

GAO

Report to the Ranking Minority Member,
Subcommittee on Oversight and
Investigations, Committee on
Commerce, House of Representatives

November 1995

ADMINISTRATIVE LAW JUDGES

Comparison of SEC and CFTC Programs



General Government Division

B-259884

November 14, 1995

The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
House of Representatives

Dear Mr. Dingell:

This report responds to your request that we compare various aspects of the Securities and Exchange Commission's (SEC) and the Commodity Futures Trading Commission's (CFTC) Administrative Law Judge (ALJ) programs. Your concerns were based, in part, on press reports indicating that CFTC routinely reverses or scales back penalties imposed by its ALJs. Generally, SEC and CFTC ALJs serve as hearing officers in enforcement cases involving alleged violations of securities and futures laws. They also provide rulings on other administrative issues. The primary objective of this report is to compare ALJ program operations at SEC and CFTC, including case-processing times and results of appeals of ALJ decisions. Detailed answers to your specific questions concerning issues such as budgets, staffing, and caseload statistics for both agencies' ALJ operations are included in appendixes I to III.

Results in Brief

The ALJ programs at SEC and CFTC were similar in function, size, case-processing time, and results of appeals when their operations involving enforcement cases were considered. SEC's ALJs do not have the same authority as CFTC's ALJs to hear cases seeking damages on behalf of customers, called reparations cases.¹ To make the program comparison meaningful, we included in our review only enforcement cases for both agencies. While the total processing times for these cases from hearings through appeals were about the same at both agencies—averaging between 3.5 and 4 years—the average processing times for initial decisions was 9 months longer at CFTC than at SEC, and 4 months longer at SEC than at CFTC for appeal decisions. In an effort to cut total processing time for ALJ cases to less than 2 years, an SEC task force report proposed changes to SEC's procedures, which it is implementing. CFTC had not done a similar study, but because of the program similarity, the kinds of changes SEC makes, if successful, may also be useful to CFTC's ALJ program. The press

¹According to CFTC officials, CFTC and the Packers and Stockyards Administration in the Department of Agriculture are the only government agencies with reparations programs.

reports that led to this request and a May 1992 hearing² about CFTC reversing its ALJ decisions primarily involved reparations cases. For enforcement cases, SEC and CFTC changed sanctions in about 40 percent of the appeal decisions. Of those changed sanctions, SEC reduced the sanctions imposed in about 70 percent of the cases, and CFTC reduced sanctions imposed in about 80 percent of its cases.

Background

The ALJ position in federal agencies, originally called Hearing Examiner, was created by the Administrative Procedure Act of 1946, Public Law 79-404. The purpose of the act was to ensure fairness and due process in federal agency rulemaking and administrative adjudication proceedings and provide those whose affairs are controlled or regulated by federal government agencies an opportunity for a “formal” hearing on the record before an impartial hearing officer or ALJ. The act sought to ensure the ALJs’ judicial capability and objectivity by precluding agencies from evaluating the ALJs’ performance and by assigning responsibility for determining their qualifications, compensation, and tenure to the U.S. Civil Service Commission, later the Office of Personnel Management (OPM). Within OPM, that responsibility resides within the Office of Administrative Law Judges.

As of April 1995, OPM reported that there were about 1,320 ALJs employed in 32 agencies. SEC and CFTC each had three positions³ for ALJs who preside over administrative proceedings against securities or futures professionals whom the agencies alleged have violated securities or commodities laws, regulations, or rules. Each agency has specialized Rules of Practice (17 C.F.R. sections 201.01 - 201.29 for SEC and 17 C.F.R. sections 10.01-109 and part 3 for CFTC) that govern these proceedings.

When agency investigations indicate that securities or futures industry professionals may have committed violations that warrant sanctions, enforcement staff are to prepare charges against the alleged violators and obtain approval from their respective commissions to issue the charges. The commissions may pursue these charges in federal district courts or in administrative hearings. The parties to the proceedings are typically the SEC or CFTC and each person or firm named as a respondent in the complaint.

²Hearing before the Subcommittee on Conservation, Credit, and Rural Development, House Committee on Agriculture, May 19, 1992.

³One position at CFTC was vacant as of March 1995.

In administrative proceedings, after finding violations of the securities or commodities acts or rules, ALJs are to decide which, if any, sanctions are warranted against the alleged violators, such as a bar⁴ or revocation of their professional registration. ALJs' responsibilities include ruling on preliminary motions; conducting prehearing conferences; controlling the course of hearings, which may include written and/or oral testimony and cross-examination; and preparing and issuing initial or recommended decisions—written findings of law and fact—and resulting conclusions.

All parties to the administrative hearings have the right to file an appeal of ALJ decisions⁵ with the appropriate commission⁶ based on the facts of the case, the law in question, or the reasonableness of the penalties assessed. After the commission issues a decision on the appeal, the respondent can seek judicial review by the U.S. Court of Appeals and the U.S. Supreme Court.

Objectives, Scope, and Methodology

To compare SEC and CFTC ALJ programs, we reviewed the Administrative Procedure Act of 1946, OPM's Administrative Law Judge Program Handbook, and SEC and CFTC ALJ policies and procedures. We also reviewed the February 1993 report by the SEC task force on administrative proceedings, Fair and Efficient Administrative Proceedings, and interviewed officials at SEC and CFTC. We also contacted officials at OPM for general information on ALJ programs. Appendix I provides details on the results of our comparison, and appendix II provides a detailed description of each agency's administrative hearings and appeals process.

