do to improve performance, including statutory change and request additional funding.<sup>56</sup> If, however, an agency misses a performance target three years in a row, the OMB may propose to Congress to terminate the program or reduce its budget.<sup>57</sup> In the era of post-financial crisis austerity, appropriations committees have been loath to increase agency budgets.

The Results Act and other reporting statutes cover a wide variety of agencies, from the largest departments to the Peace Corps.<sup>58</sup> Agencies are required to report financial and non-financial performance. The OMB has standardized financial reporting.<sup>59</sup> For most agencies, measures of financial

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49. Staudt, *supra* note 48, at 1243-44.

50. Government Performance and Results Act of 1993, Sec. 2(a), (b), Pub.L. 103-62. The Results Act was amended in early 2011 by the GPRA Modernization Act of 2010. H.R. 2142 §2; 5 U.S.C. §306(a).

51. See Mary L. Heen, *Reinventing Tax Expenditure Reform: Improving Program Oversight Under the Government Performance and Results Act*, 35 WAKE FOREST L. REV. 751, 768 n.60, 769 (2000) (describing the motivation between government reforms).

52. H.R. 2142 §3; 31 U.S.C. §1115(a).

53. H.R. 2142 §3; 31 U.S.C. §1116(a).

54. Pub. L. 103-62., Sec. 4(b).

55. 31 U.S.C. §1116(g).

56. 31 U.S.C. §1116(h)(1).

57. 31 U.S.C. §1116(i).

58. See THE PEACE CORPS, PERFORMANCE AND ACCOUNTABILITY REPORT: FISCAL YEAR 2014, <http://files.peacecorps.gov/multimedia/pdf/policies/annrept2014.pdf>. Agency reports are made publicly available on [website performance.com](http://www.performance.gov).

59. See OFFICE OF MANAGEMENT AND BUDGET, CIRCULAR NO. A-134, FINANCIAL ACCOUNTING PRINCIPLES AND STANDARDS, [https://www.whitehouse.gov/omb/circulars\\_a134/](https://www.whitehouse.gov/omb/circulars_a134/); OFFICE OF MANAGEMENT AND BUDGET, CIRCULAR NO. A-136, FINANCIAL REPORTING REQUIREMENTS.

performance are essentially useless in evaluating their performance. Non-financial measures of performance are far more pertinent,<sup>60</sup> yet what and how non-financial performance is measured is largely within considerable agency discretion.<sup>61</sup>

The GAO reported very early after the adoption of the Results Act that translating agency performance into concrete, objective measures would be difficult.<sup>62</sup> The structure of government is so complicated that it impedes the collection of relevant data. There are no useful proxies for measuring certain government functions.<sup>63</sup> OMB circulars provide more detailed guidance on reporting. Circular A-1, for example, requires agencies to report data that is complete, reliable, and of high quality.<sup>64</sup> It instructs agencies to note data limitations, including incomplete data,<sup>65</sup> imprecise measurement, and inconsistencies in data collection practices,<sup>65</sup> yet considerable problems remain.

### *C. Measuring Performance*

In order to be effective, a reporting system must produce information that is reliable, comprehensive, meaningful, and comparable across agencies. Reporting conventions that do not satisfy these requirements are at best useless.<sup>66</sup>

Agency goals are usually described in terms of general outcomes: safety,<sup>67</sup> public health,<sup>68</sup> election integrity,<sup>69</sup> and investor protection.<sup>70</sup> Ideally, an

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60. It is useful to know what percentage of monetary penalties that the SEC imposes are actually collected. See U.S. SEC. & EXCH. COMM'N, FY 2014 ANNUAL PERFORMANCE AND ACCOUNTABILITY REPORT 43 (reporting that the SEC collected in FY 2014 \$2,109 million of \$4,166 million ordered) [hereinafter SEC, 2014 ANNUAL REPORT].

61. For example, the SEC selects performance goals on the basis of the four-year strategic plan, which it drafts. In addition, the SEC itself defines the measures of performance. For example, it would be very useful to know in what percentage of enforcement actions brought does an agency obtain relief on at least one of the claims. The SEC reports in its 2014 Performance and Accountability Report that it obtained such relief in 94% of the enforcement actions it brought. See *id.* at 39. But the term “enforcement action” lumps together regulatory activities that are very different: trading suspensions when a firm has failed to file periodic financial reports are required by statute; follow-on disbarments and suspensions brought on the basis of a prior enforcement action that the SEC settled; and true new enforcement actions. The SEC’s success rate in the latter category is considerably lower than in the first two, so reporting overall success rates is quite meaningless. See discussion *infra* in Part IV.E.

62. U.S. GEN. ACC'T OFFICE, THE RESULTS ACT: AN EVALUATOR’S GUIDE TO ASSESSING AGENCY ANNUAL PERFORMANCE PLANS 9–10 (1998), available at <http://www.gao.gov/special.pubs/gg10120.pdf> [hereinafter GAO GUIDE].

63. See MANAGING FOR RESULTS: ANALYTIC CHALLENGES IN MEASURING PERFORMANCE (GAO/HEHS/GGD-97-138, May 30, 1997).

64. OFFICE OF MANAGEMENT AND BUDGET, CIRCULAR NO. A-11, §260.9.

65. *Id.*

66. See e.g., Neil Weinberg, *We Tried to Re-Crete JPMorgan’s Mutual Fund Returns and Gave Up*, BLOOMBERG, March 5, 2015, <http://www.bloomberg.com/news/articles/2015-03-05/we-tried-to-re-create-jpmorgan-s-top-mutual-fund-returns-and-just-gave-up>.

67. See U.S. CONSUMER PRODUCT SAFETY COMMISSION, 2011-2016 STRATEGIC PLAN 12, available at <http://www.cpsc.gov/PageFiles/123374/2011strategic.pdf>.

agency could describe and measure *its own* impact, directly or indirectly.<sup>71</sup> For example, a tech start-up uses the number of new users it attracts as a key performance indicator—a direct performance measure. A mature public firm measures its performance by reporting its earnings, EBITDA, and the stock price.

But measuring the impact of one agency's varied activities is both difficult and confounded by other changes in the economy or the environment. Failing measuring the agency's own impact, tracking changes in the overall quality can be reasonably informative, in particular where other underlying factors have not changed. Some agencies, like the EPA, can measure directly some of the aggregate environmental outcomes.<sup>72</sup> For example, the EPA reports on air quality by measuring the ambient concentration of fine particulate matter;<sup>73</sup> and on water quality by measuring the number of months during which drinking water met all applicable health-based standards.<sup>74</sup> By also supplying information on changes in variables that increase fine particulates, such as the number of miles driven, one can make an educated assessment of the EPA's contribution to improved air quality.

Unfortunately, most agencies cannot measure and report outcomes regularly and with any precision.<sup>75</sup> Data regarding outcomes is often difficult to collect reliably.<sup>76</sup> Even more often, outcomes cannot be quantified in a useful way. For example, the Peace Corps' mission is to promote "world peace and friendship" around the world.<sup>77</sup> Neither world peace nor friendship can be adequately measured directly, and poorly indirectly. The Peace Corps uses

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68 . See Center for Disease Control, Mission, Role and Pledge, <http://www.cdc.gov/about/organization/mission.htm>.

69. See FEDERAL ELECTION COMMISSION, FY 2014-2019 STRATEGIC PLAN 1, available at [http://www.fec.gov/pages/strategic\\_plan/FECStrategicPlan2014-2019.pdf](http://www.fec.gov/pages/strategic_plan/FECStrategicPlan2014-2019.pdf).

70. SEC; CFTC.

71. See Michael P. Vandenbergh, *The Private Life of Public Law*, 105 COLUM. L. REV. 2029, 2084 (2005).

72. The outcomes will be the product of the EPA's actions as well as many other factors, and so are not a direct measure of EPA's performance. But there is no doubt that regulation has had a considerable and lasting effect on air and water quality. See Sunstein, *supra* note 19, at 409-10. OSHA, likewise, reports overall workplace deaths and injuries over time and they have declined since 1970. Some of the decline is due to technological change and some due to OSHA's oversight and enforcement, but it may be impossible to flesh out relative contributions.

73 . U.S. ENV'T'L PROTECTION AGENCY, FISCAL YEAR 2016: JUSTIFICATION OF APPROPRIATION ESTIMATES FOR THE COMMITTEE ON APPROPRIATIONS 1090 (2015), available at [http://www2.epa.gov/sites/production/files/2015-02/documents/fy\\_2014\\_apr.pdf](http://www2.epa.gov/sites/production/files/2015-02/documents/fy_2014_apr.pdf).

74. *Id.* at 1102. Data collection is costly so agencies' data is sometimes unreliable, not collected, or not reported in a manner that would be useful. See Jonathan C. Borck, Cary Coglianese & Jennifer Nash, *Environmental Leadership Programs: Toward an Empirical Assessment of Their Performance*, 35 ECOLOGY L. QUARTERLY 771, 772 (2008).

75. See generally Richard W. Parker, *Grading the Government*, 70 U. CHI. L. REV. 1345 (2004) (showing how regulatory scorecards routinely overstate the costs of government activities by several orders of magnitude).

76. See Eric Biber, *The Problem of Environmental Monitoring*, 83 U. COLO. L. REV. 1, 18-22 (2011) (reporting that data is unavailable in ambient monitoring).

77. THE PEACE CORPS, *supra* note 58, at iii.

cross-cultural connections as a proxy for friendship and relies on volunteers' reports that they facilitated contact between an American and a local as a performance indicator.<sup>78</sup>

When outcomes cannot be measured directly, agencies report their output—the number of major rulemakings conducted, the number of seminars organized, the number of investigations opened, the magnitude of penalties collected<sup>79</sup>—and their input, such as the size of agency enforcement staffs and budgets. For example, the SEC's goal is to protect the public and market participants through a robust enforcement program.<sup>80</sup> Much of financial misconduct cannot be observed and measured directly.<sup>81</sup> Even for the small subset of publicly traded securities that trade in efficient markets, the securities' price will reflect only publicly available information, not non-public information, such as undiscovered financial misconduct. And so the SEC reports its output: the number of initiated investigations, the percentage of successful investigations, the amount of collected monetary penalties.<sup>82</sup> Output measures in enforcement depend on several factors, including (1) the prevalence of misconduct and (2) the agency's ability to detect and prosecute of such misconduct. Accounting fraud and offering frauds such as Ponzi schemes are highly cyclical: both types of violations are much more common during investment booms than otherwise.<sup>83</sup> Even if detection and prosecution rates remain flat, one would expect significant variation in enforcement figures from year to year. Aggregate enforcement numbers are a very noisy proxy for how effectively the agency conducts its work.<sup>84</sup>

Output measures are problematic when used to measure the agency's impact on outcomes, but output measures have additional limitations. First, they shift the focus from things that cannot be measured to those that can.<sup>85</sup> An

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78. *See id.* at 59-61.

79. *See* GAO GUIDE, *supra* note 62, at 16. *See also* Vandenberg, *supra* note 71, at 2084 (criticizing output reporting).

80. In efficiency terms, the goals should be to enforce to the point to where the next dollar spent on enforcement yields the benefit of at least one dollar. By that measure, SEC enforcement levels are currently much too low. *See generally* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 162 fig. 9 (2011) (showing that per dollar spent, SEC enforcement yields at least \$6.20 in fines).

81. *See e.g.*, *See* I.J. Alexander Dyck, Adair Morse & Luigi Zingales, *How Pervasive is Corporate Fraud?*, at 2-4, Rotman Sch. of Mgm't Working Paper No. 2222608, available at <http://papers.ssrn.com/abstract=2222608> (trying to estimate the prevalence of undetected accounting fraud and noting that it cannot be measured directly).

82. *See* SEC, 2014 ANNUAL REPORT, *supra* note 60.

83. *See* Tracy Yue Wang & Andrew Winton, *Product Market Interactions and Corporate Fraud* (showing that fraud rates increase during investment booms).

84. *See* Jean Eaglesham, *As SEC Enforcement Cases Rise, Big Actions Are Sparse*, WALL ST. J., Sept. 29, 2014, <http://www.wsj.com/articles/as-sec-enforcement-cases-rise-big-actions-are-sparse-1412028262> (quoting former SEC attorney Bradley Bondi for the proposition that enforcement statistics are a poor measure of how effectively the SEC deters misconduct).

85. *See* David A. Super, *Are Rights Efficient? Challenging the Managerial Critique of Individual Rights*, 93 CAL. L. REV. 1051, 1108 (2005) (reporting that USDA's Food and Nutrition Service which used to bring together "state agencies' staffs for annual discussions of a wide range

agency will bring enforcement actions that are easier to prosecute than those that require more time and effort, even if the impact of the latter would be greater.<sup>86</sup> Second, agencies select metrics on which they are measured.<sup>87</sup> Because the consequence of an agency's failure to meet a performance metric can be a reduced budget, agencies set themselves easy-to-satisfy goals.<sup>88</sup> Critics of agency reporting have noted that because of the threat to cut their budget, agencies report "statistics that are puzzling at best and misleading at worst because they suggest the Agency is making progress when it is not."<sup>89</sup> Third, metrics used often conflate apples with oranges. The SEC's enforcement statistics discussed in Parts II, III and IV are only one such example.<sup>90</sup> And fourth and finally, sometimes agencies outright misreport to avoid sanctions.<sup>91</sup>

Despite all of these problems, agency reporting remains important and useful. In particular, comparing enforcement statistics of one agency to overall indicators over a longer period of time can provide useful information about the value of various enforcement techniques.<sup>92</sup> Comparing enforcement strategies and successes across agencies can yield valuable insights into what else might work to increase compliance efficiently and effectively.

## II. A STUDY OF THE SEC'S REPORTING

The SEC has reported on its enforcement since it was created in 1934. Its reports are thorough and provide not only aggregate information and a summary of high-interest cases, but also a complete list of enforcement actions filed. This makes the SEC uniquely suited for a study of an agency's reporting conventions. In addition, the SEC is among the agencies whose enforcement record has been of particular interest to Congress and the general public.<sup>93</sup>

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of food stamp administrative issues, now convened dedicated 'payment accuracy conferences' each year").

86. See Posner, *supra* note 21, at 311-12.

87. Results Act.

88. See Sidney A. Shapiro & Rena Steinzor, *Capture, Accountability, and Regulatory Metrics*, 86 TEX. L. REV. 1741, 1744 (2008).

89. *Id.* at 1764.

90. Commentators have had no difficulty finding other examples. See e.g., Mary De Ming Fan, *Disciplining Criminal Justice: The Peril Amid the Promise of Numbers*, 26 YALE L. & POL'Y REV. 26 n.125 (2007) (discussing that officers face incentives that bias policing in favor of petty traffic violations at the expense of more serious violations that take longer to process).

91. The Veterans Health Administration reporting scandal is an example of how manipulated results obscured a real problem in the VA. See Oppel Jr. & Shear, *supra* note 31, at A1.

92. For example, before the creation of OSHA and federal regulation of workplace safety in 1970, there were 14,000 workplace deaths per year (20 per 100,000 workers). In 2013, 4585 people died on the job (3.3 per 100,000 workers). See U.S. Dep't of Labor, Worker Fatalities Reported to Federal and State OSHA, [https://www.osha.gov/dep/fatcat/dep\\_fatcat.html](https://www.osha.gov/dep/fatcat/dep_fatcat.html).

93. See e.g., Peter J. Henning, *Lawmakers Focus on How SEC Does Its Job*, N.Y. TIMES DEALBOOK, Mar. 30, 2015, <http://www.nytimes.com/2015/03/31/business/dealbook/lawmakers-focus-on-how-sec-does-its-job.html>. The EPA's activities may be scrutinized as closely.

Critiques of SEC enforcement routinely revolve around mishandling particular cases,<sup>94</sup> such as failing to uncover the Madoff Ponzi scheme<sup>95</sup> or the Enron fraud.<sup>96</sup> The Commission's usual retort is to highlight its overall enforcement record.<sup>97</sup> Reported SEC enforcement figures regularly grab newspaper headlines and capture the attention of Congress both during budget appropriation season and in post-scandal testimonies.<sup>98</sup>

The SEC's overall enforcement performance is particularly worthy of studying because the agency is very active and its leadership very proud of the agency's enforcement prowess.<sup>99</sup> SEC Chairs like to describe enforcement as the agency's "number one priority"<sup>100</sup> and the "bedrock warrant" for its continued existence.<sup>101</sup> Yet, despite intense public interest, SEC enforcement remains understudied.<sup>102</sup> Nearly all law review articles, newspaper reports, and law firm client memoranda regarding SEC enforcement rely exclusively on figures that the SEC releases.<sup>103</sup>

94. See e.g., Macey, *supra* note 7, at 652-54 (2010) (using one salient anecdote to show that the SEC pursues firms instead of going after individuals).

95. See U.S. SEC. & EXCH. COMM'N, OFFICE OF INVESTIGATIONS, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME (2009), <https://www.sec.gov/news/studies/2009/oig-509.pdf>.

96. See Jonathan Weil & John Wilke, *Systemic Failure by SEC Is Seen in Enron Fraud*, WALL ST. J., Oct. 7, 2002, <http://www.wsj.com/articles/SB1033944629262271233>.

97. See Oversight of 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. & Urban Affairs, 111th Cong. (2009) (statement of Robert Khuzami, Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm'n, & John Walsh, Acting Dir., Office of Compliance Inspections & Examinations, U.S. Sec. & Exch. Comm'n), available at <https://www.sec.gov/news/testimony/2009/ts091009rk-jw.htm>.

98. Jean Eaglesham, *SEC Brings Fewer Enforcement Actions, Slows Early-Stage Probes*, WALL ST. J., Dec. 17, 2013, <http://www.wsj.com/articles/SB10001424052702304403804579264293892648268>.

