



Consumer Federation of America

To: Presidential Transition
SEC Review Team
From: Barbara Roper
Director of Investor Protection
Re: Securities and Exchange Commission priorities
Date: November 26, 2008

Short-term priorities

- 1) Responding to the financial crisis – issues with implications for SEC
 - A. Structure – Will we retain a separate SEC with roughly the same functions it has today? Merger of SEC and CFTC? Obviously, how the administration envisions the broader financial regulatory structure has implications for SEC priorities. Crisis was not the result of structural failure; reorganizing the regulatory apparatus won't solve this crisis or prevent a recurrence.
 - B. Credit ratings – SEC did a fairly decent study of problems at the ratings agencies; has, within its limited authority, proposed modest reforms, some of which are good, some wrong-headed; needs legislation to give it broader standard-setting and oversight authority, address independence question.
 - C. Risk management – To the degree that SEC retains risk management oversight authority (with all the big investment banks gone), it needs to fundamentally rethink its approach, both in what risk-management should look like at regulated entities and how it should oversee it; this needs to be part of a wider look at risk management practices at all financial institutions where there is a risk that the government may have to provide a taxpayer backstop.
 - D. Credit default swaps – Do clearinghouse proposals go far enough? The SEC should have explicit authority to set standards (e.g., transparency, collateral) and oversee market.
 - E. Conflicts of interest, questionable practices at investment banks – Did they fulfill their role to do due diligence, provide full and fair disclosure on MBSs and CDOs they underwrote? Did they provide complete and accurate information to credit rating agencies? Did they sell securities (MBSs, CDOs, auction rate securities) to investors that they themselves were unloading because of risks? MBS pricing abuses?
 - F. Accountability for wrong-doers – Public offended by rich financial rewards executives receive even as taxpayers are being asked to provide a bail-out. Within the context of the bailout, there should be executive pay restrictions, limits on dividends, applied according to some consistent principle. A strong



enforcement response would also help greatly to counterbalance this sense that taxpayers are on the hook and those responsible walk away unscathed.

- G. Fair Value Accounting – Assert commitment to fair value accounting as the best means of providing transparency for investors. At the same time, express respect for the importance of an independent standard-setting process. (See below)

2) Restoring the agency

- A. Leadership – Appointing a strong, capable, knowledgeable, independent chairman is essential. That individual should have a proven investor-protection focus and, ideally, strong executive skills (or the ability to hire a chief of staff of sorts to provide the management expertise).
- B. Enforcement – The top priority for restoring the agency is restoring the enforcement division, not necessarily because enforcement is more important than the other divisions, but because this appears to be where the greatest damage has been done. Hire a division director who won't be seen as an industry shill, get rid of policy requiring enforcement staff to get Commission permission before negotiating a settlement, and send the message that this division is back in action.
- C. Division of Trading and Markets has suffered almost as bad a black eye as enforcement. The Office of Chief Accountant has been less in the public eye, but has really been problematic, particularly in its relationship to the PCAOB and FASB (see below). Getting the right people in these positions is going to be critical.
- D. Risk Assessment – Restore the office responsible for identifying looming marketplace risks. Find someone good (perhaps from academia) willing to take on leadership of this office for the short-term in order to get the right people in and develop a sound approach for identifying risks. Meanwhile, give it a high-profile early assignment related to current crisis where it can conduct analysis and develop proposals (perhaps related to CDSs, perhaps related to some other issue of particular interest to the first director). Turn this into a high prestige appointment.
- E. Personnel/agency structure – I see three problems in this area. One is the industry revolving door, which results in a built-in industry bias in the agency. Another is long-time staffers who are set in their ways, incapable of taking a fresh approach to issues. (See mutual fund short-form prospectus proposal.) Finally, there are divisions within the staff, often along departmental lines, that make it virtually impossible to resolve certain issues. For example, having investment adviser and broker-dealer jurisdiction in separate divisions, and dominance of market and trading division by broker-dealer mindset, has made it all but impossible to develop a rational policy for regulating financial professionals.
- F. Funding – Although the SEC received a sizeable funding increase after Enron, the current leadership has not made the case for adequate funding since then. Recognizing that budgets are likely to be tight in the near future, the new administration should nonetheless conduct a top-to-bottom review to identify areas in critical need of funding increases and to develop funding priorities.