To provide statistical data on the cases heard and their outcomes, we reviewed summary documents for all enforcement cases initiated by the agencies' enforcement divisions for which the ALJs had made initial decisions during fiscal years 1989 through 1993. To determine the extent to which ALJ rulings are accepted or overturned by SEC and CFTC, we did a similar review of enforcement cases for which the agencies had issued appeal decisions. We determined the number and types of cases that the commissions reviewed on appeal, and sanctions levied in the original and appeal decisions, if they differed. In cases where this information was

⁴A bar restricts or prohibits a broker's activities by function, length of time, or both.

⁵Civil injunctive actions, which are filed in U.S. District Court and heard by a federal judge rather than the ALJs, are beyond the two commissions' jurisdiction. Appeals of injunctive cases are heard in the U.S. Court of Appeals.

⁶Each agency has five commissioners appointed by the President and staff offices organized by various agency functions, such as enforcement and market regulation.

unavailable in the summary documents, we asked agency officials for additional documentation. We included only administrative enforcement cases for which appeal decisions had been made during fiscal years 1989 through 1993. (See app. III.)

We did our work between February 1993 and April 1995 in Washington, D.C., in accordance with generally accepted government auditing standards. We obtained oral comments from SEC and CFTC on a draft of this report. Their comments are discussed on page 5.

For Enforcement Cases, SEC and CFTC ALJ Programs Are Similar

Except for reparations cases which, only CFTC ALJs rule on, ALJs at CFTC and SEC generally performed similar functions—hearing enforcement cases involving violations of commodities or securities laws, including ruling on administrative procedural issues. CFTC estimated that its ALJ budget, excluding reparations cases, for fiscal year 1994 was \$307 thousand.⁷ SEC reported that its ALJ budget was \$585 thousand.

SEC had four and CFTC had three ALJs on board during the period covering our review—fiscal years 1989 through 1993. The agencies select judges from a register of qualified applicants tested and screened by OPM. The judges serving at SEC during the time of our review averaged about the same number of years of federal service as their counterparts at CFTC (29 years versus 28). At both agencies, the ALJs may request training as they believe it is needed, with no formal training requirements at either agency. (See app. I.)

The hearings and appeals processes at both agencies were similar (see app. II), as were the times needed by both agencies to process cases. From initiation of proceedings to appeal decisions, cases averaged about 48 months at CFTC and 43 months at SEC. The SEC cases reached initial decisions an average of 9 months faster than at CFTC, while the time from initial decision to appeal decision averaged 4 months faster at CFTC than at SEC. We recognize that many variables, such as case complexity and delaying tactics on the part of respondents, can affect case-processing times.

Only SEC had studied the reasons for lengthy case-processing times. An SEC task force report, *Fair and Efficient Administrative Proceedings*, issued in February 1993, proposed changes to SEC's processes, such as establishing

⁷CFTC officials provided us a budget estimate, which excluded an estimated amount allocated to reparations cases.

required time frames for key processes and improving its case-tracking system. Through these changes, SEC hoped to reduce its total processing time to about 19 months. SEC published its new Rules of Practice incorporating the task force recommendations in June 1995. Because its ALJ processes are similar, if the SEC changes prove successful, CFTC may also be able to adopt them.

Omitting CFTC cases involving reparations, the percentage of appeal decisions that changed the amount or type of sanctions were about the same (38 percent at CFTC versus 39 percent at SEC). Of those changed decisions, SEC reduced the sanctions imposed in about 70 percent of the cases, while CFTC reduced the sanctions in about 80 percent of the cases. (See app. III, pp. 28 and 29.)

Agency Comments

We requested comments on a draft of this report from the Chairmen of SEC and CFTC or their designees. We discussed the draft comments with the Deputy Executive Director, CFTC on September 15, 1995, and SEC provided technical comments from the Chief Judge of the Office of Administrative Law Judges and the General Counsel on September 18, 1995. The SEC and CFTC officials generally concurred with the draft's contents and conclusions. Both agencies provided us technical comments, which we have incorporated into this report where appropriate.

We are sending copies of this report to the Chairman of the Securities and Exchange Commission, the Chairman of the Commodity Futures Trading Commission, and other interested parties. We will also make copies available to others upon request.

Major contributors to this report were Michael A. Burnett, Assistant Director; Richard L. Wilson, Senior Evaluator; and Darleen A. Wall, Evaluator. If there are any questions about this report, please contact me on (202) 512-8678.

Sincerely yours,

A handwritten signature in cursive script that reads "Helen H. Hsing".

Helen H. Hsing
Associate Director
Financial Institutions and Markets Issues

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Abbreviations

ALJ	Administrative Law Judge
CEA	Commodity Exchange Act
CFTC	Commodity Futures Trading Commission
OPM	Office of Personnel Management
SEC	Securities and Exchange Commission

Comparison of SEC and CFTC ALJ Programs

According to OPM, an ALJ's responsibility is to develop factual records in matters requiring consideration of technical expertise, as opposed to common judgment; discern facts; and make fair and impartial decisions based on those facts. The roles of the ALJs at SEC and CFTC are similar for enforcement cases and administrative activities, but, unlike SEC, CFTC has authority to handle reparations cases. ALJs at both agencies render decisions in enforcement cases brought by their Enforcement Divisions against violations of commodities and securities rules and regulations as well as rule on procedural issues arising during the course of the adjudicatory procedures, such as continuances. All hearing proceedings at both agencies are governed by the Administrative Procedure Act of 1946 and specialized rules of practice (17 C.F.R. sections 201.01-29 for SEC and 17 C.F.R. sections 10.01-109 and part 3 for CFTC). The length of a hearing before an ALJ depends upon the nature of the case and may vary from an hour to several weeks or more.