99. See e.g., U.S. Sec. & Exch. Comm'n, Commission Announces Enforcement Results for FY 2013, SEC NEWS DIGEST, No. 2013-241, Dec. 17, 2013, <https://www.sec.gov/news/digest/2013/dig121713.htm>; Amir Efrati & Tom McGinty, *Youz Indictin' Who? A Rivalry Grows for Stock Cops in Brooklyn, Manhattan*, WALL ST. J., June 20, 2008, at C1 (quoting SEC spokesman's listing of the number of enforcement actions and penalties secured as evidence of aggressive enforcement); *SEC Plans Tougher Enforcement in '07*, CHICAGO TRIBUNE, Oct. 28, 2006, at 2 (reporting that the SEC was planning to bring more enforcement actions in FY 2007).

100. *UK and US "Differ on Enforcement,"* DAILY TELEGRAPH, Dec. 3, 2005, at 30 (quoting SEC Chair Christopher Cox). See also Katz, *supra* note 28, at 509 (explaining that "virtually every Chairman of the SEC in the past thirty years" believed that the SEC is primarily a law enforcement agency).

101. Bevis Longstreth, *The SEC After Fifty Years: An Assessment of Its Past and Future*, 83 COLUM. L. REV. 1593, 1612 (1983).

102. See Simi Kedia & Shiva Rajgopal, *Do the SEC's Enforcement Preferences Affect Corporate Misconduct?*, 51 J. ACCT. & ECON. 259, 259 (2011) (observing that there is little empirical work studying the overall effectiveness of SEC enforcement).

103. See Coffee, Jr., *supra* note 17, at 269 (comparing SEC enforcement actions with similar enforcement actions in the U.K. without adjusting the U.S. figures); Bratton & Wachter, *supra* note 80, at 154-57 figs. 4-7 (using the numbers in SEC Annual Reports to generate figures without making adjustments for follow-on and duplicative enforcement actions); Sonia A. Steinway, Comment, *SEC "Monetary Penalties Speak Very Loudly," But What Do They Say? A Critical*

This Part, and Parts III and IV explain why and how these figures are flawed. This Part describes in more detail the SEC's annual reporting practices, describes the data and the study methodology.

#### A. Annual Performance Reports

The SEC has released an annual report every year since 1935, including detailed information on each enforcement action brought.<sup>104</sup> As the SEC's enforcement powers expanded, so did reporting on enforcement. Since 1987, the Commission has reported its enforcement in exactly the same manner as it does today, with some minor methodological modifications. The enforcement report begins with a table aggregating enforcement actions by subject matter and by venue in which they are brought, followed by a list of all enforcement actions organized by subject matter and date filed.<sup>105</sup> In the years since 1987, the SEC has reduced reporting on case outcomes, and after the Results Act in 1993, it switched to performance indicators, which in various ways are less meaningful than enforcement statistics reported decades ago. Fortunately and usefully, the SEC has continued to provide a list of all filed enforcement actions during the fiscal year and a summary table of enforcement [as shown in Table 1]. The Commission uses that same raw data not only to report aggregate numbers but also to generate other performance indicators that it reports to Congress.

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*Analysis of the SEC's New Enforcement Approach*, 124 YALE L.J. 209 (2014); Natalya Shnitser, *A Free Pass for Foreign Firms? An Assessment of SEC and Private Enforcement Against Foreign Issuers*, 119 YALE L.J. 1638, 1667 tbl.3 (2010) (reporting figures from SEC's annual reports); Barbara Black, *How to Improve Retail Investor Protection After the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 13 U. PA. BUS. L. J. 59, 72 n.83 (using SEC data to report the share of enforcement actions against broker dealers and investment advisors); Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 VILL. L. REV. 701, 709 n.46 (2010) (arguing that the SEC's figures understate enforcement against broker dealers and investment advisors, without adjusting for follow-on cases); Elizabeth Chamblee Burch, *Reassessing Damages in Securities Fraud Class Actions*, 66 MD. L. REV. 348, 397 (2007) (reporting SEC enforcement statistics); Hillary A. Sale, *Banks: The Forgotten(?) Partners in Fraud*, 73 U. CIN. L. REV. 139, 176-77 (2004) (using the SEC's statistics to suggest that enforcement activity increases between 2002 and 2003, when the increase is exclusively due to follow-on and second cases brought – all already counted).

By contrast, financial economists ordinarily report their own hand-coded results, not the SEC's figures, though such studies are very rare. See e.g., Jonathan Karpoff, D. Scott Lee & Gerald S. Martin, *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUANTITATIVE ANALYSIS 581, 588 (2008) [hereinafter Karpoff, Lee & Martin, *The Cost to Firms*].

104. See EXCH. COMM'N, SECOND ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION: FISCAL YEAR ENDED JUNE 30, 1936, at 48-50, 54-57, available at [http://www.sec.gov/about/annual\\_report/1936.pdf](http://www.sec.gov/about/annual_report/1936.pdf).

105. See U.S. SEC. & EXCH. COMM'N, 53RD ANNUAL REPORT, 1987, at 144-151, available at [http://www.sec.gov/about/annual\\_report/1987.pdf](http://www.sec.gov/about/annual_report/1987.pdf).

TABLE 1: SAMPLE SEC ENFORCEMENT REPORT

Enforcement Action Summary Chart for Fiscal 2014 by Primary Classification  
(Each action initiated has been included in only one category listed below, even though many actions involved multiple allegations and may fall under more than one category. The number of defendants and respondents is noted parenthetically.)

Primary Classification	Civil Actions		Administrative Proceedings		Total		% of Actions
Broker-Dealer	7	(10)	159	(179)	166	(189)	22%
Delinquent Filing	0	(0)	107	(445)	107	(445)	14%
Foreign Corrupt Practices Act	3	(3)	4	(4)	7	(7)	1%
Insider Trading	40	(75)	12	(13)	52	(88)	7%
Investment Advisors/ Investment Companies	10	(34)	120	(171)	130	(205)	17%
Issuer Reporting and Disclosure	12	(28)	87	(125)	99	(153)	13%
Market Manipulation	17	(57)	46	(51)	63	(108)	8%
Miscellaneous	0	(0)	37	(40)	37	(40)	5%
Municipal Securities & Public Pensions	2	(4)	4	(8)	6	(12)	1%
Securities Offering	52	(261)	29	(42)	81	(303)	11%
Transfer Agent	2	(4)	5	(7)	7	(11)	1%
TOTALS	145	(476)	610	(1085)	755	(1561)	100%

Source: SELECT SEC AND MARKET DATA FISCAL 2014, at 3, available at <http://www.sec.gov/about/secstats2014.pdf>.

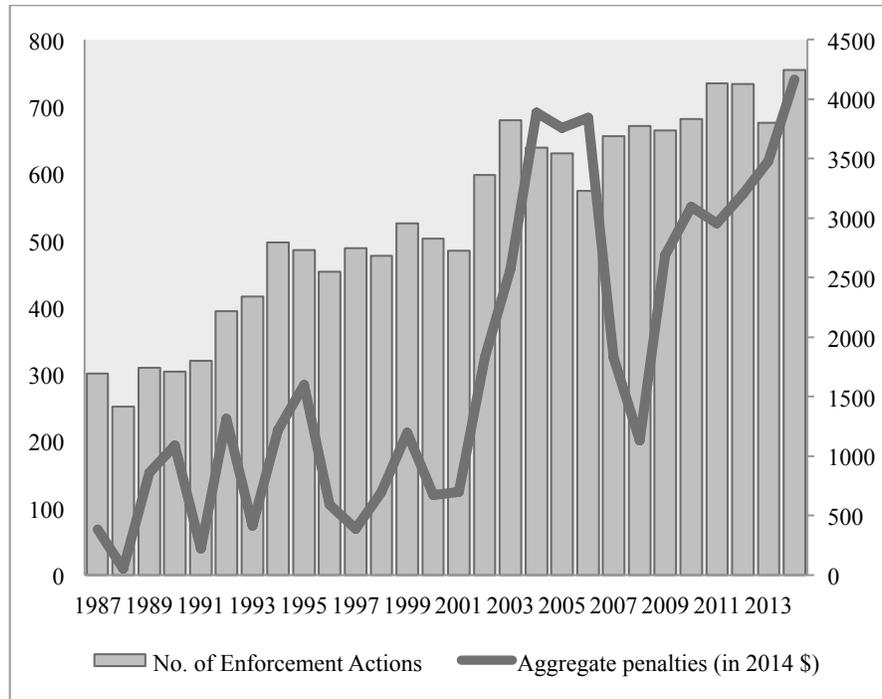
As shown below in Figure 1, the SEC's annual enforcement statistics show a trend that is continuously increasing: each fiscal year, the SEC reports that it filed more enforcement actions than the previous year, against more defendants, ordering them to pay larger monetary penalties.<sup>106</sup> The brief decline

106. The considerable decline in monetary penalties imposed in 2007 and 2008 was entirely the product of Chairman Christopher Cox's change in policy. In 2006, only a few months after Chairman Cox took over, the Commission articulated a set of criteria for imposing a monetary penalty against the firm. The goal of the guideline was to reduce corporate penalties: it limited monetary penalties to cases where the firm received a "direct and material benefit" and against penalties if they would cause additional harm to shareholders who did not violate securities laws. See Press Release, U.S. Sec. & Exch. Comm'n, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), available at <http://www.sec.gov/news/press/2006-4.htm>.

In addition, the Commission required enforcement staff to show tangible benefits to the company using an event study and to seek pre-approval of the penalty range before beginning

in monetary penalties between 2006 and 2008 during Republican Chairman Christopher Cox's administration<sup>107</sup> was quickly reversed in fiscal year 2009, as Chairman Cox stepped down, and the Madoff Ponzi scheme and the financial crisis spurred the Commission to change its approach.

FIGURE 1: SEC ENFORCEMENT STATISTICS (1987–2014)



In Part III, the Article discusses in considerable detail why the indicators that the SEC uses do not validly and reliably measure the SEC's enforcement activities. The following section, however, explains how the data was collected and what methodology was used to analyze the data.

settlement discussions. See U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 27, at 33; Christopher Cox, Chairman, U.S. Sec. & Exch. Comm'n, Address to the Mutual Fund Directors Forum Seventh Annual Policy Conference (Apr. 13, 2007), available at <http://www.sec.gov/news/speech/2007/spch041207cc.htm> ("So in a handful of cases where the need for national consistency is greatest, we're reviving what had been a long standing policy of the SEC for all cases for many years—that Commission approval be obtained before settlement discussions are commenced."). That "handful of cases" involved all cases where a corporate penalty was sought.

107. That is, between October 1, 2006 and September 30, 2008.

*B. Data and Methodology*

The SEC begins an investigation into possible securities violations by opening a matter under inquiry. If it finds evidence of misconduct, the Commission opens first an informal investigation, then a formal investigation, and ultimately files an enforcement action. Investigations vary considerably in size and complexity. An investigation into accounting fraud or a pyramid scheme usually includes multiple entities and individuals. Although investigations come in many shapes and sizes, each investigation is related to a specific and unique set of underlying facts. An enforcement action, on the other hand, is a legal proceeding that the SEC initiates by filing a civil complaint in district court or an order instituting proceedings before an administrative law judge (“ALJ”) against a specific firm and/or individuals based on the facts uncovered during the investigation. The SEC files an enforcement action at the very end of an investigation, on average some 21–22 months after it opened an informal investigation.<sup>108</sup>

The SEC often initiates multiple legal proceedings, i.e., enforcement actions, on the basis of a single investigation.<sup>109</sup> In the largest investigations the Commission initiates a dozen or more separate proceedings against various players. Following an investigation into accounting fraud at Adelphia, for example, the SEC brought an enforcement action in court seeking penalties and injunctions against the firm and its top officers,<sup>110</sup> a civil action against Adelphia’s supplier Scientific-Atlanta for aiding and abetting Adelphia’s fraud,<sup>111</sup> two administrative actions against Scientific-Atlanta’s insiders,<sup>112</sup> an

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108. SEC, 2014 ANNUAL REPORT, *supra* note 60, at 40.

109. See Karpoff, Lee & Martin, *The Cost to Firms*, *supra* note 103, at 588, 589 tbl. 3 (reporting that between 1978 and 2006, each successful investigation into accounting fraud resulted on average in 1.70 administrative enforcement actions, 2.06 civil actions and 0.56 criminal actions). Karpoff and his collaborators confusingly label investigations that lead to the initiation of legal proceedings “enforcement actions” and the legal proceedings as “regulatory events.” *Id.* at 589 tbl. 3. See also Jonathan Karpoff, D. Scott Lee & Gerald S. Martin, *The Consequences to Managers for Financial Misrepresentation*, 88 J. FIN. ECON. 195, 197 (2008) [hereinafter Karpoff, Lee & Martin, *The Consequences to Managers*] (referring to investigations that result in some form of enforcement as “enforcement actions” and to enforcement actions as “proceedings”). In SEC parlance, an enforcement action is a term of art referring to each initiated legal proceeding. Investigations that lead to legal proceedings are usually described as that, investigations, or cases. All legal literature uses the term enforcement action consistent with the SEC’s usage.

110. Complaint, Sec. & Exch. Comm’n v. Adelphia Communications Corp. et al., 1:02-cv-5776 (S.D.N.Y., Jul. 24, 2002)

111. Complaint, Sec. & Exch. Comm’n v. Scientific-Atlanta, Inc., 1:06-cv-4823 (S.D.N.Y., June 22, 2006)

112. Wallace G. Haslip, Exchange Act Release No. 54,030, Accounting and Auditing Enforcement Release No. 2444 (June 22, 2006), <https://www.sec.gov/litigation/admin/2006/34-54030.pdf>; Julian W. Eidson, Exchange Act Release No. 54,031, Accounting and Auditing Enforcement Release No. 2445 (June 22, 2006), <https://www.sec.gov/litigation/admin/2006/34-54031.pdf>.

administrative action against Deloitte & Touche, Adelphia's auditor,<sup>113</sup> and another against the engagement partner in charge of the Adelphia audit.<sup>114</sup> Investigations or cases<sup>115</sup> like Adelphia can continue to spawn enforcement actions for several years.<sup>116</sup>

The SEC collects information on its enforcement activities and presents it annually, usually in the fall, soon after the end of the fiscal year.<sup>117</sup> The SEC does not report the number of matters under investigation. It reports the number of informal investigations and the number of formal orders of investigation issued during any fiscal year.<sup>118</sup> But the SEC features most prominently enforcement actions filed. The annually-released report lists all enforcement actions brought during the fiscal year and tabulates the data by the primary category by subject matter and venue.<sup>119</sup> This report used to be included in the annual report as an appendix.<sup>120</sup> Since 2004, the SEC has included some aggregate statistics in the annual report, but the annual report no longer includes detailed information about enforcement. The SEC has continued to

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113. Deloitte & Touche LLP, Exchange Act Release No. 51,606, Accounting and Auditing Enforcement Release No. 2237 (Apr. 26, 2005), <https://www.sec.gov/litigation/admin/34-51606.pdf>.

114. Initial Decision, Gregory M. Dearlove, Initial Decision Release No. 315 (July 27, 2006), <https://www.sec.gov/litigation/aljdec/2006/id315jtk.pdf>.

115. The SEC, too, refers to investigations as "cases". See <https://www.sec.gov/litigation/litreleases/2012/lr22451.htm>.

116. In 2007, the SEC completed an investigation in stock loan scams. It brought two civil actions in court against 38 individual defendants. See *Press Release*, SEC Charges 38 in Multi-Million Dollar Stock Loan Scams (Sept. 20, 2007), <http://www.sec.gov/news/press/2007/2007-192.htm>. In 2011, it brought more than a dozen follow-on actions against the same defendants. See e.g., Craig Demizio, Exchange Act Release No. 63,921 (Feb. 17, 2011), <https://www.sec.gov/litigation/admin/2011/34-63921.pdf>; Shaun Sarnicola, Exchange Act Release No. 63,924 (Feb. 17, 2011), <https://www.sec.gov/litigation/admin/2011/34-63924.pdf>; Darin Demizio, Exchange Act Release No. 63,922 (Feb. 17, 2011), <https://www.sec.gov/litigation/admin/2011/34-63922.pdf>.

This is not a new problem. In 2001, the investigation into the Capital Consultants LLC Ponzi scheme resulted in 4 enforcement actions: a civil action and three administrative cases seeking disbarments. See *Sec. & Exch. Comm'n v. Capital Consultants LLC et al.*, CV-00-1290 (KV) (D. Or., Apr. 30, 2001) (civil action); Capital Consultants LLC, Investment Advisers Act Release No. 1963 (Aug. 10, 2001), available at <http://www.sec.gov/litigation/admin/ia-1963.htm>; Jeffrey L. Grayson, Investment Advisers Act Release No. 1964 (Aug. 10, 2001), available at <http://www.sec.gov/litigation/admin/ia-1964.htm>; Barclay L. Grayson, Investment Advisers Act Release No. 1962 (Aug. 10, 2001), available at <http://www.sec.gov/litigation/admin/ia-1962.htm>. In 2002, the SEC investigated Chimneyville Investments Group Inc. and its owner. It filed three enforcement actions: one civil action against the firm and the owner, and two administrative actions seeking permanent bars against each. *Sec. & Exch. Comm'n v. Chimneyville Investments Group Inc. et al.*, 3:98-cv-574 WS (S.D. Miss., Sept. 1, 1998); Chimneyville Investments Group Inc., Exchange Act Release No. 46,424 (Aug. 28, 2002), available at <https://www.sec.gov/litigation/admin/34-46424.htm>; Joseph Randolph Belew, Exchange Act Release No. 46,887 (Oct. 21, 2002), available at <http://www.sec.gov/litigation/admin/34-46887.htm>.

117. See *supra* note 4.

118. See e.g., SELECT SEC AND MARKET DATA FISCAL 2013, at 19 tbl. 4 (2014).

119. See *id.*

120. See SEC, ANNUAL REPORT 2003, at 103–23 tbls. 1 & 2 (2004).

release such information in a separate document, entitled *Select SEC and Market Data*, that it makes available on its website, and has continued to feature prominently enforcement statistics discussed in this Article.

