



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

August 24, 2010

The Honorable Darrell E. Issa
Ranking Member
Committee on Oversight and Government Reform
U.S. House of Representatives
2157 Rayburn House Office Building
Washington, D.C. 20515

Dear Ranking Member Issa:

This responds to your letter of August 6, 2010 concerning Section 929I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

As far back as 2006, language similar to what is contained in Section 929I has been sought. As stated then, the proposed language sought to ensure the confidentiality of sensitive business records that SEC staff obtained during examinations, noting that while such records:

generally are protected from disclosure under the Freedom Information Act (FOIA) by Exemptions 4 and 8 . . . [i]n other proceedings, such as pursuant to a court-issued subpoena, the staff must contest any production of records on grounds such as relevance and the application of common law privileges. In the absence of the [requested] provision, a judge taking an expansive view of relevance or a narrow view of possible privileges could order the production of sensitive records to a firm's competitor.¹

Since that time, the need for the provision has been heightened by the passage of the Dodd-Frank Act, which mandates new responsibilities for the Commission to protect investors, including new authority over certain types of entities. Fulfilling the Commission's new responsibilities will require that it expand and improve its examination capabilities, including its surveillance and risk assessment capabilities, to provide the type of risk-focused regulatory oversight necessary to protect investors. For these efforts to be successful, it is critical that all entities subject to examination freely share relevant and potentially sensitive information without concern that the

¹ See July 5, 2006 letter and enclosure from SEC Chairman Christopher Cox to House Financial Services Committee Chairman Michael Oxley, included on the enclosed disc. On September 11, 2008, the House of Representatives passed H.R. 6513, the Securities Act of 2008, by voice vote with bipartisan support. Section 15 of H.R. 6513 contains language similar to Section 929I.

information will later be made available to competitors or other third parties. Such disclosures may occur in response to a FOIA request or a subpoena served on the Commission in non-FOIA litigation. Section 929I addresses these issues.

I share the commitment to accountability and transparency that FOIA encourages. As I indicated in my July 30, 2010 letters to Chairmen Dodd and Frank, to address any uncertainty about how we will use Section 929I, I am asking the Commission to issue and publish on our website guidance instructing staff on when and how to assert the provision so that it is applied consistent with principles of open government and only to address issues regarding sensitive information obtained through the examination process.

I agree with the view expressed in your letter that “all of [the Commission’s] examinations should be subject to ... FOIA exemption [8], regardless of whether it is examining an investment company, an investment advisor, a securities exchange, or some other regulated entity” and that “information requested by [the Commission’s] examiners should be subject to FOIA’s examination exemption.” Unfortunately, as noted in more detail below, it has not been clearly established by the courts that certain entities regulated by the Commission – for example, credit rating agencies or municipal advisors – are “financial institutions” within the meaning of FOIA Exemption 8. Section 929I would address this by making it clear that information obtained in examinations from all such regulated entities would be protected, even if there is uncertainty as to whether they are “financial institutions” covered by Exemption 8.

I also agree that Exemption 4 should protect information provided to the Commission in examinations that constitutes “trade secrets and confidential commercial or financial information and information covered in the Commission’s examinations.” As discussed in more detail below, however, courts interpreting FOIA Exemption 4 have applied different tests based on whether information provided by the third party to the government was voluntarily or involuntarily provided, with information that is provided on a voluntary basis being more broadly protected. Information registered entities are required by statute or regulation to provide to the Commission may not be deemed to be voluntarily provided, meaning regulated entities may not receive the broader protection under this exemption for information provided to the Commission in examinations.

Section 929I also provides important protections in non-FOIA litigation, where FOIA exemptions do not apply. The Commission cannot, for example, rely on FOIA exemptions when responding to a subpoena served on it in private litigation. Section 929I clarifies that sensitive information received from third parties in examinations should be protected from forced disclosure to outside persons in both the FOIA and non-FOIA contexts, thereby removing a substantial barrier to the Commission’s ability to obtain critical information in a timely fashion via our examination and surveillance efforts.