SEC's ALJ functions are governed by the provisions of the Administrative Procedure Act, the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, as well as the Investment Advisers Act of 1940, the Investment Company Act of 1940, and the Public Utility Holding Company Act of 1935. The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Remedies Act) authorized SEC to impose civil penalties in administrative actions and to seek civil penalties in U.S. District Court as sanctions for violations of these acts. The ALJs conduct hearings following institution of proceedings by SEC against alleged violators of the securities laws. At the conclusion of those proceedings, the ALJs issue their decisions, which include any sanctions the ALJs deem necessary.

CFTC ALJ functions are governed by the provisions of the Administrative Procedure Act and the Commodity Exchange Act (CEA), as amended in October 1974. ALJs at CFTC are responsible for the fair and orderly conduct of hearings and have the authority to administer oaths, issue subpoenas, rule on and receive evidence, examine witnesses, regulate the course of hearings, hold prehearing conferences, rule on motions, enter initial decisions, and certify interlocutory appeals.⁸ The ALJs decide administrative proceedings brought by CFTC against persons or firms who are alleged to have violated CEA or CFTC rules and regulations as well as formal reparations proceedings for those cases involving amounts of \$10,000 or more.

⁸Interlocutory appeals are appeals for decisions to be made during a proceeding. See footnote 15, p. 19, for the specific requirements for these appeals.

Unlike SEC, CFTC is authorized to accept and handle customer complaints, called “reparations complaints,” against persons or firms registered under the CEA. If a complainant can prove a futures industry professional has violated the CEA or a CFTC rule and thereby proximately caused the customer financial harm, CFTC is empowered to award monetary damages. This program is not a disciplinary forum, and CFTC is not authorized to impose trading prohibitions or other nonmonetary sanctions in reparations cases. However, if a registrant fails to pay a reparations award within 15 days, his or her exchange trading privileges and CFTC registration are automatically suspended according to the CEA. CFTC ALJs and Hearing Officers issued 674 reparations decisions during fiscal years 1989 through 1993. We did not include reparations cases in this review because SEC does not have a reparations program with which to compare it.

ALJ Offices Are Independent of Investigative and Prosecutorial Functions

SEC’s ALJs are under the supervision and direction of the Chief ALJ in the Office of Administrative Law Judges, who reports directly to the SEC Chairman. CFTC’s ALJs are in the Office of Proceedings’ Hearings Section, under the supervision and direction of the Director of the Office of Proceedings, who reports to CFTC’s Deputy Executive Director. The line of supervision and direction continues to the Executive Director and then the CFTC Chairman. At both agencies, the ALJs’ nonadjudicatory responsibilities are subject to agency administrative direction regarding matters such as hours of duty, travel, office space and procedures, and staff assistance.

To maintain the independence of ALJs, the Administrative Procedure Act requires that the ALJs not be “responsible to or subject to the supervision or direction of any officer, employee, or agent engaged in the performance of investigative or prosecuting functions” for the agency. SEC and CFTC ALJs meet this requirement. The Enforcement Division at each agency handles the investigative and prosecuting functions.

Budget and Staffing

We compared budget and staffing levels for similar functions in the ALJ offices at both agencies. Both agencies were authorized four ALJ positions for fiscal years 1989 and 1990. In fiscal year 1991, CFTC decreased its ALJ positions to three. However, their ALJ staffs differ somewhat in size and composition, due in part to being organized differently. SEC’s seven-position ALJ office operated as a separate entity. In contrast, the ALJ positions at CFTC are part of CFTC’s Office of Proceedings and shared six to eight support staff with the Hearings Section.

Appendix I
Comparison of SEC and CFTC ALJ
Programs

To compare SEC and CFTC's programs, we asked both agencies to provide us information on their budgets.⁹ We asked CFTC officials to subtract from their budget estimate the costs associated with reparations cases, since only CFTC ALJs rule on these cases. SEC reported that its ALJ budget for fiscal year 1994 was \$585,000. CFTC estimated that its ALJ budget for fiscal year 1994 was \$307,000.

SEC had four ALJs during the 1989 to 1993 time period from which we selected cases for review. During 1994, the ALJ office consisted of seven positions—three ALJs, a law clerk, two paralegal specialists, and one secretary. For budgetary purposes, SEC's ALJs fall under the agency's Legal and Economic Services Program, which furnishes legal, adjudicatory, and economic analyses to SEC on a wide variety of matters. SEC figures showed that the number of administrative proceedings initiated grew from 155 in fiscal year 1989 to 271 in fiscal year 1994, about a 75 percent increase. Table I.1 shows SEC's ALJ personnel and travel budget, and table I.2 show SEC's staffing.

Table I.1: SEC ALJ Staff Budget, Fiscal Years 1989 Through 1994

Dollars in thousands						
Budget Category	FY 1989	FY 1990	FY 1991	FY 1992	FY 1993	FY 1994
Compensation	\$348	\$361	\$434	\$497	\$505	\$494
Benefits	51	55	68	80	79	71
Travel	9	19	13	12	17	20
Total	\$408	\$435	\$515	\$589	\$601	\$585

Source: SEC.

⁹We relied on data supplied by both agencies and did not independently verify these data. CFTC officials arrived at their budget estimate by calculating the percentage of ALJ administrative staff time (ALJ administrative staff worked in the Office of Proceedings as well) and expenses dedicated to enforcement related activities, as indicated in the CFTC budget figures in table I.3. Because SEC had only six cases that were not enforcement cases, we did not ask SEC to adjust their budget figure and eliminate the costs associated with these cases.