In order to analyze the SEC's reporting conventions, I reviewed all 9679 filed enforcement actions that are listed in the SEC's reports released from 2000 to 2014 (inclusive). The search uncovered some inconsistencies in the SEC's reports. The tables and figures reproduced in this Article report accurate figures. The SEC listed and counted twice a handful of enforcement actions. The report for 2004 is missing pages and so I supplemented the list by reviewing the SEC's litigation releases. In the 2005 report, delinquent filing enforcement actions are recorded in the wrong column (as civil actions), yielding a tally of civil actions that is too high by 60, and a tally of administrative proceedings that is too low by 60. In addition, the defendant count reported in the 2005 report is too high by 40 defendants, primarily in the broker-dealer and investment adviser categories. Because the number of enforcement actions reported is accurate, I suspect the SEC's reported defendant count for 2005 must be an error.

The SEC's enforcement budget as well as maximum financial penalties increased considerably in 2002 after accounting scandals and the adoption of the Sarbanes-Oxley Act.<sup>121</sup> I chose to review two years before the adoption of the Act to see whether there are any obvious differences in reporting conventions used before and after—and there are none.<sup>122</sup>

The SEC reports as enforcement actions any legal proceedings initiated in district court or before the ALJ against one or more defendants. The SEC does not include all legal proceedings as enforcement actions. For example, reinstatements after a bar or suspension are not included as "enforcement actions." In some years, the Commission does not count deferred prosecution agreements as enforcement actions, while in others it does.

I coded the enforcement actions as follows: (1) primary enforcement action seeking monetary penalties, injunctions and cease-and-desist orders; (2) follow-on action brought under Section 15(b) of the Securities Exchange Act or Rule 102(e) of the SEC's Rules of Practice brought after the conclusion of the primary enforcement action (and based on it); or (3) secondary enforcement action where the SEC brought both, a civil action seeking a fine and an administrative case seeking a cease-and-desist order, based on the same set of facts against the same defendant. In such cases, I coded the civil action as a primary enforcement action and the administrative proceeding seeking a cease-and-desist order as a secondary enforcement action. The raw data is reported in Tables 3A, 3B and 3C in the Appendix.

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121. Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

122. In fiscal years 2000 and 2001, the SEC brought fewer enforcement actions and fewer follow-on proceedings than in the later years. The relative share of follow-on proceedings was not appreciably different.

The SEC often brings an enforcement action alongside other enforcement agencies, including the DOJ,<sup>123</sup> the CFTC,<sup>124</sup> NASD or FINRA,<sup>125</sup> the PCAOB,<sup>126</sup> the exchanges,<sup>127</sup> or a state securities agency.<sup>128</sup> I coded such enforcement actions as primary if the SEC sought monetary penalties, injunctions, cease-and-desist orders, or censure. Enforcement actions where the SEC sought to disbar or suspend a defendant based on an earlier enforcement action by another agency targeting the same defendant for the same misconduct were coded as follow-on actions. I coded as two separate primary enforcement actions where the SEC sanctioned in separate actions the firm, its owners<sup>129</sup> or managers.<sup>130</sup> Bringing an enforcement action against a firm is usually considerably easier than bringing one against individuals. Individuals tend to fight charges, in particular those that give rise to temporary or permanent suspensions or bars from the industry, whereas the firm generally settles for financial penalties or less. Similarly, I counted the actions for accounting fraud against the issuer and its external auditor as two primary enforcement actions.<sup>131</sup> Auditors are not ordinarily charged when a firm misrepresents its

123. See e.g., *U.S. v. Statoil, ASA*, 1:06-cr-960 (S.D.N.Y., Oct. 13, 2006), <http://www.justice.gov/criminal/fraud/fcpa/cases/statoil-asa-inc/10-09-06statoil-agree.pdf>; Statoil, ASA, Exchange Act Release No. 54,599 (Oct. 13, 2006), <https://www.sec.gov/litigation/admin/2006/34-54599.pdf>.

124. See e.g., U.S. Bank National Ass'n, Investment Company Act Release No. 27,057, <https://www.sec.gov/litigation/admin/ic-27057.pdf>.

125. See e.g., First Command Financial Planning, Inc., Securities Act Release No. 8513, Exchange Act Release No. 50,859 (Dec. 15, 2004), available at <https://www.sec.gov/litigation/admin/33-8513.htm>; Knight Securities L.P., Exchange Act Release No. 50,867 (Dec. 16, 2004), available at <https://www.sec.gov/litigation/admin/34-50867.htm>; U.S. Sec. & Exch. Comm'n, Press Release, SEC Charges Goldman, Sacks & Co. Lacked Adequate Policies and Procedures for Research "Huddles" (Apr. 12, 2012), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171488258>.

126. See *infra* notes 187-188.

127. See e.g., Van Der Moolen Specialists USA, LLC, Exchange Act Release No. 49,502, at 14 n.11 (Mar. 30, 2004), <https://www.sec.gov/litigation/admin/34-49502.pdf>.

128. See e.g., Deutsche Asset Management et al., Investment Advisers Act Release No. 2575, Investment Company Act Release No. 27,606, at 14 (Dec. 21, 2006), <https://www.sec.gov/litigation/admin/2006/ia-2575.pdf>.

129. I used the same terminology as the SEC. In SEC parlance, an enforcement action is a term of art referring to each legal proceeding initiated. Investigations that lead to legal proceedings are usually described as investigations or cases. All legal scholarship uses the term enforcement action consistent with the SEC's usage. By contrast, Karpoff and his collaborators confusingly label investigations that lead to the initiation of legal proceedings "enforcement actions" and the legal proceedings themselves as "regulatory events." See Karpoff, Lee & Martin, *The Cost to Firms*, *supra* note 103, at 589 tbl. 3; Karpoff, Lee & Martin, *The Consequences to Managers*, *supra* note 103, at 197 (referring to investigations that result in some form of enforcement as "enforcement actions" and to enforcement actions as "proceedings").

130. See e.g., U.S. Sec. & Exch. Comm'n, SEC Charges CVS With Misleading Investors and Committing Accounting Violations, Litigation Release No. 22,968 (Apr. 8, 2014), <https://www.sec.gov/litigation/litreleases/2014/lr22968.htm>.

131. See e.g., Child, Van Wagoner & Bradshaw PLLC et al., Exchange Act Release No. 72,557, Accounting and Audition Enforcement Release No. 3565 (July 8, 2014), <https://www.sec.gov/litigation/admin/2014/34-72557.pdf>; Sec. & Exch. Comm'n v. Yuhe International & Gao Zhentao, 1:13-cv-1598.

financials, and so charging and auditor requires additional resources and expertise on the part of the SEC.

I counted as primary enforcement actions where the SEC was the first to bring an enforcement action that was later followed by a conviction.<sup>132</sup> In many cases the SEC coordinates its investigation with the DOJ. In criminal matters, either the DOJ usually moves first, or the SEC and the DOJ announce a coordinated settlement simultaneously. Rarely, the SEC moves first. In those cases, if the DOJ ultimately decides to move forward, it routinely moves to intervene in the ongoing SEC proceedings and requests a stay,<sup>133</sup> which is ordinarily granted. If the defendant is convicted, the SEC's original primary enforcement action is effectively converted into a follow-on proceeding, in which the defendant is disbarred or suspended but not otherwise sanctioned.<sup>134</sup> Such cases are rare.

Further complicating the analysis are changes in SEC reporting during the study period. Fortunately, the Commission did not change the definition of an enforcement action but has changed subject matter classifications several times during the study period. It used to break out enforcement actions against broker-dealers into four or five categories. Now it reports all cases in a single category, except for enforcement for municipal securities violations that have been reported separately since 2005, and are no longer included in the overall broker-dealer tally. As a result, the numbers of enforcement actions against broker-dealers before and after 2005 are not directly comparable. Similarly, until fiscal year 2011 the Commission reported enforcement actions brought under the Foreign Corrupt Practices Act ("FCPA") as Issuer Reporting and Disclosure cases. Since then, FCPA cases are reported separately. Finally, until fiscal year 2013 the SEC used to report contempt proceedings—actions to enforce compliance with an earlier enforcement action—in its aggregate tally of enforcement actions filed, but no longer does so.<sup>135</sup>

### III. PROBLEMS IN SEC REPORTING

This Part identifies the most serious problems in the SEC's enforcement statistics. The most important and most commonly used metric to report and evaluate the SEC's enforcement effort is the number of enforcement actions initiated during a fiscal year either by filing a complaint or an order instituting

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132. *See e.g.*, Hector Gallardo et al., Exchange Act Release No. 65,422 (Sept. 28, 2011), <https://www.sec.gov/litigation/admin/2011/34-65422.pdf>; U.S. Attorney's Office, E.D.N.Y., Stock Broker Arrested on Wire Fraud Charges (Nov. 3, 2011), <http://www.justice.gov/usao/nye/pr/2011/2011nov03.html>.

133. *See e.g.*, David M. Tamman, Esq., Exchange Act Release No. 69,746, at 1 (June 12, 2013), <https://www.sec.gov/litigation/admin/2013/34-69746.pdf>.

134. *See* David M. Tamman, Esq., Exchange Act Release No. 69,746, at 1-2 (June 12, 2013), <https://www.sec.gov/litigation/admin/2013/34-69746.pdf>, <https://www.sec.gov/litigation/admin/2013/34-69746.pdf>.

135. SELECT SEC AND MARKET DATA FISCAL 2013, at 3 n. 1. *See also* discussion *infra* in Part III.A.2.

proceedings. Yet counting enforcement actions yields an invalid and unreliable proxy for enforcement activity: it double- and triple-counts some cases, lumps together investigations with technical revocation proceedings, and can be manipulated without much difficulty.<sup>136</sup> Other enforcement statistics that the SEC reports, including defendant count, subject matter classification, and monetary penalties, are similarly problematic.

This Part identifies problems with the validity and reliability of the statistics that the SEC uses to measure its enforcement output. Then, by using recent examples, Part IV demonstrates the most significant consequences of using invalid and unreliable statistics to report on and analyze securities enforcement.

#### *A. Problem 1: Validity*

In statistics, the validity of a variable—the proxy used to measure an activity or a condition of interest—is the degree to which it measures what it is supposed to measure.<sup>137</sup> In evaluating securities enforcement, we want to know how many investigations an agency has initiated, against how many securities violators, and for what sorts of violations. We want a variable that reports how many investigations result in legal action within a given period of time, and another variable to measure the significance of the cases. We want the agency to report sanctions and to have a way to measure whether those sanctions are having the desired affect. One would expect the number and the significance of new cases to vary over time, depending on the rate of misconduct, the available resources for the enforcement agency, and the agency's effective use of those resources.

The most prominent variables that SEC uses to report on its enforcement output are the number of enforcement actions brought and the number of monetary penalties ordered.<sup>138</sup> Neither validly measures enforcement activity as conventionally understood. The SEC also reports the number of defendants targeted, which would mitigate the problems with counting enforcement actions if it did not suffer from similar defects.

#### 1. Counting Enforcement Actions

Each year, the SEC reports the number of investigations opened, the number of formal orders of investigation secured, and the number of

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136. The enforcement staff believe that gross tallies present an incomplete view of enforcement activity and are “vulnerable to manipulation.” U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 27, at 22.

137. See EDWARD G. CARMINES & RICHARD A. ZELLER, RELIABILITY AND VALIDITY ASSESSMENT 11-13 (1979), Sage University Paper Series on Quantitative Applications in the Social Sciences No. 07-017, available at [http://www.uky.edu/~clthyn2/PS671/carmines\\_zeller\\_671.pdf](http://www.uky.edu/~clthyn2/PS671/carmines_zeller_671.pdf) (discussing reliability and validity).

138. See Macey, *supra* note 7, at 646 (“The more cases that are brought and the greater the amount of fines collected during a particular time frame, the better the enforcement staff at the SEC is thought to perform.”).

enforcement actions filed.<sup>139</sup> But it is the number of enforcement actions filed, which implies a successful investigation, that is featured most prominently.<sup>140</sup> Five factors make enforcement actions problematic as a measure of enforcement activity. First, the three statistics reported—informal investigations, formal orders of investigation, and enforcement action—are not comparable. Nowhere in its annual reports does the SEC explain and report how many investigations yielded at least one enforcement action. As a result, it is not clear how many investigations are ultimately closed without legal action or whether investigations hit stumbling blocks before they become enforcement actions, and it is not obvious that the SEC does either.<sup>141</sup>

Second, counting enforcement actions may be a straightforward and convenient way to keep track of various ongoing proceedings but it does not measure enforcement activity. The SEC sometimes joins several defendants in a single proceeding and at other times sues them individually.<sup>142</sup> It is not obvious when and why the SEC chooses to divide or to consolidate enforcement actions, and its practices are not consistent over time.<sup>143</sup>

Third, as explained above, an enforcement action is a legal proceeding initiated by a complaint or an order instituting proceedings, and identified by a docket number. Many of the SEC's enforcement actions are lawsuits in district court or administrative actions seeking to establish that the defendant violated securities laws, and to impose sanctions for violations, including monetary penalties, injunctions, and cease-and-desist orders. In this Article, I dub these *primary* enforcement actions. In addition, the SEC files so-called follow-on enforcement actions in administrative proceeding seeking to impose a partial or full associational bar against an offender, to suspend or revoke registration as broker-dealer or investment adviser, or to suspend the right of an auditor or attorney to practice before the Commission. All follow-on actions are *derivative*: they are ordinarily based on an injunction that the SEC imposed in a primary enforcement action against the same offender based on the same set of facts. In all follow-on proceedings, either the defendant already settled an SEC enforcement action (or lost in court or before the administrative law judge), was convicted, or was sanctioned by another federal agency or state securities regulator. None of the follow-on cases are *new* enforcement actions and all have already been counted at least once in the SEC's enforcement tally, or that

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139. The three statistics are not comparable. Nowhere in its annual reports does the SEC explain or report how many investigations yielded at least one enforcement action.

140. The SEC reports the number of investigations and formal investigations initiated during each fiscal year, but does not report how many formal investigations result in enforcement actions. See e.g., SELECT SEC AND MARKET DATA: FISCAL 2014, at 21, available at <http://www.sec.gov/about/secstats2014.pdf>.

141. Cf. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 27, at 3-8.

142. Cf. Coffee, *supra* note 17, at 270 (noting that the SEC "typically pursues multiple individuals in each enforcement action").

143. See discussion *infra* in Part III.B.1.

of another agency.<sup>144</sup> Many have been counted twice, often in the same fiscal year. Some have been counted three or more times.<sup>145</sup>

For example, in May 2013, the SEC brought a civil action against Robert A. Gist for operating as a broker-dealer without registration, and for defrauding his customers of at least \$5.4 million.<sup>146</sup> Shortly thereafter, the SEC brought two separate follow-on enforcement actions against Gist, one imposing a full associational bar and another suspending him from appearing or practicing before the Commission as attorney.<sup>147</sup> All three enforcement actions were included in the fiscal 2013 tally. The contribution of follow-on cases to the overall enforcement tally is not trivial: each year since 2002, the SEC has brought between 150 and 250 follow-on enforcement actions, boosting the overall number of enforcement actions by between 23% and 34%. Like contempt proceedings,<sup>148</sup> follow-on cases that prevent rogue brokers and investment advisers from managing other people's money are important and should be reported, but separately. But it is misleading to include follow-on cases in a statistic that purports to measure new enforcement activity.<sup>149</sup>

Fourth, the SEC brings enforcement actions in district court and before in-house administrative law judges. In many cases, the agency can choose the forum.<sup>150</sup> But not always: the SEC can seek a cease-and-desist order only in an administrative proceeding and an injunction in district court only; it can obtain an asset freeze in district court only, and can sue a broker-dealer for failing to supervise an employee in an administrative proceeding only. As a result, the

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144. A large majority of follow-on cases are triggered and/or accompanied by a primary SEC enforcement action. Only a handful of follow-on cases are based on a prior criminal conviction or bar imposed by state securities regulators, without an accompanying SEC primary enforcement action. For example, in fiscal 2010, the SEC brought 223 follow-on enforcement actions and 8 secondary enforcement actions seeking cease-and-desist orders. Of those, only 14 (6.1%) were not accompanied by a primary SEC enforcement action against the same defendant for the same violation, and thus already counted at least once in the SEC enforcement tally.

In fiscal 2014, the number of follow-on cases not accompanied by a primary SEC enforcement action declined. Of 248 follow-on enforcement actions, 83 (33.5%) were not previously included in the SEC enforcement tally: 71 follow-on enforcement actions were triggered by criminal convictions without an accompanying primary SEC enforcement actions and 12 follow-on enforcement actions were triggered by actions of the CFTC or state banking and securities regulators.

145. In 2013 alone, the SEC brought three separate enforcement actions for the same violation against James S. Quay and two follow-on cases against Kenneth Ira Starr, whom the SEC first sued for the violation in 2010.

146. U.S. Sec. & Exch. Comm'n, SEC Charges Atlanta Attorney with Converting Investor Funds, <https://www.sec.gov/litigation/litreleases/2013/lr22710.htm>.

147. Robert A. Gist, Esq., Exchange Act Release No. 70,243, 2013 WL 4,447,054 (Aug. 21, 2013), Robert A. Gist, Exchange Act Release No. 69,729, 2013 WL 9,936,062 (June 11, 2013).

148. See discussion *supra* at note 135.

149. A handful of convictions listed as a reason for the permanent bar imposed in fiscal year 2014 were entered in 2008 and 2009. It is admirable for the SEC to keep up with convicted criminals. It also shows just how silly is to measure the performance of the SEC's enforcement division by counting how many legal proceedings it initiated in a given year.

150. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P, 124 Stat. 1376, 1862-65 (2010) (codified at 15 U.S.C. § 77h-1(g)).