With respect to how Section 929I has been utilized, it is important to note that neither the Commission nor the staff has formally asserted Section 929I in response to any FOIA requests. In the FOX News matter you reference, FOX and the Commission have been engaged in litigation for approximately a year over certain pre-existing FOIA requests. I have been

informed by staff that Commission counsel in that litigation explained in telephone conversations with opposing counsel and the judge's law clerk that Section 929I exists and could provide an additional basis for withholding documents the Commission has already withheld pursuant to other FOIA exemptions. The Commission has not filed any papers relying on Section 929I in that or any other FOIA matter.

Your letter also raises an administrative proceeding relating to *Morgan Asset Management*, a non-FOIA matter. It would not be appropriate for me to comment on that case given its status as an administrative proceeding before the Commission. That said, weeks ago I instructed the staff not to invoke Section 929I in any capacity until the Commission has had the opportunity to review the provision and issue guidance to ensure its appropriate use. I anticipate such guidance will be issued soon and will be made public. As a factual matter, I have been informed that the staff's invocation of Section 929I in the *Morgan Asset Management* case preceded my directive that staff not utilize this provision until after the Commission issues guidance.

Below are responses to your specific questions:

1. *Provide all records and communications referring or relating to internal policies or guidance, effective between January 2, 2005 and the present, governing the SEC's treatment of FOIA requests.*

PDF copies of responsive documents are included on the enclosed disc.²

2. *Provide all records and communications referring or relating to Section 929I and every similar legislative proposal that is referred to by your July 30, 2010 letter.*

PDF copies of responsive documents are included on the enclosed disc.

3. *State the basis for your suggestion that FOIA's examination exemption [5 U.S.C. § 552(b)(8)] might cover some entities that the SEC regulates, but not others.*

Exemption 8 applies to matters that are "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." (emphasis added)

Neither the text nor the legislative history of FOIA defines the term "financial institution" or otherwise sheds light on what Congress intended that term to encompass. The courts have looked for guidance to the Government in the Sunshine Act (Sunshine Act), holding that FOIA and the Sunshine Act are *in pari materia*, or "upon the same matter or subject." Although the text of the Sunshine Act also does not define the term "financial institution," the legislative history includes an illustrative list of types of institutions that Act was intended to encompass.

² Two internal memoranda are being provided without attachments because the attachments disclose nonpublic information that is not responsive to your request.

The case law applying Exemption 8 to the Commission has addressed entities specifically named in the legislative history to the Sunshine Act. *See, e.g., Mermelstein v. SEC*, 629 F. Supp. 672 (D.D.C. 1986) (securities exchanges); *Feshbach v. SEC*, 5 F. Supp. 2d 774 (N.D. Cal. 1997) (broker-dealers and self-regulatory organizations), and *Berliner, Zisser, Walter & Gallegos v. SEC*, 962 F. Supp. 1348 (D. Colo. 1997) (investment advisers). Despite this, other types of entities the Commission is now responsible for supervising, regulating or examining (e.g., credit rating agencies, transfer agents, municipal advisors) are not specifically named in the Sunshine Act legislative history and, indeed, may not even have existed when the Sunshine Act was passed three decades ago.

Although I believe such entities are encompassed by the term “financial institution” and agree with the view expressed in your letter that all entities subject to examination by the Commission should be covered by this exemption, it cannot be presumed that the courts will find that every entity the Commission examines is necessarily a “financial institution.” For example, before the Sunshine Act was passed, the governing case law rejected the argument that national securities exchanges and broker-dealers were “financial institutions.” *M.A. Schapiro & Co. v. SEC*, 339 F. Supp. 467, 470 (D.D.C. 1972).

Section 929I eliminates any legal uncertainty that may exist concerning Exemption 8 by allowing all entities subject to supervision, regulation or examination the ability to rely on a straightforward statute that directly addresses their concerns about the potential disclosure of sensitive information.