Appendix I
Comparison of SEC and CFTC ALJ
Programs

Table I.2: SEC ALJ Staffing, Fiscal Years 1989 Through 1994

Number of Positions						
Job category	FY 1989	FY 1990	FY 1991	FY 1992	FY 1993	FY 1994
ALJ	4	4	4	4	4	3
Law clerk	0	0	1	1	1	1
Paralegal specialist	0	0	0	0	0	1
Secretary	2	2	2	2	2	2
Total	6	6	7	7	7	7

Source: SEC.

According to CFTC officials, during most of fiscal years 1989 through 1993, CFTC had three ALJs. By fiscal year 1994, CFTC's Office of Proceedings had two ALJs (one of the three ALJ positions was vacant) and six support staff—three attorney-advisors, two legal technicians/administrative staff, and one law clerk—who also did other work in the Hearings Section of the Office of Proceedings. For comparison purposes, the CFTC Budget Office computed the budget figures shown in table I.3. They used a multiplier that represents their estimate of the percentage of staff time and expenses spent on enforcement cases, eliminating that portion of the budget they believe was not attributable to enforcement cases. An Office of Proceedings official told us that the percentages shown in table I.3 for each fiscal year are estimates of the percentages of staff-time directed toward enforcement cases during the fiscal years covered by this report. Table I.4 shows actual staffing.

Table I.3: CFTC ALJ Staff Budget, Fiscal Years 1989 Through 1994 (Estimated)

Dollars in thousands						
Budget Category	FY 1989	FY 1990	FY 1991	FY 1992	FY 1993	FY 1994
Estimated percentage of actual staffing devoted to enforcement cases	30%	40%	50%	60%	60%	60%
Compensation	\$158	\$214	\$287	\$280	\$335	\$242
Benefits	27	39	53	54	67	49
Travel	10	15	11	15	7	16
Total	\$195	\$268	\$351	\$349	\$409	\$307

Source: CFTC.

Appendix I
Comparison of SEC and CFTC ALJ
Programs

Table I.4: CFTC ALJ Staffing, Fiscal Years 1989 Through 1994

Number of Positions						
Job category	FY 1989	FY 1990	FY 1991	FY 1992	FY 1993	FY 1994
ALJ	4	4	3	3	3	2
Attorney-advisor	3	2	4	3	4	3
Legal technician	3	3	3	2	2	2
Legal clerk	1	0	0	0	0	0
Law clerk	1	2	0	1	1	1
Total	12	11	10	9	10	8

Source: CFTC.

Background, Experience, and Training

SEC and CFTC select their ALJs from a register, provided by OPM, of qualified applicants for the positions. The Administrative Procedure Act of 1946 gave OPM the responsibility¹⁰ for determining the qualifications of federal ALJs. OPM ascertains that applicants have met its minimum qualifications for the ALJ positions¹¹ and rates and ranks them on the quality of their experience and other factors, such as written demonstrations, panel interviews, and personal reference inquiries, before listing them on the register.

The ALJs presiding over SEC administrative proceedings in fiscal year 1993 had served an average of 20 years as ALJs and averaged 29 years of federal service, while the CFTC ALJs averaged 14 years as ALJs and 28 years of federal service. Most had previously held ALJ positions in other federal agencies, and all had served federal or state agencies in other capacities. Two of SEC's ALJs had previously held management positions at SEC¹²—one as Assistant Regional Administrator of a regional office, and one as an

¹⁰The act conferred responsibility to the U.S. Civil Service Commission, predecessor to the OPM.

¹¹OPM's minimum qualifications for the position of ALJ require that all applicants must (1) be attorneys with a minimum of 7 years of administrative law and/or trial experience involving formal administrative hearing proceedings before local, state, or federal administrative agencies, courts, or other administrative bodies and (2) have had either 1 year of experience characteristic of the next grade level below that of the position applied for or 2 years of experience characteristic of the grade level two levels below that of the position applied for.

OPM rates applicants on the quality of their experience in various areas, such as analytical and decisionmaking ability, oral communications, judicial temperament, writing ability, rules of evidence, and trial procedures as well as on the results of a panel interview and personal reference inquiries, before placing them on a register of eligible applicants from which OPM refers them to agencies wishing to fill vacancies. ALJ appointments are permanent career appointments, requiring no probationary or conditional service.

¹²Both ALJs with previous SEC experience are no longer with SEC.

Associate Director—and none of CFTC’s ALJs had previously served the agency in other capacities.

Regarding ALJ training, OPM’s Administrative Law Judge Program Handbook states that it strongly encourages continuing education programs to help ALJs keep current in new developments in their field and profession. However, officials at SEC and CFTC told us that the agencies also have no specific training requirements for their ALJs, leaving the ALJs to request training as desired. Agency officials indicated that all of the ALJs had taken at least one training course during the 5-year period we reviewed.

Description of the SEC and CFTC Administrative Hearings and Appeals Process

Historically, SEC and CFTC have used two types of enforcement actions against those who violate the securities and commodities laws: (1) civil injunctive action in U.S. District Court or (2) administrative proceedings before an agency ALJ. Civil injunctions are court orders that prohibit existing or imminent violations of the securities or commodities laws and that sometimes provide other equitable relief, such as a freeze on funds to protect the investing public or an accounting and disgorgement¹³ of illegal profits. Violation of civil injunctions can result in civil or criminal contempt charges that subject violators to fines or imprisonment.

Administrative proceedings can be brought against regulated entities and persons associated with such entities. The Remedies Act of 1990 expanded SEC's authority to bring administrative proceedings against persons not associated with regulated entities as well. ALJs can impose cease and desist orders and other types of sanctions, such as suspension from doing business, monetary penalties, limitations of activities, bar from doing further business or from participation in the securities industry, and disgorgement of illegal profits (SEC only). SEC and CFTC may also refer an investigation to the Department of Justice for criminal prosecution or to a state or local agency or a self-regulatory agency for their appropriate action.