SEC must sometimes bring two enforcement actions against the same defendant for the same violation to obtain the full relief it seeks, one in district court and one before the ALJ. The remedies the SEC seeks in different fora are important yet, like with follow-on cases, that alone does not imply that counting enforcement actions is an accurate measure of enforcement activity. Secondary enforcement actions—filed simultaneously against the same defendant for the same misconduct in court and before the ALJ—are rarer than follow-on enforcement actions. Between 2000 and 2014, the SEC brought between 2 and 11 secondary enforcement actions per fiscal year.<sup>151</sup>

And finally, the SEC counts every enforcement action filed, including where the first proceeding is discontinued for failure to serve the complaint and a new legal proceeding is subsequently initiated against the same defendant based on the same set of facts.<sup>152</sup> The SEC sometimes brings an enforcement action before the ALJ after moving to dismiss a civil action against the same defendants for the same violation, and counts both in the enforcement action tally.<sup>153</sup> Such cases are quite rare and alone would not significantly bias enforcement statistics. But they are a manifestation of the same reporting problem.

If measured by the number of filed enforcement actions, the SEC's enforcement activity increased between 2000 and 2014 by 50%, from 503 to 755, and peaked in 2014. However, once follow-on and secondary enforcement actions are excluded from the count, enforcement actions increased from 388 in fiscal year 2000 to 507 in FY 2014—still a considerable 31% increase. But, enforcement actions did not peak in 2014, as suggested by the SEC's preferred statistic,<sup>154</sup> but in 2009, when the SEC brought 510 new enforcement actions. If contempt proceedings and delinquent filing cases also are removed from the enforcement action count,<sup>155</sup> then SEC enforcement has not increased since 2002, as shown in Figure 2.

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151. The SEC brought 10 secondary enforcement actions in 2000, 11 in 2010, 3 in 2011, 2 in 2012 and 3 in 2013.

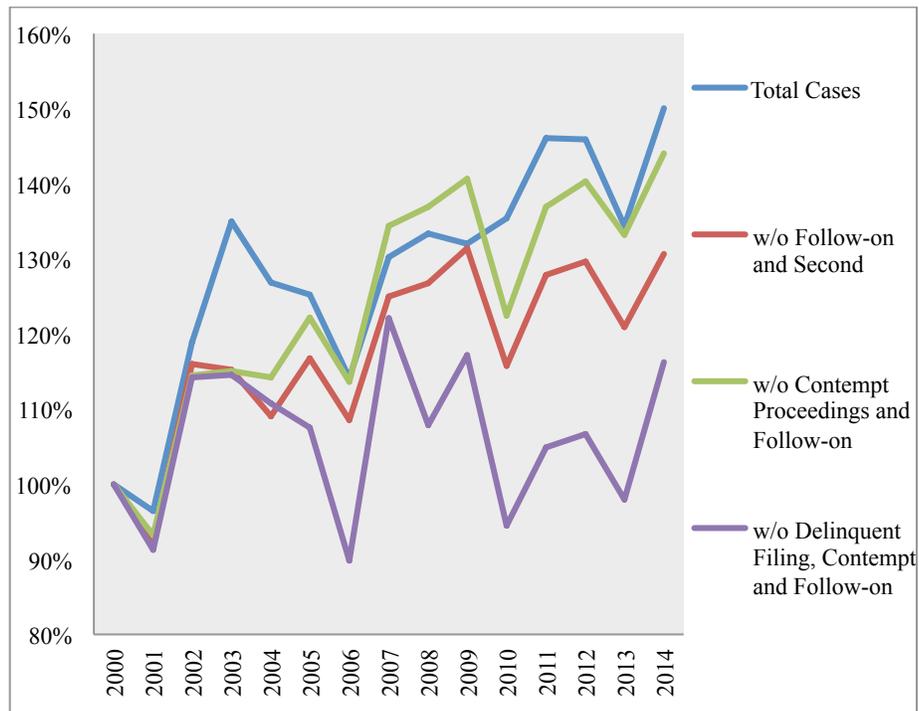
152. *See e.g.*, Christine M. Zamorsky et al., Administrative Proceedings Rulings Release No. 653 (June 4, 2010), <http://www.sec.gov/alj/aljorders/2010/ap653bpm.pdf> (discontinuing the proceeding as to Jeffrey M. Zamorsky for failure to serve); Jeffrey M. Zamorsky, Exchange Act Release No. 62,938 (Sept. 20, 2010), <https://www.sec.gov/litigation/admin/2010/34-62938.pdf> (re-filing the action against Jeffrey M. Zamorsky); SELECT SEC AND MARKET DATA FISCAL 2013, at 16, 18 (including both actions in the fiscal 2013 tally).

153. *See* U.S. Sec. & Exch. Comm'n, Litigation Release No. 17,302, Jan. 10, 2002, <https://www.sec.gov/litigation/litreleases/lr17302.htm> (reporting that the SEC dismissed the civil action it brought against an investment adviser and its manager and settled an administrative cease-and-desist that "alleged the same conduct").

154. *See also* 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> (citing a retiring SEC enforcement employee for the proposition that the SEC's enforcement division is obsessed with measuring its performance by the number of cases it brings).

155. *See* discussion *infra* in Part III.A.2.

FIGURE 2: SEC ENFORCEMENT ACTIONS AS PERCENTAGE OF THE 2000 BASELINE (2000–14)<sup>156</sup>



That, by itself, is not problematic. Misconduct rates change over time, declining in normal times and peaking during and immediately after investment booms.<sup>157</sup> If enforcement resources are kept more or less constant, one would not expect the number of serious enforcement actions to continue to increase year after year. What is problematic, however, is that SEC leadership continues to highlight the number of filed enforcement actions as the single more important statistic measuring its enforcement activity.

## 2. Including Contempt Proceedings and Delinquent Filing Cases

The SEC's enforcement activity varies over time, depending on the violations that occur, detection, and prosecution. Most enforcement actions involve misconduct that clearly deserves punishment. Two reported categories that the SEC includes in its enforcement statistics are different from the rest: contempt proceedings and delinquent filing cases.

156. For the raw data, see Table 2 in the Appendix.

157. See e.g., Paul Povel, Rajdeep Singh & Andrew Winton, *Booms, Busts, and Fraud*, 29 REV. FIN. STUD. 1219, 1222 (2007) (showing that fraud can prolong and exacerbate investment booms, leading to more painful busts); Wang & Winton, *supra* note 83.

The SEC brings contempt proceedings against defendants who do not comply with prior SEC enforcement orders. For example, the Commission targets accountants who audit SEC-registered broker-dealers despite being permanently barred from appearing or practicing before the Commission.<sup>158</sup> It sues defendants who fail to pay fines and disgorgements.<sup>159</sup> Contempt orders prosecute violations of remedial orders, not violations of securities laws. Contempt proceedings are, by definition, derivative. They presumably increase compliance with SEC and court orders, and boost the deterrent effect of securities enforcement. There is no doubt that the SEC should aggressively pursue defendants who violate its orders, and should report the number of contempt proceedings filed, but separately. Contempt proceedings do not belong in a statistic designed to measure how many *unique* securities violations the SEC prosecutes and how many *new* cases it brings each year. The SEC finally removed contempt proceedings from its count of enforcement actions in 2013, but reported enforcement figures for the earlier fiscal years remain inflated.<sup>160</sup>

By contrast, enforcement actions brought for delinquent filings are usually not derivative; they are new enforcement proceedings for never-before prosecuted violations of securities laws. Firms whose securities trade on the stock exchanges or in the over-the-counter market must file quarterly and annual reports with the SEC on forms 10-Q and 10-K.<sup>161</sup> If a publicly traded firm fails to file mandatory periodic reports, the SEC has the power to revoke registration of the firm's common stock and other securities.<sup>162</sup> Doing so is important because such companies' stock is often used in pump-and-dump and other schemes, and thus poses real risk to investors as long as the securities trade publicly.<sup>163</sup>

But, delinquent filing cases are very different from other primary enforcement actions.<sup>164</sup> First, delinquent filing is a strict liability offense: no

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158. See U.S. Sec. & Exch. Comm'n, SEC Seeks Contempt Finding Against Certified Public Accountant Joseph S. Amundsen, Litigation Release No. 22,150 (Nov. 10, 2011), <https://www.sec.gov/litigation/litreleases/2011/lr22150.htm>

159. See U.S. Sec. & Exch. Comm'n, Court Finds Bay Area Hedge Fund Manager in Civil Contempt for Failing to Pay More than \$12 Million in Disgorgement to Defrauded Investors, Litigation Release No. 22,397 (June 25, 2012), <https://www.sec.gov/litigation/litreleases/2012/lr22397.htm>.

160. Between 2000 and 2012, the SEC filed enforcement actions in between 9 and 47 contempt proceedings, representing between 1.2% (in 2012) and 7.9% (in 2002) of enforcement actions.

161. See 15 U.S.C. § 78m(a).

162. See 15 U.S.C. §§ 78l(j).

163. See Greg Farrell, *SEC Enforcement Activity Lags*, USA TODAY, Aug. 21, 2006, at B6 (reporting an increase in delinquent filing cases and noting that such actions require less work than accounting fraud investigations).

164. See U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 27, at 22 (citing enforcement staff's concerns about giving delinquent filing cases equal weight as "enforcement cases involving significant violations of market practices").

mens rea is necessary.<sup>165</sup> In fact, if the SEC has evidence of false disclosure, it seeks a different remedy, either a stop order or accounting fraud charges.<sup>166</sup> By contrast, most other enforcement actions require the SEC to show at least negligence and many require a showing of scienter.<sup>167</sup> To be fair, the Commission has brought a considerable number of enforcement actions for strict liability violations in fiscal years 2013 and 2014, but that is not the norm in securities enforcement.<sup>168</sup>

Second, when a firm fails to file periodic reports, the SEC first suspends trading and then revokes registration of its common stock. In delinquent filing cases, the SEC never imposes sanctions that are common other primary enforcement actions, such as those for insider trading, accounting fraud or investment adviser violations. It never orders a company to pay monetary penalties, obtains an injunction or a cease-and-desist order, or orders that a corporate monitor be appointed.

And third and finally, delinquent filing cases are ordinarily decided by default (more than two-thirds of the cases are decided by default, and in many years, 80% of delinquent filing cases are decided by default). Firms, usually empty shells anyway, fail to respond to the SEC's order instituting proceedings and an order of default is entered. By contrast, defendants charged with other types of securities misconduct, from market manipulation to insider trading, routinely fight the charges; default judgments are relatively rare. For example, of 1152 defendants targeted in enforcement actions filed during the 2009 fiscal year (not including delinquent filing cases and contempt proceedings), 98 defendants (8.5%) failed to file a responsive pleading, and the SEC obtained a default judgment. In fiscal year 2010, 110 defendants (10.5%) of 1051 charged<sup>169</sup> defaulted.

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165. See 15 U.S.C. § 78l(j) (The Commission is authorized . . . to revoke the registration of a security, if the Commission finds . . . that the issuer[] of such security has failed to comply with any provision of this chapter. . .”).

166. See e.g., Shopeye Inc., Initial Decision Release No. 615 (June 16, 2014), available at <https://www.sec.gov/aljdec/2014/id615cff.pdf> (issuing a stop order against a company that made false statements in its registration statement); Registration Statement of Mobile Vault, Inc., Securities Act Release No. 9576 (Apr. 22, 2014), available at <https://www.sec.gov/litigation/stoporders/2014/33-9576.pdf> (same).

167. See e.g., Latour Trading LLC & Nicolas Niquet, Exchange Act Release No. 73,125, at 13 (Sept. 17, 2014), available at <https://www.sec.gov/litigation/admin/2014/34-73125.pdf> (finding that defendant Latour willfully violated securities laws). In the recent years, the SEC has ramped up enforcement of strict liability offences, such as Rule 105 of Regulation M and Section 16(a) of the Securities Exchange Act.

168. See discussion *infra* in Part IV.D.

169. The figure does not include delinquent filing cases (596 defendants), contempt proceedings (26 defendants) and relief defendants (151 defendants). Including those, the SEC prosecuted 1817 defendants in 2010. See SELECT SEC AND MARKET DATA FISCAL 2010, at 3, available at <http://www.sec.gov/about/secstats2010.pdf>.

FIGURE 3: UNIQUE SEC ENFORCEMENT ACTIONS (2000–14) (NOT INCL. FOLLOW-ON CASES)

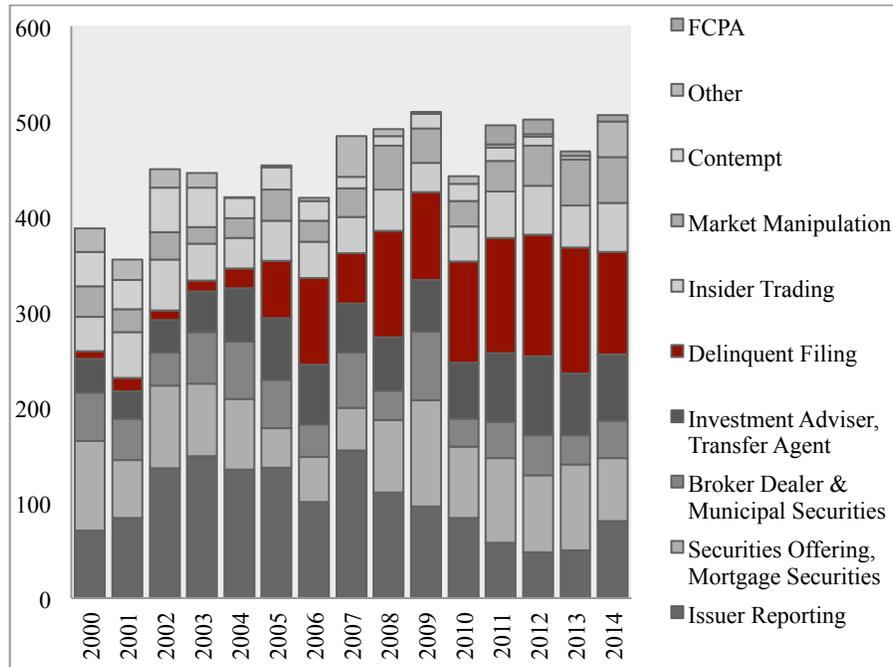
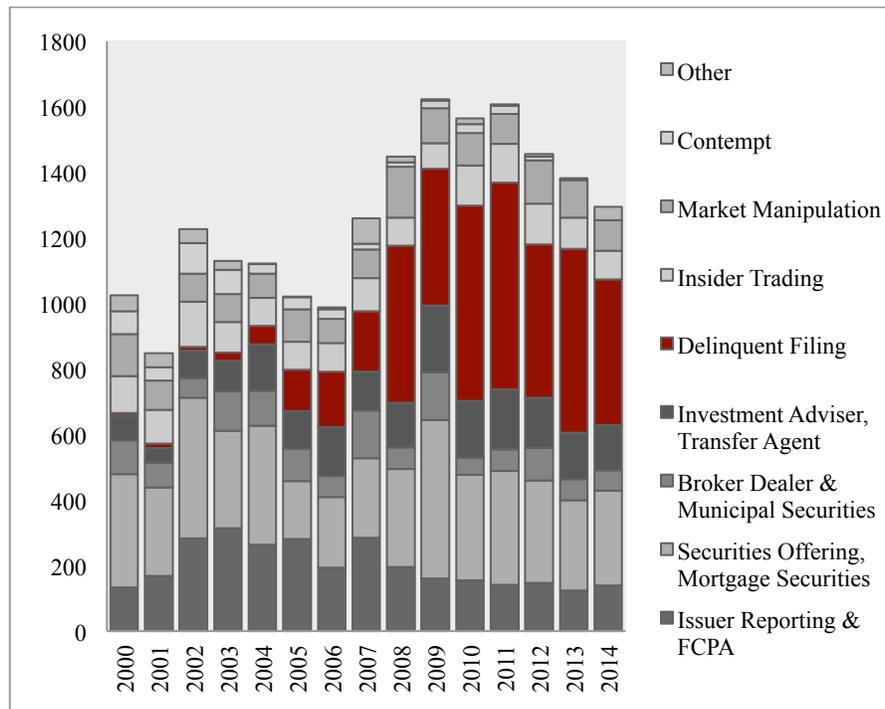


FIGURE 3B: UNIQUE DEFENDANTS IN SEC ENFORCEMENT ACTIONS (2000–14)  
(NOT INCL. FOLLOW-ON CASES)



That the SEC includes easy-to-bring delinquent filing cases in the enforcement count would not be significant if their number had not ballooned in recent years as shown in Figures 3A and 3B. The SEC used to bring ten or so delinquent filing cases against ten or so defendants each fiscal year. Since 2005, it has filed more than 50 enforcement actions per year, and since 2010 it has brought more than 100 delinquent filing enforcement actions against 500 or more defendants per year.<sup>170</sup> Since 2005, when the SEC began seriously policing delinquent filing, it has revoked the registration of 4,075 publicly traded firms. The share of delinquent filing cases has increased from 2% of the total number of enforcement actions (1.8% of defendants) in fiscal 2003 to 20% (35% of all defendants) in fiscal 2013.<sup>171</sup> Since 2004, the total numbers of enforcement actions and defendants targeted have increased by about one hundred, less than the increase in the number of delinquent filing cases. As a result, the number of enforcement actions requiring a showing of a guilty or at

170. See e.g., SELECT SEC AND MARKET DATA FISCAL 2013, at 3 (reporting 132 delinquent filing cases against 560 defendants).

171. Excluding follow-on and secondary cases, delinquent filing cases were 28% of primary enforcement actions and 41% of defendants in 2013.

least negligent mind has declined.<sup>172</sup> Yet the statistics on enforcement activity and defendant counts that the SEC reports to Congress obscure this potentially significant trend.