4. *Describe every action taken by the SEC in response to the September 25, 2009 Inspector General report entitled, “Review of the Securities and Exchange Commission’s Compliance with the Freedom of Information Act.”*

Please see the enclosed Memorandum from Barry D. Walters, Chief Freedom of Information Act/Privacy Act Officer, to H. David Kotz, Inspector General, dated June 30, 2010 and entitled “Corrective Action Plan in Response to Report No. 465, *Review of the Securities and Exchange Commission’s Compliance with the Freedom of Information Act*,” included on the enclosed disc. In summary, significant actions taken in response to the OIG Report include:

- Hiring a new Chief Freedom of Information Act/Privacy Act Officer in October 2009;
- Requiring that a staff attorney be contacted to verify whether an open enforcement investigation is active or inactive before asserting FOIA Exemption 7(A);
- Issuing new procedural guidance that provides clear and concise processing guidance to all FOIA/Privacy Act liaisons and Commission staff tasked with involvement in FOIA responses;³

³ See June 2010 “Freedom of Information and Privacy Act Processing Guidance for Liaisons,” included on the enclosed disc.

- Implementing a policy that, in general, a decision on a FOIA appeal may be made only by a senior officer who did not participate substantively in processing the initial FOIA request;⁴
 - Restructuring the FOIA/Privacy Act Office to improve management oversight of quality and consistency of responses, adherence to policy and procedure, and workload volume and backlog management;
 - Increasing training opportunities for FOIA staff and liaisons, including annual 3-day seminars led by the former Co-Director of the Department of Justice's Office of Information Policy (the office responsible for providing guidance to all agencies on FOIA-related questions);
 - Emphasizing the importance and seriousness of every staff member's obligation to assist with making timely FOIA responses through my sending of an agency-wide email;⁵
 - Reinstating a web-based resource for all FOIA and Privacy Act matters that can be accessed by any staff member through the Commission's intranet; and
 - Improving technology and office equipment resources for the FOIA/Privacy Act Office, including upgrading the FOIAXpress software, server support and performance that is at the center of the Office's work.
5. *In categorical terms, describe any information that was actually withheld from an SEC examiner under the circumstances described by your July 30, 2010 letter and was not covered by any FOIA exemption.*

It is impossible to know all the circumstances where an entity has withheld information from the Commission's examiners. That said, Commission examinations unquestionably have been hindered by registered entities' refusal to produce certain information requested by staff during an examination due to concerns about the Commission's ability to protect the information from compelled third party disclosure. Examples characteristic of the type of information the Commission has had difficulty obtaining without clear assurance of FOIA and subpoena protection include:

- During an examination of an investment adviser registered with the Commission that manages several large funds that pursue a quantitative trading strategy, the adviser refused to turn over the details of its strategy to the Commission because the adviser feared that the information would be revealed to the public pursuant to a FOIA request or

⁴ See March 17, 2010 Memorandum from Mark D. Cahn and Richard M. Humes to David M. Becker re "OIG Audit Report No. 465 – Recommendation regarding separation of roles between initial Freedom of Information Act requests and subsequent appeals," included on the enclosed disc.

⁵ See November 2009, "From the Chairman: Freedom of Information Act Program at the SEC," included on the enclosed disc.

otherwise. Specifically, the registrant asserted that the Commission could not have the proprietary trading strategies because there was too much risk that the information would be disclosed to third parties, thereby harming the adviser's business. Without assurances by the staff guaranteeing confidentiality of the information, the adviser refused to provide the staff the requested information. After extended discussions with staff, the adviser eventually agreed to turn over certain information in response to narrowed requests.

- Registered investment advisers ask that Commission staff not take copies of internal audit reports because the firms fear that the staff cannot safeguard the information. Staff often will be permitted to view the internal audit reports onsite, but will not be provided with copies.
 - Investment advisers sometimes refuse to turn over personal trading records of investment management personnel, instead requiring the staff to review hard copies that the staff cannot take with them off premises. To address these concerns, staff has resorted to taking notes and then manually reviewing the personal trading against the firm's trade blotter.
 - During a recent exam of a high-frequency trading firm, the Commission encountered several objections and substantial delays in receiving documents and information because of confidentiality fears related to the firm's trading strategies and profit/loss reports.
6. *If it is your position that "customer information, trading algorithms, internal audit reports, trading strategy information, portfolio manager trading records and exchanges electronic trading and surveillance specifications and parameters" are not covered by any FOIA exemption, state the basis for your position.*

Please see the discussion in response to Question 3 regarding certain issues surrounding the applicability of FOIA Exemption 8.