SEC and CFTC enforcement staff investigate possible violations of securities and commodities laws and make recommendations to their commissions for enforcement action. Staff evaluate information obtained from many sources to decide whether further investigation is warranted. These sources include public complaints; inspections of broker-dealer books and records; review and analysis of market surveillance and news media data; and referrals from other divisions within their agencies and federal, state, or local agencies. An investigation may constitute a routine examination into the conduct of one person or entity or a complex inquiry into an elaborate scheme involving many persons and entities. The investigation may or may not result in enforcement actions seeking sanctions.

Enforcement staff must obtain their respective commission's approval for each specific enforcement action, such as naming each proposed respondent and citing alleged violations, after which the staff are to file the official complaint in the appropriate venue. For administrative actions, at any time after charges have been issued and before the ALJ's initial decision, the agency and the respondents may negotiate a consent agreement whereby the respondents agree to accept the sanctions and

¹³Disgorgements are awards made to return ill-gotten gains to affected investors or to the Treasury.

remedies sought by the agency without admitting or denying the charges. Acceptance of this settlement by all parties ends the administrative proceedings.

The administrative proceedings processes at SEC and CFTC are similar. As discussed in appendix 1, these proceedings are governed by the Administrative Procedure Act of 1946 and by 17 C.F.R. part 201 at SEC and 17 C.F.R. parts 10 and 3 at CFTC. The regulations cover procedures such as deadlines and filings. Neither agency has separate written guidelines for the conduct of proceedings beyond the applicable C.F.R. requirements. The proceedings process for enforcement cases is described in the following section.

Hearings Proceedings

An administrative adjudicatory proceeding is a judicial-type proceeding, which leads to the formulation of a final order on the outcome of the proceeding. The actual parties to an enforcement adjudicatory proceeding are the Division of Enforcement at SEC or CFTC and each party named as a respondent in the complaint. The agency rules on appeals of administrative enforcement cases, functioning as an appellate adjudicatory body guided by legal precedents, and considers each commissioner's individual interpretation of the applicable legal principles.¹⁴ The commissions' decisions are subject to judicial review by federal circuit courts of appeal.

Administrative proceedings begin when the agency issues a document, called "order instituting proceedings" (order) by SEC and "complaint and notice of hearing" (complaint) by CFTC. The document sets forth facts that, if proved, would, in the view of the agency, constitute violations of commodities or securities laws and, where appropriate, directs a respondent when to file an answer. Enforcement proceedings as well as proceedings to deny or condition registration as an industry professional always begin with this order or complaint. Proceedings in which a hearing will be held are assigned to an ALJ who will preside over the proceeding and prepare an initial decision at its conclusion. The order or complaint generally sets forth alleged violations of commodities or securities laws that are based upon the results of the Division of Enforcement's investigation or upon information brought to its attention and the Division's view of the law. Following receipt of the order or complaint, each respondent must file an answer stating whether they admit, deny, or

¹⁴The commission also sits as an appellate adjudicatory body in reviewing disciplinary cases decided at the securities and futures exchanges, the National Association of Securities Dealers, and registered futures associations.

do not have and are unable to obtain sufficient information to admit or deny each allegation. Failure to file a timely answer can result in a default judgment.

At SEC, cases are forwarded to the Chief ALJ, who issues the order designating the time and place of the hearing and determines which law judge will preside over the case. The CFTC's Director of the Office of Proceedings assigns the cases to ALJs, who handle all aspects of the hearing. Both agencies generally assign cases by "rotation so far as practicable," a standard prescribed by 5 U.S.C. 3105.

The hearing may be held at the respective commission's office in Washington, D.C., a regional office, or other locations selected by the ALJ, with due regard for the public interest and the convenience and necessity of the participants or their representatives. The hearings are public; however, a respondent or affected witness may request the ALJ to direct that certain documents or testimony be kept private to prevent unwarranted disclosure of trade secrets, sensitive commercial or financial information, or an unwarranted invasion of personal privacy.

Prehearing motions may be filed and prehearing conferences may be held to resolve various procedural and/or substantive matters to facilitate a fair and expeditious hearing. After any motions and conferences, the ALJ may issue a prehearing memorandum indicating any agreements reached and any procedural determinations made.

Rules also provide procedures for depositions, requests for admissions, and issuance of subpoenas. Prehearing discovery, which involves the production of documents before the hearing, is addressed by CFTC rules, which require the Enforcement Division to disclose specified investigatory materials to the respondents unless otherwise ordered by the ALJ or the commission. Though not required by SEC rules, the parties may voluntarily exchange documents, or the staff may turn over relevant portions of the investigative record that are not privileged or otherwise protected.

Following completion of discovery, the ALJ will ordinarily schedule a hearing on the merits of the case. SEC rules permit disposition of the case without a hearing by either a motion for summary judgment or a shortened procedure for the submission of direct evidence.

At the hearing, the respondents may appear personally or be represented by counsel. The rules stipulate notification requirements, rights to legal

representation, presentation of evidence, and the right to request appropriate relief.¹⁵

The ALJ presides over the hearing. The Federal Rules of Evidence serve as a general guide for the admission of evidence. All witnesses testify under oath or affirmation administered by the ALJ and may be cross-examined by adverse parties. The ALJ, at his or her discretion, may permit cross-examination on any relevant matter without limitation to the scope of the direct examination. At SEC, the ALJ also may order witnesses to testify by verified written statement (deposition), although such witnesses must remain available for oral cross-examination and redirect examination. CFTC rules allow expert witnesses to give direct testimony in writing.