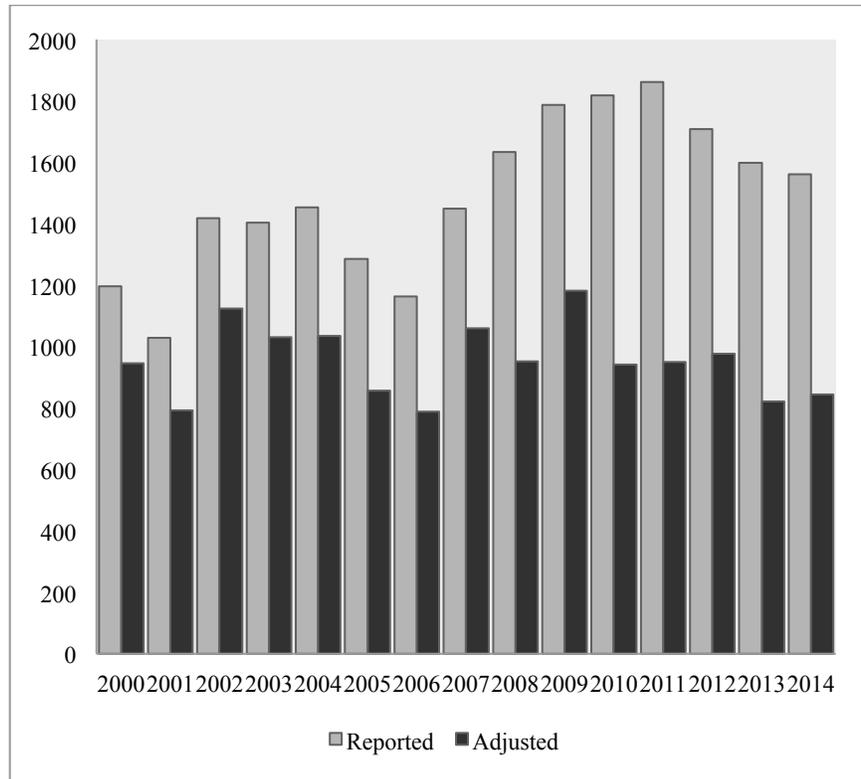
### 3. Counting Defendants

The SEC reports the number of defendants in addition to reporting the number of enforcement actions. Reporting the number of discrete individuals and firms investigated and prosecuted for securities violations could mitigate considerably the measurement bias introduced by the way in which the SEC counts enforcement actions. Unfortunately, when the SEC counts defendants, it does not count discrete individuals and firms that it targets. Rather, it counts up the parties named in enforcement actions filed and reports them as defendants targeted. For example, Robert A. Gist, whom the SEC targeted in 2014 in one primary and two follow-on enforcement actions arising from the same violation, was counted in the 2014 tally of defendants three times, instead of only once. As a result, just as the Commission counts follow-on and secondary cases more than once, it also counts defendants identified in such cases two or three times. Between 150 and 300 defendants each year are counted more than once due to follow-on and secondary enforcement.

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<sup>172</sup> *Cf.* Burns & Scannell, *supra* note 23, at C3 (reporting that the increase in delinquent filing enforcement actions “conceal[s] a steep decline in enforcement cases”).

FIGURE 4: DEFENDANTS IN SEC ENFORCEMENT ACTIONS (2000–14)



\* Adjusted: *discrete* defendants in SEC enforcement actions not including follow-on and secondary cases, Delinquent Filing and Contempt Proceedings.

In addition, the SEC reports as defendants not only those violating securities laws but also relief defendants: individuals and entities who are not charged with securities violations. Rather, they are named as relief or nominal defendants because they received property that was originally obtained illegally and to which they have no legitimate claim.<sup>173</sup> While it is true that relief defendants tend to fight SEC's charges much in the same way as primary defendants, requiring the SEC to expend its limited enforcement resources, non-culpable individuals are, by definition, not securities violators that the SEC punishes.

If the number of relief defendants remained stable over time, including them in the count would merely overstate the true number of securities violators targeted in SEC enforcement. But the number is not stable. Unlike

173. See *Sec. & Exch. Comm'n v. Collelo*, 139 F.3d 674, 677 (9th Cir., Mar. 18, 1998) (explaining that a "nominal defendant" is someone who "has received ill gotten funds and that he does not have a legitimate claim to those funds").

“real” defendants, whose assets are often frozen when the SEC brings a significant enforcement action, the SEC cannot freeze relief defendants’ assets. As a result, it usually pursues relief defendants only when the primary defendant is judgment proof and the amount that the relief defendant received is large.<sup>174</sup> This is very common in Ponzi schemes and offering frauds, and much less common in accounting fraud and insider trading cases. The number of relief defendants thus varies considerably from year to year, depending largely on the number of offering frauds and Ponzi schemes prosecuted.<sup>175</sup> In 2009, the fiscal year in which Madoff’s Ponzi scheme came to light, the SEC prosecuted a record number of similar schemes. It also prosecuted 192 relief defendants (10.7% of all defendants). By contrast, in fiscal 2013, the SEC went after 53 relief defendants (3.3% of the total).

#### 4. Aggregate Monetary Penalties

The second most significant and widely reported statistic, after the number of enforcement actions filed, is the amount of monetary penalties ordered by the SEC. Monetary penalties as reported are less problematic than the enforcement action count,<sup>176</sup> but still require three adjustments to be valid. First, it is not unusual for the SEC to prosecute a defendant concurrently with criminal authorities. The U.S. Attorney’s Office usually intervenes in the parallel SEC’s civil proceeding and requests a stay, but not always. In a non-negligible number of cases, the SEC orders a defendant to pay disgorgement, agreeing to credit dollar-for-dollar any amount that the defendant is ordered to pay as restitution in a criminal case. In addition, the SEC sometimes includes a civil fine ordered by another enforcement agency or one of the exchanges in its enforcement order. If one were to report aggregate monetary penalties imposed by various enforcement agencies, such fines and disgorgements would be counted twice: once in the SEC’s tally and for the second time in the tally reported by the U.S. Department of Justice, FINRA, or the exchanges. The amounts involved are routinely in the millions.

Second, the SEC also includes in its aggregate tally monetary penalties ordered but waived either due to defendant’s inability to pay or in light of criminal penalties imposed. A defendant punished with a decade or longer prison sentence is usually unable to pay anyway. But such penalties should generally not be included in reported aggregate monetary penalties.

Finally, and less problematically, the SEC reports monetary penalties ordered, not collected. Of \$4.17 billion in ordered monetary penalties in fiscal 2014, the SEC has been able to collect \$2.1 billion, or just about half of the

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174. “We don’t charge relief defendants in every case. It’s probably more the exception to the rule.” *Proceedings of the 2007 Midwest Securities Law Institute Symposium*, 8 J. BUS. & SEC. L. 59, 96 (2007).

175. *See id.* at 95. In 2014, the SEC sued 71 relief defendants. Of that 59 were sued in connection with offering fraud or Ponzi schemes.

176. In fact, because of the challenges involved in cross-country comparisons of enforcement actions, one commentator proposed to focus on monetary penalties instead. *See Coffee, supra* note 17, at 270.

amount ordered.<sup>177</sup> The aggregate amount collected is still higher than in any prior year except for 2005, but it is considerably smaller than the amount ordered. The SEC's ability to collect fines depends on whether defendants it targets are solvent or not.<sup>178</sup> The J.P. Morgans of the world pay the entire monetary penalty ordered, while Ponzi schemers like Allan Stanford cannot and do not. Focusing too much on collections could skew the SEC's enforcement effort towards solvent defendants, at the expense of pursuing penny stock frauds, pyramid schemes, and the like. But the way that the Commission presents its statistics makes it very easy for even informed researchers to miss that the SEC collects far less than it orders.<sup>179</sup> For example, the SEC uses the terms "secured"<sup>180</sup> or "obtained"<sup>181</sup> when describing monetary penalties, implying that the amounts were collected, not merely that such orders were imposed.

### B. Problem 2: Reliability

A reliable measure is one that is consistent, producing similar results under consistent conditions. For example, tracking the venue in which the SEC brings an enforcement action—district court or the administrative forum—tells us something meaningful about litigation choices and can be reported reliably: one only needs to record where the action was filed which the SEC reports unambiguously. A measure can be reliable but not valid: the variable "enforcement action" discussed above measures consistently the number of initiated proceedings, but because those include many follow-on and secondary cases against the same defendant for the same misconduct, it does not measure what we want to measure: new securities enforcement activity. However, a measure that is not reliable cannot be valid.

A measure is not reliable when it cannot be reproduced consistently.<sup>182</sup> As noted in the previous section, when reporting its enforcement output, the SEC counts the number of legal proceedings brought. It can increase the number by filing separate complaints against multiple defendants charged with the same violation based on the same set of facts when it could file a single complaint, contrary to its established practice. Also, the SEC categorizes enforcement actions by primary subject matter. Classification is within the discretion of the

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177. See SEC, 2014 ANNUAL REPORT, *supra* note 60, at 43.

178. See *id.* at 43 Performance Indicator 2.3.5. (explaining why the SEC orders defendants to pay monetary penalties that it knows that they cannot pay).

179. For example, in fiscal year 2011, the SEC ordered \$2.8 billion in monetary penalties and collected about half, \$1.5 billion. Yet an article published in the *Harvard Law Review* in 2014 reports the higher figure as the amount that the SEC recovered, not the lower, correct figure. See Margaret H. Lemos & Max Minzner, *For-Profit Public Enforcement*, 127 HARV. L. REV. 853, 855 (2014) (noting that the SEC reported "total recoveries of \$2.8 billion") (emphasis added).

180. U.S. Sec. & Exch. Comm'n, FY 2011 Performance and Accountability Report 192 (2012), <http://www.sec.gov/about/secpar/secpar2011.pdf#2011review>.

181. U.S. SEC. & EXCH. COMM'N, IN BRIEF: FY 2013 CONGRESSIONAL JUSTIFICATION 1 (2012), available at <http://www.sec.gov/about/secfy13congbudgjust.pdf>.

182. See CARMINES & ZELLER, *supra* note 137, at 12 (describing a measure as reliable when repeated measures, or classifications, yield the same result).

enforcement staff, who sometimes feel pressure from leadership to prefer one category over another. Because classification is inconsistent from year to year, reliability suffers.

### 1. Slicing and Dicing

Litigated cases are nearly automatically consolidated to preserve resources. In securities litigation, plaintiffs ordinarily file two, three, or more complaints in different courts.<sup>183</sup> The cases are ultimately consolidated and defendants—the fraud firm, its auditor, sometimes officers or directors—settle a single case and pay damages into a single pot. Because virtually all securities class actions are consolidated, reporting the number of filed securities class actions provides a useful and reliable metric to track securities litigation over time.<sup>184</sup>

This is not the case with SEC enforcement. Like securities litigation, the vast majority of SEC cases are settled. But unlike private suits, which are never settled at the time they are filed, many of the SEC's cases are. In fiscal 2009, for example, the SEC sued 1152 defendants.<sup>185</sup> Of those, 462 (40.1%) settled at the time that the legal proceeding was initiated. Of 1050 defendants sued in fiscal year 2010, 483 (46.0%) settled with the SEC before the enforcement action was filed.

When the SEC litigates cases, it has the same incentive as every other litigant: consolidate to the extent possible to preserve resources.<sup>186</sup> By contrast, when the SEC brings a settled enforcement action, the cost pressure to consolidate disappears. Since the SEC counts legal proceedings filed, and not investigations that yield at least one enforcement action, it has an incentive to file multiple settled actions where it could file one to increase the number of enforcement actions filed. For example, in a coordinated action with the Public Company Accounting Oversight Board (“PCAOB”) against an audit firm, the PCAOB brought a single action against the audit firm and two of its partners.<sup>187</sup> By contrast, the SEC brought three separate settled enforcement actions: against the firm and each of the partners.<sup>188</sup> Similarly, in December 2005 the

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183. Cf. Adam B. Badawi & David H. Webber, *Deal Litigation, Law Firm Quality, and Firm Value*, 41 J. CORP. L. \_ (2016) (forthcoming) (reporting that 2.8 complaints are filed on average in each class action targeting acquisitions).

184. See e.g., CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2014 YEAR IN REVIEW 4 (2015), available at <https://www.cornerstone.com/GetAttachment/52bfaa16-ff84-43b9-b7e7-8b2c7ab6df43/Securities-Class-Action-Filings-2014-Year-in-Review.pdf> (reporting the number of cases filed annually as a measure of litigation activity).

185. The count does not include contempt proceedings and delinquent filing cases and only includes defendants charged with securities violations, not relief defendants.

186. See e.g., Thomas Y. Jimenez, Exchange Act Release No. 65,466, Accounting and Auditing Enforcement Release No. 3325 (Oct. 3, 2011), <https://www.sec.gov/litigation/admin/2011/34-65466.pdf> (explaining that GlobeTel case in 2008 consolidated into an earlier 2007 case).

187. See Chisholm, Bierwolf, Nilson & Morrill, LLC, Todd D. Chisholm, CPA & Troy F. Nilson, CPA (Apr. 8, 2011), PCAOB Release No. 115-2011-003, available at <http://pcaobus.org/Enforcement/Decisions/Documents/Chisholm.pdf>.

188. See Chisholm, Bierwolf, Nilson & Morrill, LLC, Exchange Act Release No. 64,280, Accounting and Auditing Enforcement Release No. 3267 (Apr. 8, 2011),

SEC completed its investigation into campaign contributions and subsequent participation in municipal bond offerings. Executives of CIBC World Markets Corporation made contributions for California Governor Gray Davis' re-election bid. The rules barred CIBC from participating in municipal offerings for two years, but CIBC served as underwriter in several offerings. The firm and three individuals, all employees of CIBC, settled before the SEC initiated formal legal proceedings. The SEC could have brought one enforcement action but brought four instead, one against each participant in the scheme.<sup>189</sup>

I do not want to suggest that the SEC files multiple enforcement actions in order to improve its end-of-the year numbers. There is no evidence that the SEC brings separate cases opportunistically, merely that it does so without a good explanation why. More often than not, the SEC files separate actions because some of the defendants have settled while the others have not. There are several examples in the fiscal year 2014 alone. In its case for accounting manipulation at the Regions Financial Corporation, the SEC's investigation targeted the firm and three individuals. Regions Financial Corporation entered into a deferred prosecution agreement that was not reported as an enforcement action.<sup>190</sup> Two of three individual defendants settled, while the third fought the charges. The SEC brought two separate enforcement actions,<sup>191</sup> closed the one against settling defendants quickly while the second is still ongoing, and reported two enforcement actions in its annual enforcement report.<sup>192</sup> The Commission did something very similar following its investigations into accounting fraud at QSGI Inc.<sup>193</sup> and Natural Blue Resources.<sup>194</sup>

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<https://www.sec.gov/litigation/admin/2011/34-64280.pdf>; Todd D. Chisholm, CPA, Exchange Act Release No. 64,279, Accounting and Auditing Enforcement Release No. 3266 (Apr. 8, 2011) <https://www.sec.gov/litigation/admin/2011/34-64279.pdf>; Troy F. Nilson, CPA, Exchange Act Release No. 64,277, Accounting and Auditing Enforcement Release No. 3264 (Apr. 8, 2011), <https://www.sec.gov/litigation/admin/2011/34-64287.pdf>.

189. CIBC World Markets Corp., Exchange Act Release No. 52,942 (Dec. 12, 2005), *available at* <https://www.sec.gov/litigation/admin/34-52942.pdf>; Paul D. Rogers, Exchange Act Release No. 52,941 (Dec. 12, 2005), *available at* <https://www.sec.gov/litigation/admin/34-52941.pdf>; Peter J. Crowley, Exchange Act Release No. 52,943 (Dec. 12, 2005), *available at* <https://www.sec.gov/litigation/admin/34-52943.pdf>; Robert J. Dentice, Exchange Act Release No. 52,944 (Dec. 12, 2005), *available at* <https://www.sec.gov/litigation/admin/34-52944.pdf>.

190. U.S. Sec. & Exch. Comm'n, Deferred Prosecution Agreement, <http://www.sec.gov/news/press/2014/2014-125-dpa.pdf>.

191. See Jeffrey C. Kuehr & Michael J. Willoughby, Securities Act Release No. 9606, Exchange Act Release No. 72,471 (June 25, 2014), *available at* <https://www.sec.gov/litigation/admin/2014/33-9606.pdf>; Thomas A. Neely, Jr., Securities Act Release No. 9605, Exchange Act Release No. 72,470 (June 25, 2014), *available at* <https://www.sec.gov/litigation/admin/2014/33-9605.pdf>.

192. See U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA FISCAL 2014, at 15.

193. See Edward L. Cummings, Exchange Act Release No. 72,722, Accounting and Auditing Enforcement Release No. 3572 (July 30, 2014), *available at* <https://www.sec.gov/litigation/admin/2014/34-72722.pdf> (settling with the SEC); Marc Sherman, Exchange Act Release No. 72,723, Accounting and Auditing Enforcement Release No. 3573 (July 30, 2014), *available at* <https://www.sec.gov/litigation/admin/2014/34-72723.pdf> (opposing the SEC's charges).