With respect to FOIA Exemption 4, while it provides broad protection for trade secrets and confidential commercial or financial information submitted voluntarily to the government, information that is required to be submitted to the government enjoys a far more limited protection. *See, e.g., Nat'l Parks & Conservation Ass'n v. Morton*, 498 F.2d 765, 767-70 (D.C. Cir. 1974), as clarified by *Critical Mass Energy Project v. NRC*, 975 F.2d 871, 878 (D.C. Cir. 1992) (en banc); *see generally* Department of Justice Guide to the Freedom of Information Act (*FOIA Guide*) at 276. Because the Commission's examination authority allows it to require entities to produce information in examinations, there is concern that the broad protection for voluntarily submitted information might not apply to information obtained in an examination. *See Center for Auto Safety v. Nat'l Highway Traffic Safety Admin.*, 244 F.3d 144, 149 (D.C. Cir. 2001).

When information is required to be submitted, it is protected only if "disclosure of the information is likely to have either of the following effects: (1) to impair the Government's ability to obtain necessary information in the future; or (2) to cause substantial harm to the

competitive position of the person from whom the information was obtained.” *Nat’l Parks & Conservation Ass’n v. Morton*, 498 F.2d 765, 770 (D.C. Cir. 1974). To satisfy the first prong, the government cannot simply argue that forced disclosure could impair its ability to quickly and efficiently obtain similar information in the future; instead it must show that disclosure “will result in a diminution of the ‘reliability’ or ‘quality’ of what is submitted.” *See, e.g., Critical Mass*, 975 F.2d at 878; *FOIA Guide* at 301 (and cases cited therein). Courts rarely have found the first prong met, rejecting arguments about potential harms to reliability and quality as too speculative. *See, e.g., Niagara Mohawk Power Corp. v. DOE*, 169 F.3d 16, 18 (D.C. Cir. 1999); *Aguirre v. SEC*, 551 F. Supp. 2d 33, 52-53 (D.D.C. 2008); *FOIA Guide* at 301.

Thus, as a practical matter, an entity must rely on the second prong: it must show that disclosure is likely to “cause substantial harm to [its] competitive position.” Courts have limited the definition of “competitive harm” to “harm flowing from the affirmative use of proprietary information by competitors” and have explained that this “should not be taken to mean simply any injury to competitive position, as might flow from customer or employee disgruntlement.” *See, e.g., Pub. Citizen Health Research Group v. FDA*, 704 F.2d 1280, 1291 n.30 (D.C. Cir. 1983). Even if an entity can clear that hurdle, there are stringent requirements to state a “competitive harm,” including in some cases a line-by-line analysis and justification of potentially thousands of pages of documents. Given these impediments, courts have frequently required disclosure of information that businesses endeavored to keep confidential. *See, e.g., N.C. Network for Animals v. USDA*, No. 90-1443, slip op. at 8-9 (4th Cir. Feb. 5, 1991) (finding “evidence presented by” agency “insufficient to support” its burden, noting absence of sworn affidavits or detailed justification for withholding from submitters); *Lee v. FDIC*, 923 F. Supp. 451, 455 (S.D.N.Y. 1996) (rejecting competitive harm when submitter failed to provide “adequate documentation of the specific, credible, and likely reasons why disclosure of the document would actually cause substantial competitive injury”); *see generally FOIA Guide* at 305-47.

Of course, FOIA Exemption 4 is not available in non-FOIA litigation.

* * *

Please call me at (202) 551-2100 or have your staff call Eric Spitler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010 if you have any questions or comments.

Sincerely,


Mary L. Schapiro
Chairman

Enclosure