Generally, rulings made by the ALJ during the proceeding will not be reviewed by the commission until the conclusion of the entire adjudicatory proceeding. However, the CFTC rules do provide for interlocutory review at the discretion of the commission under extraordinary circumstances.¹⁶ After the hearing is over, each party has the opportunity to submit to the ALJ proposed findings of fact and conclusions of law as well as a brief containing points and authorities in support of the proposed findings and conclusions.

Following final submissions by the parties, the ALJ prepares the initial decision on the basis of the record. The initial decision becomes the final decision of the agency 30 days after service unless a timely notice of appeal is filed (in which case, the decision would not be final as to that party) or the commission on its own initiative decides to review the initial decision. In formulating the initial decision, the ALJ determines what, if any, violations the respondents committed and what sanctions would best protect market integrity and the public interest.

¹⁵The Equal Access to Justice Act, 5 U.S.C. 504, provides for the award of attorney fees and other expenses to eligible individuals and entities who are parties to certain administrative proceedings before either commission. An eligible party may receive an award when it prevails over the commission unless the commission's position in the proceeding was substantially justified or special circumstances make an award unjust.

¹⁶The Rules permit interlocutory appeals from rulings: (1) denying a motion to disqualify an ALJ, (2) suspending any attorney from participating in a particular proceeding, (3) denying intervention or limited participation, or (4) requiring the issuance of a subpoena of an officer or employee of the commission or other government agency or the production of government records. In all other situations, review may be permitted upon certification by the ALJ that the ruling involves a controlling question of law or policy; an immediate appeal may materially advance the ultimate resolution of the issues and to avoid the unnecessary delay and expense created by subsequent reversal of the ruling.

Sanctions available to both commissions' ALJs in enforcement cases include cease and desist orders, suspension or revocation of registration and trading privileges, and civil monetary penalties. SEC ALJs can also limit activities, such as limiting respondents to not having supervisory or proprietary interest in a firm doing securities business and impose disgorgements to repay money gained as a result of violating securities laws and regulations.¹⁷ Certain violations, such as federal felony convictions, result in statutory disqualification hearings, in which ALJs determine whether the respondent should remain registered, with or without restrictions. The courts have stated that the ALJs should exercise discretion in individual cases to determine which of the statutory remedies should be invoked and to what degree, rather than automatically impose across-the-board penalties for each type of violation.

Appeal Process

To appeal an initial decision, dismissal, or other final disposition by the ALJ, any, or all, of the parties—the respondents and the Division of Enforcement—may file a notice of appeal with the agency within 15 days after service of the initial decision or order. Rules stipulate time frames for filing briefs and filing for oral argument (which is authorized only at the respective commission's discretion).

Even if neither party appeals, the respective commission can order review of all or a portion of the decision on its own initiative. At SEC, respondents have a statutory right to commission review on certain issues, such as when the initial decision suspends, denies, or revokes a broker-dealer registration pursuant to section 15(b) of the Securities Exchange Act of 1934.

No statutorily prescribed standard exists for commission review of ALJ decisions. In delegating authority to ALJs to initially decide cases, neither commission transfers all of its powers, but each retains the authority to examine all aspects of the administrative proceedings and to substitute its own judgment for that of the ALJ on any or all matters of fact, law, or policy. In considering appeals of ALJ initial decisions, the degree of review of findings of fact and evidentiary matters by the commissions may differ, depending on the issues to be addressed and the circumstances. The two commissions customarily review matters of law and new policy to retain responsibility for interpreting the law and establishing policy. A commission's decision may contain any findings and conclusions based on

¹⁷The Remedies Act of 1990 explicitly authorized SEC's practice of compelling disgorgement of illegal profits by individuals and firms found to have violated securities laws and regulations. Only one of the cases we reviewed included these newly authorized sanctions.

the record the commission deems proper and may affirm, reverse, modify, set aside, or remand to the ALJ for further proceedings, in whole or in part.

If no one files an appeal within the time allowed and the commission does not order a review, the initial decision becomes the respective commission's final decision. Rulings of law expressed in initial decisions submitted to the commission for review have no weight as precedent in future cases unless the commission adopts the same rulings.

The commissions have delegated to the Secretary and the General Counsel at SEC, and to the General Counsel at CFTC, much of the responsibility for managing cases appealed to them. The staff members review the record and the briefs and schedule oral arguments as well as handle requests for postponements or extensions of time to file.

At SEC, General Counsel staff members review and approve appeal requests then provide the commission members copies of the record and briefs. If oral argument is to be held, the staff distributes to each commission member a summary preargument memorandum describing the facts and analyzing the issues prior to the argument.

After oral argument, the SEC commission members discuss the case in executive session, outside the presence of all but those staff members assisting in the preparation of the opinion. Staff members write a proposed majority opinion in accord with the Commission's guidance, which the commission members review and comment on before voting on the final opinion. Individual commission members may elect to prepare separate statements of concurrence or dissent. Opinions in cases where no oral argument was made are handled similarly. Staff members prepare a draft opinion and explanatory memorandum that are circulated among the commission members for their review and vote.

The CFTC's Office of General Counsel assists the Commission in its adjudicatory role by (1) reviewing the record and the pleadings and (2) drafting a proposed opinion and order and then submitting it to each of the commission members for consideration, together with the ALJ's initial decision and the parties' appeal briefs. Office of General Counsel staff members then meet with the commissioners' legal assistants regarding the proposed disposition of a case and discuss the policy and precedential implications of the draft opinion. After discussion and any revisions, the draft document is then circulated among the commission members for final consideration.