In addition, at least sometimes the SEC conducts one investigation but files multiple enforcement actions based on the same set of facts because of a statutory directive.<sup>195</sup> In 2014 the SEC investigated John Briner's scheme in which he set up twenty mining companies and filed registration statements offering stock to public investors. The statements contained falsities and failed to disclose that Briner, a recidivist, was promoting the offerings.<sup>196</sup> Based on one investigation, SEC initiated twenty separate administrative stop-order proceedings and reported them as twenty enforcement actions.<sup>197</sup>

Even if the SEC rarely slices and dices investigations into many enforcement actions opportunistically, which would clearly render the measure unreliable, it is still problematic to use the number of enforcement actions to measure performance of the enforcement division if the count depends on the defendants' willingness to settle and other extraneous factors unrelated to the underlying enforcement effort.<sup>198</sup>

## 2. Inconsistent Classification

In addition to reporting the aggregate number of enforcement actions, the SEC also reports in its annual report the primary subject matter for each action. The SEC's subject matter classification is exceptionally useful for studying enforcement trends in a subset of offenses, such as insider trading or accounting fraud. The SEC regularly includes aggregate figures on the number of actions brought in various categories in reports and congressional testimony as evidence of vigorous activity.<sup>199</sup>

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194. See Eric H. Perry, Securities Act Release No. 9615, Exchange Act Release No. 72,618 (July 16, 2014), *available at* <https://www.sec.gov/litigation/admin/2014/33-9615.pdf> (settling at the time of filing on both liability and monetary sanctions); Toney Anaya, Securities Act Release No. 9613, Exchange Act Release No. 72,616 (July 16, 2014), <https://www.sec.gov/litigation/admin/2014/33-9613.pdf> (settling at the time of filing on liability but deferring decision on monetary sanctions); Natural Blue Resources et al., Securities Act Release No. 9614, Exchange Act Release No. 72,617 (July 16, 2014), <https://www.sec.gov/litigation/admin/2014/33-9614.pdf> (instituting proceedings against defendants that contest liability).

195. Section 8(d) of the Securities Act sets out the requirement for initiating stop order proceedings, implying that the SEC must bring separate proceedings for each affected registration statement. 15 U.S.C. § 77h(d).

196. See Press Release, SEC Seeks Stop Orders Against 20 Purported Mining Companies With Misleading Registration Statements (Feb. 3, 2014), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540716442>.

197. See e.g., The Registration Statement of La Paz Mining Corp., Securities Act Release No. 9523 (Feb. 3, 2014), *available at* <https://www.sec.gov/litigation/admin/2014/33-9523.pdf>. While the SEC charged each defendant firm separately, it produced a single order suspending all twenty registration statements. See Initial Decision on Default, La Paz Mining Corp. et al., Initial Decision Release No. 580 (Mar. 20, 2014), *available at* <https://www.sec.gov/alj/aljdec/2014/id580bpm.pdf>.

198. See discussion *supra* in Part III.A.1.

199. See e.g., *supra* notes 15, 97. See also Mary L. Schapiro, Chair, Testimony Concerning SEC Oversight: Current State and Agenda, Before the United States House of Representatives Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government-

The problem is that the categories are overbroad and the lines between them not clearly delineated. For example, accounting frauds are nearly always classified as Issuer Reporting and Disclosure cases,<sup>200</sup> but not all Issuer Reporting and Disclosure cases are accounting frauds. A considerable number are follow-on and secondary proceedings, a problem described in more detail in Part III.A.1, which renders quick assessments of SEC enforcement by looking at the number of enforcement actions in each subject matter category largely useless.<sup>201</sup>

However, removing follow-on and secondary cases does not fix the problem with vagueness in subject-matter classification. Many cases that the SEC investigates could be classified in more than one category, but are reported in only one. For example, Bernard Madoff's Ponzi scheme was classified as a violation of rules pertaining to investment advisors. It was also violation of the rules pertaining of the offering of securities—many Ponzi schemes are classified as such—and a violation of rules regarding broker-dealers. This is a known challenge in SEC reporting and the Commission readily acknowledges it.<sup>202</sup> The SEC's primary concern with reporting only primary subject matter classification is that the SEC's reported figures *understate* the number of cases filed in a given subject area, such as insider trading.<sup>203</sup>

But the reported figures also *overstate* the number of enforcement actions filed in each category. The primary cause for inflated figures is duplicative counting of follow-on and secondary cases, discussed above. The secondary cause is the fact that subject matter classification is within the discretion of the enforcement staff. When an enforcement action can plausibly fit into more than one category, the staff can err on the side of classifying the action as a preferred category in one year and another category in a subsequent year.

For example, the Commission has traditionally classified all enforcement actions triggered by a company's failure to file periodic reports as "Delinquent Filing" cases.<sup>204</sup> In 2014, however, five such cases are classified as "Issuer Reporting and Disclosure" cases.<sup>205</sup> In addition, 27 enforcement actions

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Sponsored Enterprises, July 14, 2009, <http://www.sec.gov/news/testimony/2009/ts071409mls.htm>.

200. One exception are cases where investment managers overstate the value assets in their funds, an offense at core accounting fraud, but recorded as an Investment Adviser case.

201. See e.g., Eaglesham & Rapoport, *supra* note 5 (tracking enforcement actions for accounting fraud using the SEC's reported figures without adjustment).

202. See U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA FISCAL 2014, at 3.

203. See UNITED STATES OF AMERICA, *supra* note 17, at 186 n.349.

204. Classification errors occur. For example, in fiscal 2010, one delinquent filing case is classified under Investment Adviser category and another as Issuer Disclosure and Reporting violation.

205. See Jason S. Flemmons & Martin S. Wilczynski, *SEC Enforcement' Accounting Statistics for Fiscal 2014—Up or Down*, SECURITIES DOCKET (Jan. 21, 2015, 2:01 PM), <http://www.securitiesdocket.com/2015/01/21/sec-enforcements-accounting-statistics-for-fiscal-2014-up-or-down/> (reporting that the SEC classified 5 delinquent filing cases and issuer reporting cases).

brought in 2014 and classified as “Issuer Reporting and Disclosure” cases were stop order proceedings under Section 8(d) of the Securities Act.<sup>206</sup> In these cases the Commission sought to suspend the effectiveness of a registration statement that it believed included an untrue statement or omission of material fact. Issuers file registration statements when they seek to offer new securities to the public. And so, such cases should be classified as “Securities Offering” actions. By contrast, “Issuer Reporting and Disclosure” cases primarily involve accounting, auditing, and reporting issues in periodic reports that issuers are required to file, not fraud in offering documents.<sup>207</sup> In fact, in fiscal year 2013, the SEC classified a stop order under Section 8(d) as a “Securities Offering” case.<sup>208</sup>

These might seem like small misclassifications except that the SEC has celebrated the increase in Issuer Reporting and Disclosure cases prosecuted in 2014.<sup>209</sup> Once follow-on and secondary cases, and misclassified cases are removed from the tally, enforcement actions for accounting fraud have not increased in 2014 from prior year. Although classification inconsistencies are likely due to human error, they are problematic because they render the SEC’s reported figures unreliable for long-term study of enforcement trends. To obtain reliable results, one cannot use the SEC’s reported tables but must code all enforcement actions by hand.<sup>210</sup>

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206. *Id.*

207. *Id.*

208. See The Registration Statement of Counseling International, Inc., Securities Act Release No. 9444 (Aug. 22, 2013), available at <https://www.sec.gov/litigation/admin/2013/33-9444.pdf>; SELECT SEC AND MARKET DATA FISCAL 2013, at 17, available at <http://www.sec.gov/about/secstats2013.pdf>.

But back in 2002, the SEC classified two stop orders as “Issuer Reporting and Disclosure Cases.” SEC 2002 ANNUAL REPORT 151, 154, available at <http://www.sec.gov/about/annrep02.shtml>.

209. See Mary Jo White, Chair, Chairman’s Address at SEC Speaks 2015 (Feb. 20, 2015), <http://www.sec.gov/news/speech/2015-spch022015mjw.html> (highlighting the 40% increase in financial reporting cases in 2014); Andrew Ceresney, Director Div. of Enforcement, Testimony on “Oversight of the SEC’s Division of Enforcement” (Mar. 19, 2015), <http://www.sec.gov/news/testimony/031915-test.html#.VRPx7vnF-n8> (referencing a 40% increase in financial reporting and auditing enforcement actions in FY2014).

210. In addition, SEC reporting used to be more useful. The Commission used to produce a more detailed classification than it does now. Compare SEC 2002 ANNUAL REPORT 144 (breaking down enforcement actions into 18 different classifications) with SELECT SEC AND MARKET DATA FISCAL 2013, at 3 (reporting 10 classifications).

## IV. THE CONSEQUENCES OF REPORTING PROBLEMS

The SEC has used invalid and unreliable statistics in congressional reports and testimony, press releases, and public speeches to suggest an increase in activity, to calm wary investors and the general public after scandals, and to suggest a better use of resources. In turn, consumers of the SEC's statistics, including law firms and legal academics, have relied on them to identify enforcement trends in widely distributed client memoranda<sup>211</sup> and to offer policy prescriptions regarding securities enforcement.

The problems identified in Part III distort the SEC's reporting in a variety of ways. First and most obviously, they overstate the Commission's activity levels. The figures also obscure real problems and suggest the presence non-existent problems. Flawed statistics bleed into other aspects of SEC reporting when the Commission uses one statistic as a denominator to generate a new performance indicator, such as its success rate. Finally, not only do the used statistics fail to represent the SEC's true enforcement output, they also have the potential to distort its enforcement choices in favor of easier investigations for strict liability violations that are more likely to yield reportable "results."

*A. Overstatement*

The SEC's statistics regularly overstate its enforcement output: reporting follow-on and secondary cases in the enforcement action tally inflates the number of new cases filed, and overstates the number of individuals and firms targeted in SEC enforcement; so does including in the SEC's overall count monetary penalties imposed by other agencies or waived.

Overstating enforcement statistics is problematic because it suggests that SEC enforcement is more vigorous than it really is. It renders comparisons with other enforcement agencies that do not misreport in the same manner useless.

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211. See e.g., Shearman & Sterling LLP, SEC Enforcement Year in Review (Jan. 2014), available at <http://www.shearman.com/~media/Files/NewsInsights/Publications/2014/01/SECEnforcementYearinReview2013Litigation021114.pdf>; WilmerHale, A Memorandum from Bill McLucas (Mar. 9, 2015), available at [https://www.wilmerhale.com/uploadedFiles/Shared\\_Content/Editorial/Publications/Documents/review-of-sec-enforcement-developments-in-2014.pdf](https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/Documents/review-of-sec-enforcement-developments-in-2014.pdf); Ben A. Indek et al., Morgan Lewis & Bockius LLP, A Snapshot of 2012 SEC and FINRA Enforcement, LAW360.COM (Feb. 19, 2013, 3:48 PM), [http://www.morganlewis.com/~media/files/publication/outside%20publication/article/law360\\_snapshot2012secfinraenforcement\\_19feb13.ashx](http://www.morganlewis.com/~media/files/publication/outside%20publication/article/law360_snapshot2012secfinraenforcement_19feb13.ashx); David B. Bayless & Tammy Albarran, Covington & Burling LLP, The Changing Composition of SEC Enforcement Actions, Law360.com (Feb. 21, 2013, 1:17 PM), [https://www.cov.com/~media/files/corporate/publications/2013/02/the\\_changing\\_composition\\_of\\_sec\\_enforcement\\_actions.ashx](https://www.cov.com/~media/files/corporate/publications/2013/02/the_changing_composition_of_sec_enforcement_actions.ashx); Tracy Richelle High & Malaika R. Staten, New Trends in SEC Enforcement Activity, [http://www.sullcrom.com/siteFiles/Publications/PLI2015\\_New\\_Trends.pdf](http://www.sullcrom.com/siteFiles/Publications/PLI2015_New_Trends.pdf); David F. Marcus & Sara E. Gilley, *The Changing Nature of SEC Enforcement Actions*, LAW360.COM (Oct. 8, 2013, 11:48 AM), <https://www.cornerstone.com/GetAttachment/0f99342c-a62d-4a18-b889-9c0e2468ec8b/The-Changing-Nature-Of-SEC-Enforcement-Actions.pdf>; Sara Gilley et al., *SEC Focus on Administrative Proceedings: Midyear Checkup*, LAW360.COM (May 27, 2015, 10:25 AM), <https://www.cornerstone.com/GetAttachment/19bf7104-14c7-4656-9d52-1cfe561967ed/2015-Midyear-Checkup-on-SEC-Administrative-Proceedings.pdf>.

Overstatement in the numbers of enforcement actions and defendants is greater in subject-matter categories with a disproportionate share of follow-on and secondary cases, such as enforcement against broker dealers and investment advisers. Almost 60% of enforcement actions classified as Broker Dealer between 2000 and 2014 are follow-on actions; 40% of enforcement actions in Investment Adviser category are follow-on actions.<sup>212</sup> Inflated statistics thus suggest that the SEC is a much more serious enforcer in the financial industry than it really is.<sup>213</sup>

Despite known problems in enforcement statistics, high-ranking SEC employees routinely use them without acknowledgment that they might be overstated. For example, former SEC enforcement director Linda Chatman Thomsen testified before the U.S. Senate Committee on the Judiciary that between 2001 and 2006, the SEC brought over 300 enforcement actions (304) categorized as Insider Trading cases against well over 600 defendants (646).<sup>214</sup> But once the figures are adjusted for follow-on and duplicative cases, the total falls to 252 enforcement actions against 589 unique defendants. In fact, during her testimony, Ms. Thomsen suggested that the count she reported was *too low* because insider trading cases are sometimes categorized as Broker-Dealer cases.<sup>215</sup> The suggestion omits that all such cases were follow-on proceedings against broker-dealers who had already been fined for insider trading violations, and the primary enforcement actions for insider trading were already counted and included in the SEC's annual report.

### *B. Meaningless Trend Analysis*

The number of follow-on and secondary cases fluctuates over time.<sup>216</sup> As a result, not only does counting enforcement actions and defendants overstate the SEC's enforcement activity, it also renders trend analysis useless unless such cases are removed from the analysis.

Agencies are required by statute to report on trends related to their activities.<sup>217</sup> Moreover, there is considerable public interest in identifying trends and reading the tea leaves in enforcement. In the last decade, and in particular during the last five years, the SEC's press releases and reporting on SEC enforcement have relied heavily on reported enforcement statistics to

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212. Between 2011 and 2014, the relative shares of follow-on actions were 73% for Broker Dealer cases and 50% of Investment Adviser cases. See Tables 3A, 3B and 3C in the Appendix.

213. Even in the two enforcement categories where the SEC has been most active during the last decade and a half—Issuer Reporting and Disclosure (i.e., accounting fraud) and Securities Offering—follow-on cases represent 27-28% of all enforcement actions between 2000 and 2014 and thereby inflate the count by that percentage.

214. See Linda Chatman Thomsen, Testimony Concerning Insider Trading, Before the U.S. Senate Committee on the Judiciary, Sept. 26, 2006, <https://www.sec.gov/news/testimony/2006/ts092606lct.htm#18>.

215. See *id.* at note 18.

216. See Velikonja, *Politics in Securities Enforcement*, *supra* note 25, at [] fig. 2.

217. H.R. 2142 §3; 31 U.S.C. §§1121(a)(1), 1122(b)(6) (requiring the Director of OMB to report "overall trend data" in agency reports).

suggest an increase or a decline in the Commission's enforcement overall or in a subset of cases.<sup>218</sup>

For example, including the ever-growing number of delinquent filing cases in the number of enforcement actions filed obscures the fact that SEC enforcement for negligence and scienter-based securities violations has not increased since 2002. The analysis of enforcement actions brought in subject matter categories as reported by the SEC, such as insider trading or accounting fraud, is even more prone to biases. It is not rare that the SEC reports an underlying decline as improvement. For example, after Madoff's Ponzi scheme was uncovered during the 2009 fiscal year, the SEC reportedly ramped up enforcement against broker-dealers and investment advisers.<sup>219</sup> Looking at the SEC's reported figures might give one that impression: in fiscal 2010–14, the SEC brought on average 121 enforcement actions against broker-dealers and 139 against investment advisers, a significant increase over 89 and 79, respectively, that it brought between 2000 and 2009. But in reality, much of the increase is due to follow-on cases. Primary enforcement actions against broker-dealers declined between 2010 and 2014, whereas primary enforcement actions against investment advisers increased more modestly, by 44% and not by 77% as the SEC's numbers would imply.<sup>220</sup>

Similarly, in 2008, the SEC celebrated the most insider trading cases ever brought, sixty-one.<sup>221</sup> But seventeen of the cases were follow-on cases; sixteen of the seventeen disbarment proceedings were filed because the SEC secured a permanent injunction and monetary penalties against the same defendants for the same violations in an earlier enforcement action that was already included in the count.<sup>222</sup> Once those are removed from the tally, the number of enforcement actions brought in 2008 (44) is lower than in 2002 and 2003 (48 and 53, respectively), while the number of new defendants sued for insider trading in 2008 is near its 9-year low.

Even where the reported direction of the trend is correct, the magnitude is distorted by follow-on actions. In 2008, the SEC brought 60 enforcement actions against broker-dealers, compared with 89 in 2007.<sup>223</sup> The 33% decline was considered significant because large Wall Street investment banks are

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218. See e.g., U.S. Sec. & Exch. Comm'n, Year-by-Year Enforcement Statistics, <https://www.sec.gov/news/newsroom/images/enfstats.pdf>.

219. David B. Bayless & Tammy Albarran, The Changing Composition of SEC Enforcement Actions, LAW360.COM (Feb. 21, 2013, 1:17 PM), <http://www.law360.com/articles/416542/the-changing-composition-of-sec-enforcement-actions>.

220. The result is the same if we look at defendants.

221. See U.S. Sec. & Exch. Comm'n, SEC Announces Fiscal 2008 Results, Oct. 22, 2008, available at <https://www.sec.gov/news/press/2008/2008-254.htm>.

222. The one exception is a follow-on case against Laurence McKeever that was brought after McKeever pleaded guilty to insider trading. The SEC did not separately sue McKeever for insider trading other than seeking a full collateral bar. See U.S. Sec. & Exch. Comm'n, Seven Defendants Settle SEC Charges in Wall Street Serial Insider Trading Ring, Litigation Release No. 20,725 (Sept. 18, 2008), <https://www.sec.gov/litigation/litreleases/2008/lr20725.htm>.

