August 4, 2010

Senator Christopher Dodd
Chairman
Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Representative Barney Frank
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Re: A FOIA Exemption for SEC Misconduct?

Dear Chairmen Dodd and Frank:

Congress missed a golden opportunity with the Dodd-Frank Act to bring a small measure of transparency to the Securities and Exchange Commission (SEC). Instead, with Section 929I, Congress boarded shut the last tiny beam of light afforded by the Freedom of Information Act (FOIA) into the SEC’s regulation of Wall Street.

Ironically, the preamble to the Dodd-Frank Act states its purpose is “to promote the financial stability of the United States by improving accountability and transparency in the financial system.” These words echo President Obama’s directive in his first day in office that, “All agencies should adopt a presumption in favor of disclosure, in order to renew their commitment to the principles embodied in FOIA, and to usher in a new era of open government. The presumption of disclosure should be applied to all decisions involving FOIA.”¹

In recent years, the SEC has been neither transparent nor accountable. It releases information in response to bare 13% of the FOIA requests it receives, while other federal agencies do so in response to 60% of the FOIA requests, according to a September 25, 2009, report of the SEC’s Inspector General, David Kotz.² Mr. Kotz concluded the SEC had a


Table 3 illustrates the SEC’s disposition of FOIA requests in comparison to ”All Federal Agencies,” as reported in the SEC’s Freedom of Information Act Annual Reports for FY 2008 (Annual Reports). The table shows that the SEC made “full grants” and “partial grants” 10.5 and 2.9 percent of the time, respectively. In contrast, “All Federal Agencies” reported making “full grants” and “partial grants” of information 41.8 and 18.7 percent of the time, respectively.
“presumption of withholding” rather than the “presumption of disclosure” urged by President Obama.3

Mr. Kotz has also issued a series of reports over the past two years describing how the SEC mishandled investigations of investor fraud (by Madoff),4 insider trading (by Pequot),5 overvaluing mortgage backed securities (by Bear Stearns),6 and overleveraging by the big banks (again by Bear Stearns).7 The SEC has implemented few of Mr. Kotz’s recommendations addressing the underlying deficiencies. Nor has it disciplined any of the responsible officials.

Yet, the Dodd-Frank Act carved out a new and broad FOIA exemption for the SEC. It creates an absolute bar to the release of information collected by the SEC under the three statutes which empower it to monitor the activities of regulated entities: the Securities and Exchange Act of 1934, the Investment Adviser’s Act of 1940 and the Investment Company Act of 1940.

Last week, SEC Chairman Mary Schapiro broke the SEC’s silence why it needed a new FOIA exemption. Ms. Schapiro’s July 30, 2010, letter8 told you, as the Act’s authors, that the SEC needed an expanded FOIA exemption so the firms it regulates “will be able to provide us with access to confidential information without concern that the information will later be made public.” But FOIA Exemption 4 already exempts confidential information from FOIA’s reach.

Further, FOIA is the least of the concerns a regulated entity would have about the possibility that confidential information released to the SEC could fall into the hands of a third party. When the SEC requests information from any source, it provides the individual or firm with SEC form 1661, which lists 22 separate situations when the SEC may share the information it receives from that source with third parties, including the media, bar associations, witnesses, and the general public.9

I learned just how narrow FOIA access is to SEC records when I sued the SEC to obtain records relating to its decision to close its investigation of Pequot Capital Management for insider trading.10 First, to overcome the SEC’s assertion of the law enforcement privilege, I had to prove that the SEC had acted unlawfully in conducting the investigation.11 I then had to prove that the public interest in the disclosure outweighed the privacy interests of persons described in

3 Id.
5 Id.
6 Id.
7 Id.
11 Id.
those records.\textsuperscript{12} I also had to prove that the records did not contain proprietary information of regulated entities and that the release of the information would not impair the SEC’s ability to collect similar records in the future.\textsuperscript{13} I finally obtained an order from a US District Court judge directing the SEC to produce the records, but the process took three years and tens of thousands of dollars in legal fees.\textsuperscript{14}

I relied heavily on information from these records in my 16-page letter on January 2, 2009, to the Department of Justice, the FBI, several Congressional committees, and the SEC explaining why the SEC should file insider charges against Pequot.\textsuperscript{15} In June 2010, the SEC filed those charges against Pequot and its CEO, which were promptly settled by both with a payment of $28 million to the SEC. The SEC complaint closely tracks the facts stated in my January 2009 letter.\textsuperscript{16}

Under the SEC’s broad new exemption, a court would likely deny access to the Pequot records which I obtained through the court proceedings described above.

In short, the SEC has a unique new FOIA exemption: it blocks access to records demonstrating how the SEC violated the law in botching an investigation.

Sincerely,

Gary J. Aguirre

\begin{footnotes}
\footnote{Id.}
\footnote{Id.}
\footnote{Id.}
\footnote{Id.}
\footnote{http://www.whistleblower.org/storage/documents/AguirreLetter.pdf.}
\footnote{http://www.sec.gov/litigation/complaints/2010/comp-pr2010-88.pdf.}
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