3) Other short-term priority issues

- A. International Standards – The push for greater reliance on international standards has, in my view, been designed as a way to provide an end-run around stronger U.S. standards. This relates to the whole “global competitiveness” movement, that fails to recognize that strong investor protections are the best basis on which our markets can compete in an increasingly competitive global marketplace. A top priority for a new administration needs to be restoring an investor protection focus to its approach to international issues.
1. IFRS – Do not approve proposed roadmap, or, if Chairman Cox has rushed it through before new administration takes over, immediately rescind it. Develop a revised roadmap based on convergence, with a plan for resolving differences between the two sets of standards and clear independence guidelines IASB must meet before IFRS is recognized for use by U.S. companies.
 2. Mutual recognition – Do not approve exemptions under Australia MRA until this issue has been rethought. If we take this approach, which is fraught with risks in my opinion, we need, at the very least, to have clear standards to be used in making comparability assessments and a transparent process for making and releasing the results of that assessment. We should also delay any further work in this area until we have our own house in order.
 3. PCAOB Full Reliance/International Audit Standards – The PCAOB has proposed to rely on foreign oversight bodies to inspect foreign audit firms that play a significant role in the audits of U.S. companies. When that proposal proved controversial, the PCAOB didn’t act on it, but it continues to see delays in inspections of foreign firms. One board member has also made a special project of pushing international auditing standards, which would eviscerate PCAOB authority and return us to the days of audit firm influence over (control of?) standard-setting. An early message to stop this in its tracks would be very helpful.
- B. Corporate Governance – The new administration could earn a lot of goodwill from the investor community by announcing early on that it was reviving proxy access and say-on-pay proposals abandoned by this administration.
1. CIFIIR – Make clear early on that the agency will not adopt the CIFIIR recommendations to weaken materiality standards with regard to financial restatements.
 2. Reg FD – Make clear that posting information on a corporate website does not satisfy requirement for broad dissemination
 3. SOX 404 – End implementation delay for small companies
- C. Oversight of FASB/PCAOB – The current SEC has been responsible for politicizing this relationship in ways that are really damaging to investor interests. The mechanisms included in SOX to protect these agencies from direct political influence from Congress have been turned on their head.
1. An early statement, some symbolic action, recognizing the importance of the independence of these agencies would be helpful.



2. Assuming the SEC hasn't already filled the Niemeier vacancy when the new administration takes over, appointing an independent-minded, non-industry CPA board member and/or chairman would be useful.

Longer-term Priority – Developing a credible retail investor agenda

- 1) Regulation of Financial Professionals – Traditional divisions between broker-dealers and investment advisers have, to a large extent, been erased. To the degree that differences remain, they are at best poorly understood by investors. The basis for determining regulatory status makes no sense. The result is that brokers and advisers providing services that are indistinguishable to the investing public are subject to very different regulatory standards. The SEC staff was supposed to come up with a range of options for addressing this situation, but those have never been released. Moreover, the divisions between Trading and Markets and Investment Management on these issues really hamper the development of good ideas.
 - A. True functional regulation – All those who perform similar functions, provide comparable services subject to the same standards
 - B. Fiduciary duty for all those who give personalized investment advice
 - C. Additional standards to protect against conflicts where advice is associated with product sales
 - D. Pre-engagement disclosure for all financial professionals covering key information relevant to an informed decision among service providers
 - E. Improved pre-sale disclosure for all financial products, not just mutual funds (mutual fund short-form prospectus project just completed)
 - F. Improved pre-sale compensation disclosure for all financial products, not just mutual funds (12b-1 fee proposal developed, but never released)
- 2) Unfinished Mutual Fund Agenda – The agency had an extensive mutual fund reform agenda under Donaldson that was never completed. Go back and look at it to see what deserves to be revived (independent chairman?) and what deserves to be revived with revisions (e.g., 12b-1 fee, point-of-sale). Talk to Mercer Bullard if he's not already on your list.
- 3) Disclosure – Chairman Cox has made a priority of improved Internet disclosure, but there is a lot of room to bring an improved investor focus in this area.
 - A. Better use of Internet – The recently improved mutual fund short-form prospectus seems like a perfect example of how not to do Internet disclosure. It basically posts a paper document online (though with click-through ability). It makes little use of the creative methods fund companies already use in their proprietary documents to enhance disclosure on the Internet. Someone who could really rethink disclosure for the Internet age could accomplish a lot.
 - B. Access does not equal delivery – The industry constantly fights for an access equals delivery approach to disclosure. For example, in the proposed rewrite of the ADV form, brokers want the existence of disciplinary information on the Internet to substitute for a requirement to deliver that information to investors.



- C. Costs of paper disclosure have been used over the years as an excuse not to delivery information to investors. Rethinking of how Internet disclosure could be used to enhance the information made available to investors – both content and delivery – could offer exciting new possibilities.
 - D. Uniform disclosure document for all financial professionals. Currently, the SEC is engaged in revising the ADV Form to make it into a more effective disclosure document for investment advisers. While we support this effort, we believe the real issue should be providing uniform information for all types of financial professionals rather than just improved disclosure for one class of individuals. Also, the ADV rewrite could use a new set of eyes with a more creative approach.
- 4) Advisory committees – To the degree that the new administration appoints advisory committees, make sure they have robust investor representation and a fair representation of differing viewpoints.