223. See Amit R. Paley & David S. Hilzenrath, *SEC Chief Defends His Restraint*, WASH. POST, Dec. 24, 2008, at A01 (referencing a study by Morgan, Lewis & Bockius LLP).

usually prosecuted for broker-dealer violations.<sup>224</sup> Excluding follow-on cases, however, the decline is larger: from 58 to 31 enforcement actions (47% decline) and from 137 to 58 defendants (58% decline). Similarly, at the end of fiscal 2011, the SEC celebrated record numbers of enforcement actions against investment advisers and broker dealers.<sup>225</sup> The numbers were indeed higher than the year before, but enforcement against broker-dealers was down considerably compared with the period between 2003 and 2009.

The bias in reported numbers does not always favor the SEC. For example, in 2008 the SEC celebrated a 45% increase in market manipulation enforcement actions using its noisy figures.<sup>226</sup> When follow-on cases are removed, the increase is actually larger: a 53% increase in enforcement actions targeting market manipulation and a 75% increase in the number of defendants prosecuted.

Because of these problems, any effort to analyze SEC enforcement by comparing the SEC's reported numbers of enforcement actions brought in various categories is largely pointless. In addition, since financial enforcement agencies not only adopt different enforcement practices but also employ different reporting conventions, comparisons across agencies are meaningless, whether domestically or internationally.

### *C. Problems Obscured*

The SEC's reported enforcement statistics produce both, false negatives (i.e., obscure problems) and false positives (i.e., identify a non-problem as a problem).

The publication of data assembled using unreliable and invalid reporting conventions can obscure real underlying problems. As noted above, most enforcement against Wall Street falls in the category of broker-dealer violations. This Article reports that primary enforcement actions against broker-dealers, as well as the number of defendants prosecuted, have declined since 2009. But the SEC's reported figures show a different picture, suggesting a considerable increase in enforcement against broker-dealers. Although the SEC has been criticized for failing to bring large cases,<sup>227</sup> it is not obvious that the agency itself is aware of the decline in primary enforcement actions for broker-dealer violations.

Also, the SEC reports the number of initial investigations and the number of formal orders of investigation, but does not report how many formal orders of investigation yield at least one enforcement action. Since 2003, the SEC has opened at least 900 informal investigations per year, except in three years. It issued about 250 formal orders of investigation per year until 2009; since then, the number has more than doubled. The number of enforcement actions

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224. *See id.*

225. *See* Mark Schoeff Jr., *SEC Sets Record in Crackdown on Advisers, B-D's*, INVESTMENT NEWS, Nov. 14, 2011, at 4.

226. *See id.*; SEC Probes Reach 671 in Fiscal Year, L.A. TIMES, Oct. 23, 2008, at C5.

227. *See* Jean Eaglesham, *supra* note 84.

certainly has not doubled since 2009, even if one included all follow-on and secondary cases in the count. The SEC's figures do not explain whether the agency is closing more formal investigations without bringing an enforcement action than before 2009 or whether something else is going on.

Finally, a review of all follow-on cases suggests that two modifications are in order. Under existing law, a professional or associational bar is not automatic upon conviction or the imposition of a permanent injunction for violating securities laws. Rather, the SEC must initiate an enforcement action. The process to impose a collateral bar or to suspend an attorney or an accountant from appearing before the Commission appears to be burdensome and costly without any countervailing benefit. Targeted individuals frequently fight such efforts even though their opposition is futile. The SEC wins all follow-on cases, so long as it is able to locate and serve the defendant. For example, in fiscal 2010 the SEC initiated follow-on proceedings against 235 individuals and firms. About three-quarters of defendants settled at the time the proceeding was initiated, but 11% fought the charges. None of them prevailed. Professional and associational bars ought to be automatic, with a right to reapply for admission or registration, like most collateral consequences of criminal and civil enforcement.<sup>228</sup>

Moreover, even if disbarment is not automatic, the SEC should have the authority to disbar or suspend a defendant in the primary enforcement action regardless of whether the action is filed in court or before the ALJ. A large majority of follow-on proceedings are triggered by the imposition of a permanent injunction in a civil action that the SEC brought in district court. Under existing laws, the Commission cannot obtain a professional or associational bar in court, it must initiate an administrative proceeding. But, the Commission has the power to impose an officer and director bar and a penny stock bar in a court proceeding. To avoid wasting resources by having to prosecute multiple enforcement action, the SEC ought to be able to obtain a professional or associational bar against a defendant in court when the primary enforcement action is brought in court.<sup>229</sup>

It is hard to imagine that the Commission is not aware that follow-on proceedings consume resources without any apparent benefit to defendants, who never prevail against the SEC. Yet, because follow-on cases boost enforcement figures, the SEC has no incentive to try to change procedural rules.

#### *D. Non-Problems Revealed*

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228. See e.g., Urska Velikonja, *Waiving Disqualification: When Do Securities Violators Receive a Reprieve?*, 103 CALIF. L. REV. (2015) (forthcoming) (describing collateral consequences of securities enforcement that are triggered automatically upon imposition of certain sanctions).

229. At least some defendants appear surprised by follow-on proceedings. For those, it is plausible that the SEC secured a settlement in court where the defendant was not aware that the settlement would trigger the disbarment. In such cases, it is likely that the defendant would have resisted longer in court, costing the SEC more in resources, on net.

At least as troublesome as problems obscured by reporting are alleged “problems” that the SEC’s reporting reveals. For example, much has been made of the SEC’s recent shift towards bringing more enforcement actions before administrative law judges in lieu of filing civil actions in district court. Looking at SEC-reported figures during the last fifteen years, it looks like the SEC used to bring about half of all enforcement actions in court and half in administrative proceedings. Between 2010 and 2013, after the Dodd-Frank Act empowered the Commission to bring more administrative cases, it brought about two-thirds of enforcement actions before ALJs. And in 2014, it brought 81% of enforcement actions before administrative law judges. These figures imply that the SEC is shifting enforcement actions to in-house administrative law judges, depriving defendants of procedural rights they would enjoy if sued in court.<sup>230</sup> Several defendants have raised constitutional objections. Jonathan Macey went as far as to suggest that the SEC chooses arbitrarily and stupidly what defendants to sue before administrative law judges.<sup>231</sup>

But these conclusions imply that nothing else has changed in SEC enforcement, during a time when much has changed. Of 755 enforcement actions brought in fiscal 2014, 145 were filed in district court and 610 in administrative court. Of those 610, a record 248 were follow-on cases, which are always filed in administrative forum, and another 107 were delinquent filing cases, also always filed in the administrative forum. If these cases are excluded, the SEC brought between 60% and 74% of primary enforcement actions in court between 2000 and 2013. The shift to the administrative forum occurred in fiscal 2014, when the SEC brought 37% of enforcement actions in court and 63% before ALJs.

In addition, some subject matter categories saw larger shifts towards administrative enforcement than others. The two subject-matter categories with the largest shifts in filings away from district courts were Market Manipulation and Issuer Reporting and Disclosure cases. In 2012, the SEC brought 83.3% of primary enforcement actions for Market Manipulation in district court; in 2014, it brought 35.4% in court. The nearly 50% decline seems to imply that many more equally-situated defendants must defend themselves before administrative law judges in 2014 than did in 2012. But the SEC also changed enforcement priorities in 2013 and 2014. It began prosecuting vigorously compliance with Rule 105 of Regulation M<sup>232</sup> in lieu of going after penny stock fraudsters.<sup>233</sup>

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230. See e.g., Michael Dvorak, *SEC Administrative Proceedings and Equal Protection “Class of One” Challenges: Evaluating Concerns About SEC Forum Choices*, *COLUM. BUS. L. REV.* (2015) (forthcoming) (suggesting that SEC forum selection may violate equal protection).

231. Stephanie Russell-Kraft, *Why Challenges to SEC Admin Court Will Likely Keep Failing*, LAW360.COM (Mar. 6, 2015, 8:04 PM), <http://www.law360.com/articles/628601/why-challenges-to-sec-admin-court-will-likely-keep-failing> (quoting Yale Law Professor Jonathan Macey).

232. Rule 105 of Regulation M prohibits underwriters in public offerings of equity securities from shorting such securities during a restricted period before the public offering. See 17 C.F.R. § 242.105.

233. In 2013, the SEC initiated 25 enforcement actions for Rule 105 violations. In 2014, it initiated 30. By contrast, in 2012, it initiated 2 such enforcement actions.

The former actions have always been brought before administrative law judges while the latter are always filed in court. If Rule 105 actions are removed from the count, the SEC's forum choices for market manipulation have not changed: 23 of 26 actions (88.4%) classified as Market Manipulation cases were filed in court in 2013 (not including Rule 105 and follow-on cases) and 17 of 18 such actions (94.4%) were filed in court in 2014 (again, not including Rule 105 and follow-on cases). These percentages are very similar to the overall figures for 2012, when the SEC brought only two enforcement actions for violation of Rule 105 of Regulation M.<sup>234</sup> As a result, the SEC's forum choices in market manipulation cases seem perfectly consistent over time—but the types of enforcement actions the Commission brings for market manipulation have, in fact, changed considerably.

Similarly, in 2013, the SEC brought 38.0% of all primary enforcement actions for Issuer Reporting and Disclosure violations in administrative forum; in fiscal 2014, it brought 85.2%. However, of 87 administrative enforcement actions, 18 were follow-on cases; 27 were stop orders and 5 were delinquent filing cases, both misclassified as Issuer Reporting cases. If correctly coded, these should be included in Delinquent Filing or Securities Offering categories. Once these cases are removed, the SEC brought 75.5% of Issuer Reporting and Disclosure cases in administrative forum. Of those, the enforcement staff brought several cases before ALJs to avoid litigating the same issue twice, now that the SEC can obtain monetary penalties against unregistered individuals, such as CEOs and CFOs, in administrative proceedings.<sup>235</sup> There has been a shift in enforcement of accounting fraud to the administrative forum, but smaller than SEC-reported figures would imply.

#### *E. The Denominator Problem*

The variables used to measure SEC enforcement activity, most notably the number of enforcement actions and the number of defendants, are used as the denominator to evaluate and report on other aspects of the SEC's performance, such as its success rate.<sup>236</sup> As a result, measurement problems bleed into other important parts of the entire performance report.

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234. See Touradji Capital Management L.P., Exchange Act Release No. 65,923, Investment Advisers Act Release No. 3333, Dec. 9, 2011, <https://www.sec.gov/litigation/admin/2011/34-65923.pdf>; Wesley Capital Management LLC, Exchange Act Release No. 67,510, Investment Adviser Act Release No. 3439, July 26, 2012, <https://www.sec.gov/litigation/admin/2012/34-67510.pdf>.

235. As a result, the SEC brought fewer *secondary* enforcement actions in 2014. See discussion *supra* in Part II.B.

236. The denominator problem is very common in agency performance reporting. The 2014 SEC reports includes For example, in its 2006 Performance and Accountability Report the SEC reported collection rates. But both the numerator and the denominator were incorrect, and yielded a collection rate that exceeded the actual rate by a considerable percentage (for example in 2003, the actual collection rate was 7%, not 40%). Compare 2006 PERFORMANCE AND ACCOUNTABILITY REPORT 54 exhibit 2.20, available at <http://www.sec.gov/about/secpar/secpar2006.pdf> with 2005 PERFORMANCE AND ACCOUNTABILITY REPORT 47 exhibit 2.20, available at <http://www.sec.gov/about/secpar/secpar2005.pdf>

The SEC reports its success in an annual report:<sup>237</sup> it is measured by the percentage of defendants in enforcement actions against which the SEC prevails on at least one of the counts.<sup>238</sup> The fact that follow-on cases are lumped together with primary enforcement actions biases the success rate upwards. The Commission wins all follow-on cases, including contested cases, except for a handful of actions where it cannot locate the defendant. The Commission does not win all primary enforcement actions, but lumping all actions together biases the success rate upwards.

According to the 2010 annual report the agency prevailed against 92% of defendants in enforcement actions resolved during the fiscal year.<sup>239</sup> My analysis of all enforcement actions filed in FY 2010, a slightly different sample, nevertheless shows a similar figure. The SEC prevailed against 93.1% of defendants,<sup>240</sup> while defendants prevailed in less than 1% of cases. Enforcement actions against the remaining defendants are either still ongoing, or were dismissed voluntarily because the entity ceased to exist or the defendant passed away, because the entity defendant agreed to wind down operations, or because the owner-manager defendant paid the disgorgement, so the case against the defunct entity became moot. But success rate thus measured overstates the SEC's success in primary enforcement actions because it includes follow-on cases. In follow-on cases filed in 2010, the SEC prevailed in all but 4 cases in which it was unable to serve process on the defendant, for a 98.3% success rate. In primary enforcement actions, the SEC prevailed against 92.1% of defendants and lost against 1%.

#### F. Changed Enforcement Incentives

With little information about what drives SEC's enforcement choices, legal academics have speculated about the SEC's incentives. Adam Pritchard suggested that the SEC's prosecutions are politically motivated.<sup>241</sup> By contrast, Joseph Grundfest and Amanda Rose have proposed that the SEC, as an expert agency, considers the public interest while avoiding bringing enforcement actions that it does not believe it can win.<sup>242</sup> While this study cannot shed light on how the SEC selects whom to prosecute,<sup>243</sup> it suggests that the dominant

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237. See SEC, 2014 ANNUAL REPORT, *supra* note 60, at 39.

238. See *id.*

239. See *id.*

240. Excluding relief defendants, delinquent filing and contempt proceedings.

241. See A.C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 1018 (1999).

242. See Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961, 970 (1994); Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1306 (2008).

243. Two studies released recently suggest that the SEC is sensitive to pressure from Congress and influential congressmen in selecting enforcement targets. See Maria M. Correia, *Political Connections and SEC Enforcement*, 57 J. ACCT. & ECON. 241, 255 (2014) (finding that firms that contribute to congressmen who sit on oversight committees are only about half as likely to be subject to SEC enforcement as those that do not); See Jonas Hesse, *Government Preferences*

statistics on enforcement that it reports to Congress likely influence what types of cases it brings.

The SEC takes great pride in its enforcement program and likes to report that it continuously increases its enforcement output.<sup>244</sup> Contested cases consume greater resources, so the agency has an incentive to bring cases that are easily settled and those that are strict-liability offenses.<sup>245</sup> The increase in enforcement actions targeting delinquent filing, a strict liability offense, may be driven as much by the concern about fraud as it is by statistics. Similarly, the SEC filed thirty-six enforcement actions in September 2014 for failure to report insiders' transactions in the company's stock under Section 16(a) of the Exchange Act, a strict liability offense. These enforcement actions served as a reminder to market participants that the Commission is serious about policing even the smallest infractions.<sup>246</sup> They also had the fortunate side effect of boosting the SEC's enforcement statistics. Similarly, in 2013 and 2014 the SEC brought dozens of enforcement actions for violation of Rule 105 of Regulation M, another strict liability offense. Until 2013, the SEC brought one or two such cases per year. In addition to reminding market participants that the SEC is always watching, these cases boosted the SEC's enforcement tally.

By using the wrong statistics to measure its performance, the Commission communicates to its staff the wrong things about what matters and what should not.<sup>247</sup> Because they are rewarded for the number of enforcement actions brought, the SEC staff rationally focus on cases that can be investigated and prosecuted quickly,<sup>248</sup> regardless of whether doing so increases compliance with securities laws and protects investors.<sup>249</sup>

## V. TOWARDS MORE MEANINGFUL REPORTING

Quality reporting can help identify areas that need improvement, as well as indicate what things work well. Reporting thus helps direct resources to where

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*and SEC Enforcement*, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2542242](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2542242) (finding reports that the SEC is less likely to prosecute large employers, in particular during presidential election years if they are headquartered in politically important states).

244. See Marc J. Fagel, *What The SEC Enforcement Stats Really Tell Us*, LAW360.COM (Mar. 3, 2015, 4:44 AM), [http://www.law360.com/articles/627323/what-the-sec-enforcement-stats-really-tell-us?article\\_related\\_content=1](http://www.law360.com/articles/627323/what-the-sec-enforcement-stats-really-tell-us?article_related_content=1).

245. See generally Posner, *supra* note 21, at 311–12 (concluding that a rational administrative agency has an incentive to focus on smaller cases).

246. Policing “broken windows” has been one of SEC Chair Mary Jo White’s enforcement priorities since she was appointed in 2013. See Mary Jo White, Chair, Remarks at the Securities Enforcement Forum, Oct. 9, 2013, <http://www.sec.gov/News/Speech/Detail/Speech/1370539872100>.

247. Katz, *supra* note 28, at 506.

248. *Id.* (“Because people strive to achieve the results that are measured, the choice of measures strongly determines what people try to do. When an agency uses faulty measures to evaluate its staff, it rewards the wrong people for the wrong actions.”).

249. See J. Robert Brown, *Reforming the SEC: The Unnecessary Emphasis on Stats*, THE RACETOTHEBOTTOM.ORG (Oct. 5, 2009, 5:00 AM), <http://www.theracetothetbottom.org/the-sec-governance/reforming-the-sec-the-unnecessary-emphasis-on-stats.html>.

they are needed. However, bad reporting produces none of the benefits, but at significant cost, including the direct cost of preparing reports and the opportunity cost engendered by shifts in priorities of the agency and its staff, wasted opportunities to improve, and undermined oversight.

The metrics used to measure the SEC's enforcement performance are invalid and unreliable, and thus inappropriate. This Part proposes several changes to agency reporting to improve its quality. Like many other agencies, the SEC is under enormous pressure to report increasing enforcement figures despite a modest budget appropriation. Moreover, a hostile Congress, relying on the Results Act, has threatened to punish agencies that fail to meet performance targets with budget cuts, even where targets are missed because of meager appropriations. The SEC has responded rationally by reporting statistics that are nearly useless. There are two possible approaches to improving reporting. First, reduce incentives for biased reporting, and second, remove reporting discretion from the agencies' hands. This Part discusses both in turn. Finally, the Part proposes that agencies share more liberally their raw enforcement data to encourage external research.