Appendix II
Description of the SEC and CFTC
Administrative Hearings and Appeals
Process

At SEC and CFTC, a majority of the commissioners reviewing a case must agree on whether to affirm or alter an initial decision. If a vote is tied, an initial decision will be affirmed without opinion.

Any party may petition for reconsideration of a commission's opinion at either agency within 15 days of the opinion being served. The petition must specify the relief sought and the supporting grounds and must be confined to new questions raised in the opinion that the party did not have the opportunity to argue. The filing of such a petition does not automatically stay the order of the commission.

Analysis of SEC and CFTC ALJ Cases Heard During Fiscal Years 1989 Through 1993

Results of Enforcement Cases

In response to specific questions on (1) the types of charges filed, (2) financial activities involved, (3) dollar amounts of cases and proportion of claims awarded, (4) civil fines assessed or fees recovered, (5) other disciplinary actions, (6) case-processing times, and (7) outcomes of appeals, we analyzed the results of enforcement cases processed by SEC and CFTC during fiscal years 1989 through 1993, which are presented in tables III.1, III.2, and III.3.

Table III.1: Types of Charges Filed for SEC ALJ Cases

Charges	Initial decision	Appeal
Criminal/civil conduct/convictions	16	3
Disclosure/misrepresentation	16	8
Failure to adequately supervise	5	3
Failure to register stock	3	2
Inaccurate/incomplete reports/forms	4	0
Violation of net capital rule	2	1
Failure to register as broker-dealer	2	0
Fraud/misconduct in offer/sale	8	3
Manipulative/deceptive practices	4	2
Wash sales/matched orders	2	0
Excessive trades or mark-ups	5	0
Unsuitable trades	2	0
Failure to segregate funds	1	1
Parking	1	0
Soft dollar payments	1	0

Appendix III
Analysis of SEC and CFTC ALJ Cases Heard
During Fiscal Years 1989 Through 1993

Table III.2 Types of Charges Filed for CFTC ALJ Cases

Charges	Initial decision	Appeal
Statutory disqualifications	19	13
Disclosure/misrepresentation	21	14
Failure to report/false or omitted information	15	15
Not registered/violating registration provisions of CEA	2	4
Failure to keep complete records	6	6
Failure to adequately supervise	11	7
Fraud in solicitation	8	6
Fraudulent/fictitious transactions	12	17
Unauthorized/unlawful transactions	12	10
Manipulation	0	1
Misappropriation of funds	2	3
Violating a Commission order	3	2

Note: The charges listed are charges we identified from the enforcement cases that were either initially decided by ALJs or appealed during the fiscal year 1989 to 1993 time period. Initial decisions and appeals were not necessarily the same cases because we only looked at cases that were decided during the period of our review. SEC issued 38 initial decisions on enforcement cases and 18 appeals during this period, and CFTC issued 46 initial decisions and 48 appeals. Most cases had more than one charge either on initial decision or on appeal.

Source: GAO analysis.

Appendix III
Analysis of SEC and CFTC ALJ Cases Heard
During Fiscal Years 1989 Through 1993

Table III.3: Type of Financial Activity Involved

SEC activities	Initial decision	Appeal
Penny stocks	10	5
Common stocks	4	1
Municipal/government securities	2	2
Limited partnerships	2	1
Revenue bonds	1	1
Pension funds	1	0
Junk bonds	1	0
Options	1	1
Various/unspecified	16	7
Total SEC cases	38	18
CFTC activities		
Soybean futures	6	6
Precious metals	1	4
Foreign currencies	5	4
Orange juice	0	1
T-bonds	1	1
Various/unspecified	33	32
Total CFTC cases	46	48

Source: GAO analysis.

Dollar Amounts Involved and Proportion of Claims Awarded

Unlike reparations cases, enforcement cases are not based on claims of specific dollar losses. Instead, the agencies seek to discipline violators of securities and futures rules and regulations as a disincentive to would-be violators and to protect the integrity of the markets. The monetary damages in enforcement cases were generally not found in the public records we reviewed.

Civil Fines Assessed or Disgorgements

Although CFTC has had the authority to levy civil monetary penalties against violators in its enforcement cases since its inception, SEC has had the ability to impose fines in administrative proceedings only since the passage of the Remedies Act of 1990. Only 1 of the 38 SEC enforcement cases we reviewed—a disgorgement award of \$430,000—included this type of sanction. None of the SEC appeals awards we reviewed assessed fines or disgorgements.

For CFTC, 20 of the 46 initial decisions we reviewed included civil monetary penalties totaling \$5,196,708. Of the 48 appeal cases we reviewed, 27 included civil monetary penalties totaling \$5,269,600. On appeal or remand,¹⁸ penalties in three cases were raised by a total of \$175,100; penalties in nine cases were lowered by a total of \$747,000; and penalties in three cases involving a total of \$343,100 were still open, pending remand decisions. Excluding the open remand decisions, the net result was that the total civil monetary penalties were reduced by \$571,900 on appeal and remand.

Other Disciplinary Actions Taken

SEC Actions

Bar - In 10 appeal cases where ALJs had imposed bars, SEC affirmed bars against all 12 respondents. In two cases, involving one respondent each, SEC raised the ALJ imposed sanction of a 120-day and 90-day suspension to a bar.

Suspension - In 8 appeal cases involving 13 respondents, SEC affirmed suspensions of 2 respondents, lowered suspensions of 5 respondents to censure, dismissed or vacated suspensions of 2 respondents, raised suspensions of 2 respondents to bar, and increased the duration of suspension for 2 respondents.

Registration revoked - In three appeal cases, SEC affirmed the revocation of registration for all three respondents against whom this sanction was imposed.