#### *A. Reducing Incentives for Biased Reporting*

Misconduct rates are cyclical and noisy. In the aftermath of crisis, wrongdoers are easier to identify than earlier, when capital is plentiful and investors pay less attention. As a result, enforcement rates usually move in step with misconduct rates (with a lag of a year or two), unless enforcement budgets receive a significant and sustained increase. And so, agencies should not be punished with budget cuts for reporting declining enforcement. Trying to avoid cuts, agencies might pursue nickel-and-dime cases at the expense of more significant prosecutions in order to report high enforcement figures.

To reduce shifts in enforcement and biased reporting, agencies should not be punished with budget cuts for bringing fewer enforcement actions or reporting a lower success rate than they forecast. In addition, it appears plausible that less congressional oversight would yield better results, while more congressional oversight would be counterproductive.<sup>250</sup> And so, rather than tracking enforcement annually, multiple-year budgeting and greater discretion would allow agencies to save resources in low-misconduct years and shift them to later years, and vice versa. Multiple-year budgeting 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.<sup>251</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 SEC Chair to plan accordingly

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250. For a more detailed discussion as applied to SEC enforcement, see Velikonja, *Politics in Securities Enforcement*, *supra* note 25.

251. Joel Seligman, *Key Implications of the Dodd-Frank Act for Independent Regulatory Agencies*, 89 WASH. U. L. REV. 1, 22 (2011).

and pursue longer-term goals, and enable the Commission to shift resources from year to year.

In fact, Section 991 of the Dodd-Frank Act, includes a longer-term budget planning for the SEC.<sup>252</sup> It authorizes annual budgets of \$1.3 billion in 2011 increasing to \$2.25 billion in 2015.<sup>253</sup> Unfortunately, Dodd-Frank's mandate has been honored in the breach.<sup>254</sup> Actual appropriations have lagged those enacted in the Dodd-Frank Act: in 2012, the actual budget was \$180 million less (12%) than commanded by the Dodd-Frank; in 2013 it was \$500 million less (28.6%); in 2014 it was \$650 million less (32.5%); and in 2015 it was \$750 million less (33.3%).<sup>255</sup>

### B. Standardizing Agency Reporting

Agencies possess considerable discretion in defining performance indicators. As a result, some agencies include a lot of information in annual reports, while others include very little. Agencies also report very different performance indicators, and use different methods to calculate performance indicators that nominally measure the same thing. As a result, comparisons among agencies are difficult or impossible.

Changing incentives may improve reporting somewhat, but will likely be insufficient when favored performance metrics are as “built into the soul” of an agency as they are at the SEC.<sup>256</sup> Like financial reporting, performance indicators regarding important non-financial items should be removed from agency discretion and, to the extent possible, standardized across agencies. Many of the annual performance reports feature similar indicators, such as the number of investigations, enforcement actions, sanctions, success rates, collection rates, and the like. Ensuring that such indicators are measured consistently would shed light on enforcement overall. In addition, like it did for agency financial reporting, OMB could develop indicators to measure both the quantity and the quality of enforcement more accurately.<sup>257</sup>

Standardized reporting of non-financial indicators would likely improve the accuracy and the quality of reports, and would allow for comparisons among enforcement agencies. It would be useful to know whether enforcement rates and actual sanctions vary across agency jurisdictions. To some extent, agencies already report comparable figures. For example, the largest SEC

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252. Sec. 991, Dodd-Frank Act.

253. *Id.*

254. It is not uncommon for one statute to increase an agency's workload and budget appropriation, and for the budget committees to approve lower budget figures.

255. See U.S. Sec. & Exch. Comm'n, Frequently Requested FOIA Document—BA vs. Actual Obligations (\$ in 000s), <https://www.sec.gov/foia/docs/budgetact.htm>.

256. J. Robert Brown Jr., *The SEC, Enforcement, and the Problem of Stats*, THE RACETOTHEBOTTOM.ORG (June 6, 2014, 6:00 AM), <http://www.theracetothetbottom.org/the-sec-governance/the-sec-enforcement-and-the-problem-of-stats.html> (quoting an SEC enforcement attorney saying that the metric of counting enforcement actions to report on enforcement performance “is built into the soul of the [Enforcement] Division”).

257. See discussion *supra* at note 59.

monetary penalty imposed is \$800 million against AIG for accounting fraud. The largest monetary penalty that the Occupational Safety and Health Administration ever imposed against recidivist BP Products North America Inc. for hundreds of serious and willful violations was \$81.34 million.<sup>258</sup> General Motors paid \$35 million to the U.S. Department of Transportation, “the highest civil penalty amount ever paid as a result of a National Highway Traffic Safety Administration investigation,”<sup>259</sup> after it failed to do anything for ten years about an ignition switch defect that killed at least thirteen people and led to a massive recall.<sup>260</sup> Whether these penalties are effective or not has not been seriously explored, in part because information is unavailable, and in part because we know so little about what works and what does not in enforcement. Standardized reporting would likely reveal persistent and large discrepancies between enforcement and sanctioning authority of various agencies, and set the stage to begin a conversation on overall enforcement priorities. Moreover, it would help agencies learn about what works in enforcement and what does not.

### *C. Public Access to Information*

However, if standardizing enforcement reporting across agencies is too large of a project, agencies should outsource: make available their enforcement raw data to researchers for analysis. There is currently no publicly-available database of SEC enforcement actions. The *Wall Street Journal* collects the data and publishes the occasional article based on the information in its database, but according to the *Journal*, the database is proprietary.<sup>261</sup> NERA Economic Consulting, a private consultancy, used to publish a semi-annual SEC enforcement report.<sup>262</sup> It also used to share its enforcement action database with academics in return for credit. It discontinued the practice in early 2013. Finally, Professors Karpoff, Martin, and Lee compiled a complete dataset of enforcement actions for accounting fraud brought between 1978 and 2006. They have shared the data quite liberally with academics in accounting and finance but ceased at some point.<sup>263</sup> As a result, any academic analysis of securities enforcement would require an investment of considerable resources and time to collect the needed data. Not surprisingly, such studies remain very rare.

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258. The second largest ever OSHA fine was imposed against BP Products North America Inc. four years earlier, for similar violations. See U.S. Dep’t of Labor, Occupational Health & Safety Administration, Top Enforcement Cases Based on Total Issued Penalty, [https://www.osha.gov/dep/enforcement/top\\_cases.html](https://www.osha.gov/dep/enforcement/top_cases.html).

259. Alex Rogers, *GM to Pay Record \$35 Million Fine Over Ignition Switch Recalls*, TIME MAG., May 16, 2014, <http://time.com/102906/gm-fine-ignition-recalls/>.

260. *Id.*

261. Author’s request for data was denied.

262. See e.g., MAX GULKER, ELAINE BUCKBERG & JAMES OVERDAHL, NAT’L ECON. RESEARCH ASSOCS., SEC SETTLEMENT TRENDS: 2H11 UPDATE 2 (2012); ELAINE BUCKBERG, JAMES OVERDAHL & JORGE BAEZ, NAT’L ECON. RESEARCH ASSOCS., SEC SETTLEMENT TRENDS: 2H12 UPDATE 2 (2013).

263. The author requested but was unable to obtain that data.

Sharing enforcement data would not impose a significant cost on the SEC. The SEC ordinarily publishes a litigation or administrative release at the time that it files an enforcement action and often releases updates as the action proceeds. But press releases are incomplete because they are not published consistently, they do not include complete relief obtained, and are almost never published when the SEC loses. SEC annual reports and inspector general reports suggest that the Commission maintains a database of open and closed enforcement actions. Releasing such information in a format that can be analyzed without a considerable investment of time and effort would attract academic research.

External research should be attractive to the Commission because it does not currently have the resources in-house to analyze much of the information it produces,<sup>264</sup> yet accurate research and analysis would be very useful.<sup>265</sup> Data access would enable researchers to address serious concerns about SEC enforcement quickly and effectively. For example, the SEC routinely faces criticism that it punishes firms at the expense of going after individual defendants.<sup>266</sup> Yet the claim appears to lack empirical support,<sup>267</sup> but the SEC has not analyzed the data in its possession to deflect such critiques. Also, there is widespread belief that defendants the SEC sues in court are much more likely to prevail than those it sues before the administrative law judges.<sup>268</sup> The source of the information purported to compare outcomes in contested cases filed in district court and before the ALJs. Yet it compared trial verdicts with initial decisions by ALJs,<sup>269</sup> and omitted dozens of contested court cases that are decided by summary judgment each year. After those are added, defendants' odds of prevailing against the SEC are pretty much the same in court and before an ALJ.<sup>270</sup> Although the SEC possesses all the information it needs to correct the misapprehension,<sup>271</sup> it apparently lacks resources to

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264. See Michael S. Piwowar, Comm'r, *Remarks at the University of Notre Dame, Mendoza College of Business, Center for the Study of Financial Regulation*, Mar. 13, 2015, <http://www.sec.gov/news/speech/remarks-at-university-of-notre-dame.html>.

265. The SEC appears quite eager to attract external research, just not by sharing any data. See William D. Cohan, *SEC Raises Barrier to Disclosure of Information*, N.Y. TIMES DEALBOOK (Nov. 4, 2014, 11:47 AM), <http://dealbook.nytimes.com/2014/11/04/s-e-c-raises-barrier-to-disclosure-of-information/>.

266. Macey, *supra* note 7, at 651.

267. See generally 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) (showing that individuals pay fines more often than firms in cases that give rise to a fair fund distribution).

268. The belief finds support in a newspaper article published in the Wall Street Journal. Jean Eaglesham, *SEC Is Steering More Trials to Judges it Appoints*, WALL ST. J., Oct. 21, 2014, <http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590> (reporting that the SEC won 100% contested administrative cases and 61% of contested court cases between September 2013 and September 2014).

269. See *id.*

270. My research is complete for enforcement actions filed in years 2009, 2010 and 2011. Coding for fiscal years 2012 thru 2015 is in progress. See also Zaring, *supra* note 22.

271. See SEC, 2014 ANNUAL REPORT, *supra* note 60, at 39 (listing a source for SEC success rates).

analyze the information in its hands. Instead, the SEC has responded with vague statements that the administrative process is “very fair,”<sup>272</sup> which are considerably less effective.

The SEC appears quite thin-skinned about criticism, yet it is likely that much of academic research would be favorable to the agency and would help further its enforcement objectives.<sup>273</sup> Finally, disclosure would add credibility to SEC reporting and, indirectly, to its enforcement program.

#### CONCLUSION

Enforcement agencies are often criticized for their failures. These critiques routinely revolve around mishandling particular cases. That approach is not wrong, since individual failures often reflect systemic failures. But it is incomplete and could lead to changes that are not warranted. Better assessment would be based on overall enforcement performance. In order to be useful, that performance should be reported in a manner that is reliable, meaningful, standardized, and comparable from year to year and across agencies.

This Article pulls back the curtain on the SEC’s reporting of its enforcement activities. By carefully reviewing fifteen years of data, the Article shows that all of the SEC’s favored statistics are deeply flawed. They way that the SEC counts enforcement actions filed and aggregate monetary penalties ordered consistently overstates the SEC’s enforcement output, masks trends, obscures real problems in enforcement, and reveals non-existent “problems” that the SEC then tries to resolve. Furthermore, flawed statistics bleed into other aspects of SEC reporting when the Commission uses one statistic as a denominator to generate a new performance indicator. Finally, not only do the used statistics fail to represent the SEC’s true enforcement output, they also have the potential to distort its enforcement choices in favor of easier-to-prosecute strict liability violations that are more likely to yield reportable “results.”

Because of the SEC’s “obsession with measuring its performance by the number of cases it brings,”<sup>274</sup> it is unlikely to change reporting conventions on its own. This Article proposes to remove the selection and development of performance indicators from agency discretion and to standardize non-financial reporting across agencies, much like financial reporting is already standardized. Doing so would depoliticize reporting, as well as enable comparisons among agencies, both domestically and internationally.

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272. Jean Eaglesham, *SEC Wins With In-House Judges*, WALL ST. J., May 6, 2015, <http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803> (quoting SEC Chair Mary Jo White).

273. See e.g., Velikonja, *supra* note 267 (commending the SEC’s fair fund program).

274. See also Weil, *supra* note 154 (quoting Jim Kidney, a retiring SEC enforcement employee).

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## APPENDIX

TABLE 2: NUMBER OF SEC ENFORCEMENT ACTIONS FILED (2000–14)

	Reported Number	w/o Follow-on and Second Cases	w/o Follow-on/Second & Contempt Proceedings	w/o Follow-on/Second, Contempt & Delinquent Filing
2000	503	388	352	344
2001	485	359	328	314
2002	598	450	403	393
2003	679	447	405	394
2004	638	423	402	381
2005	630	453	430	370
2006	574	421	400	309
2007	655	485	473	420
2008	671	492	482	371
2009	664	510	495	403
2010	681	449	431	325
2011	735	496	482	361
2012	734	503	494	367
2013	676	469	469	337
2014	755	507	507	400

TABLE 3A: SEC ENFORCEMENT ACTIONS AS REPORTED (2000–14)

	2000	2001	2002	2003	2004	2005	2006	2007
Issuer Reporting and Disclosure	103	112	163	199	179	184	138	219
Securities Offering	125	95	120	109	98	60	61	68
Broker Dealer & Municipal Securities	72	65	73	137	141	98	83	94
Investment Adviser	46	46	57	77	94	106	102	83
Delinquent Filing	8	14	10	11	21	60	91	53
Insider Trading	40	57	59	50	42	50	46	47
Market Manipulation	48	40	42	32	39	46	27	36
Contempt	36	41	47	42	21	23	21	12
Other	25	25	23	22	4	2	5	44
Total	503	485	598	679	639	629	574	656

	2008	2009	2010	2011	2012	2013	2014	All (2000 – 2014)
Issuer Reporting and Disclosure	157	143	126	89	79	68	99	2058
Broker Dealer & Municipal Securities	62	111	76	121	151	130	172	1590
Securities Offering	121	141	144	123	89	103	81	1538
Investment Adviser	90	84	113	151	155	140	137	1481
Delinquent Filing	111	92	106	121	127	132	107	1064
Insider Trading	61	37	53	57	58	44	52	753
Market Manipulation	52	39	34	35	46	49	63	628
Contempt	10	15	18	14	9	n/a*	n/a*	299
Other	7	2	11	4	5	5	37	221
FCPA	n/a	n/a	n/a	20	15	5	7	47
Total	671	664	681	735	734	676	755	9679

Source: U.S. Securities & Exchange Commission, Select SEC and Market Data FY 2000-2014.

\* In 2013, the SEC stopped including contempt proceedings (i.e., actions to enforce payment of previously imposed monetary penalties or compliance with a prior enforcement action). As a result, enforcement tallies after FY 2013 are depressed compared with prior years.

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TABLE 3B: SEC ADJUSTED ENFORCEMENT ACTIONS (I.E., NOT INCL. FOLLOW-ON AND SECONDARY CASES) (2000–14)

	2000	2001	2002	2003	2004	2005	2006	2007
Issuer Reporting and Disclosure	71	84	136	149	135	137	101	155
Securities Offering	94	61	87	76	74	41	47	45
Broker Dealer & Municipal Securities	51	43	35	54	60	51	34	58
Investment Adviser	35	29	34	43	56	65	63	51
Delinquent Filing	8	14	10	11	21	60	91	53
Insider Trading	36	48	53	39	32	42	38	38
Market Manipulation	32	24	29	17	21	33	22	30
Contempt	36	41	47	42	21	23	21	12
Other	25	21	19	15	1	2	3	43
Total	388	355	450	446	421	454	420	485

	2008	2009	2010	2011	2012	2013	2014	All (2000 – 2014)
Issuer Reporting and Disclosure	111	96	84	58	48	50	81	1496
Broker Dealer & Municipal Securities	31	72	29	38	42	31	37	666
Securities Offering	76	112	75	89	81	90	66	1114
Investment Adviser	56	54	59	72	83	65	68	833
Delinquent Filing	111	92	106	121	127	132	107	1064
Insider Trading	44	31	37	49	52	44	52	635
Market Manipulation	46	36	29	32	42	48	48	489
Contempt	10	15	18	14	9	n/a*	n/a*	299
Other	7	2	8	3	3	4	3	193
FCPA	n/a	n/a	n/a	20	15	5	7	47
Total	492	510	445	496	502	469	503	6836

\* In 2013, the SEC stopped including contempt proceedings (i.e., actions to enforce payment of previously imposed monetary penalties or compliance with a prior enforcement action). As a result, enforcement tallies after FY 2013 are depressed compared with prior years.

TABLE 3C: FOLLOW-ON AND SECONDARY ENFORCEMENT ACTIONS (2000–14)

	2000	2001	2002	2003	2004	2005	2006	2007
Issuer Reporting and Disclosure	32	28	27	50	44	48	36	64
Securities Offering	31	34	33	33	24	19	14	23
Broker Dealer & Municipal Securities	21	21	42	82	79	47	49	36
Investment Adviser & Transfer Agent	11	14	23	34	37	41	39	32
Delinquent Filing	0	0	0	0	0	0	0	0
Insider Trading	4	9	6	11	10	8	8	9
Market Manipulation	16	16	13	15	18	14	5	6
Contempt	0	0	0	0	0	0	0	0
Other	0	4	4	7	3	0	2	0
Total	115	126	148	232	215	177	153	170

	2008	2009	2010	2011	2012	2013	2014	All (2000 – 2014)
Issuer Reporting and Disclosure	45	47	40	31	31	18	18	559
Securities Offering	45	29	69	34	8	13	15	424
Broker Dealer & Municipal Securities	31	39	46	83	109	99	132	916
Investment Adviser	35	30	53	79	71	75	68	642
Delinquent Filing	0	0	0	0	0	0	0	0
Insider Trading	17	6	16	8	6	0	0	118
Market Manipulation	6	3	7	3	4	1	15	142
Contempt	0	0	0	0	0	n/a	n/a	0
Other	0	0	2	1	2	1	0	26
FCPA	n/a	n/a	n/a	0	0	0	0	0
Total	179	154	233	239	231	207	248	2827