Censure - In two appeal cases involving two respondents, in which ALJs had imposed censures, SEC affirmed the censure against one respondent and dismissed the other censure.

Cease and desist orders - Since the passage of the Remedies Act of 1990, SEC has imposed administrative cease and desist orders to halt improper practices. In the disciplinary actions imposed in the cases we reviewed, two respondents in initial decisions and no respondents in appeals cases had cease and desist orders levied against them.

CFTC Actions

Trading prohibitions or suspensions - In 38 appeal cases in which ALJs ordered trading prohibitions or suspensions of 69 respondents, CFTC

¹⁸Remanded cases are those that have been returned to the ALJ for further consideration.

affirmed or otherwise did not change those sanctions against 29 respondents. CFTC vacated and dismissed sanctions against 15 respondents from 8 cases. CFTC modified the prohibitions or suspensions against 10 respondents, increasing them for 4 respondents and decreasing or eliminating them for 6 respondents. CFTC remanded prohibition or suspension decisions in 15 cases for 15 respondents. On remand, the ALJ reduced the sanctions against two respondents and maintained the sanction against one respondent. The remaining 12 remanded cases were still open at the end of fiscal year 1993.

Registration revoked - In 20 appeals of cases in which ALJs revoked registrations against 41 respondents, CFTC affirmed or otherwise did not change those sanctions against 23 respondents in 13 cases. The cases against 11 respondents were vacated. Of five remanded cases involving seven revoked registrations, there was no change in one case involving one respondent, and the rest remained open at the end of fiscal year 1993.

Cease and desist orders - ALJs imposed cease and desist orders against 98 respondents in 42 appealed initial decisions. CFTC affirmed or otherwise did not change the orders against 81 of the respondents, revoked the orders against 10, and raised the sanction against 1. In addition, CFTC imposed a cease and desist order on an additional respondent after vacating a monetary fine. Of two remanded decisions involving two respondents, the charges were not changed in either. Six remanded cases involving six respondents remained open at the end of fiscal year 1993.

Case-Processing Time

SEC

From the date of the order instituting proceedings to initial decision, the SEC enforcement cases we reviewed averaged 15 months, and they averaged 28 months from initial decision date to an appeal decision. SEC had been concerned about its administrative process and formed a task force to review ALJ administrative operations. In its February 1993 report, Fair and Efficient Administrative Proceedings, the task force recommended that SEC establish guidelines of no more than 10 months for the average time from instituting proceedings to rendering an initial decision and no more than 9 months after issuing the order establishing a briefing schedule to rendering a final decision on an appeal.

The task force recommended other actions regarding the timeliness of administrative adjudications, such as scheduling status conferences for

those cases that do not progress from stage to stage within specified periods and improving SEC's case activity tracking system, with responsibility for the system to be centralized in the Office of General Counsel. SEC officials claim that by implementing interim task force recommendations, SEC has improved the productivity of its administrative process since the task force was created.¹⁹

CFTC

CFTC cases we reviewed took an average of 24 months from issuance of complaint and notice of hearing to initial decision, and they averaged 24 months from initial decision date to appeal decision.

Commissioners at each agency modified sanctions levied by ALJs in 7 of 18 SEC appeal decisions (39 percent) and 18 of 48 CFTC appeal decisions (38 percent). The commissioners made no changes to ALJ-imposed sanctions for the rest of the appealed decisions. Seventy-one percent of the modified sanctions at SEC and 78 percent of the modified sanctions at CFTC resulted in lower sanctions for the respondents. The uniqueness and complexity of each case preclude generalizations about the adequacy and consistency of penalties. Cases typically involved different mixes of abuses occurring over varying periods of time, with different amounts of customer funds involved, differing numbers of trades involved in the abuses, and offenders with varying disciplinary records, whose cooperation during the conduct of proceedings differed as well. Moreover, differences in the types of abuses that occur in the futures and securities markets do not allow for comparisons as to whether similar cases received consistent penalties.

Outcomes of Cases Accepted for Appeal

SEC

SEC reported that it had disposed of a total of 846 enforcement cases during fiscal years 1989 through 1993, for which its ALJs issued 38 initial decisions.²⁰ SEC commissioners ruled on 18 appeals of ALJ decisions in cases brought by SEC's Enforcement Division against individuals and firms alleged to have violated securities acts, rules, or regulations. SEC made no changes to sanctions in 11 cases (61 percent) and modified them in 7 cases

¹⁹According to SEC, by implementing steps such as (1) increasing the number of attorneys assigned to the office responsible for drafting Commission opinions, (2) filling new senior management positions in that office, and (3) obtaining help from outside that office to aid in preparing draft opinions, SEC issued 85 percent more opinions in fiscal year 1992 than in the previous year.

²⁰According to SEC's task force report, over 90 percent of administrative proceedings authorized by the Commission were settled. These included enforcement and other types of proceedings.

(39 percent). SEC reduced the sanction imposed in five of the seven modified cases (71 percent) and increased the sanctions imposed in the other two cases (29 percent).

CFTC

During fiscal years 1989 through 1993, CFTC reported that it had disposed of a total of 197 cases brought by the CFTC against individuals and firms alleged to have violated the CEA or CFTC rules or regulations. The ALJs issued 46 initial decisions in enforcement cases during that period. CFTC commissioners ruled on 48 appeals of ALJ enforcement decisions, modifying sanctions in 18 cases (38 percent), reducing sanctions imposed in 14 cases (78 percent) and increasing sanctions imposed in 4 cases (22 percent).²¹

²¹We did not include in our analysis two other appeals cases, which ruled on remuneration granted the respondents by the ALJs under the Equal Access for Justice Act, because the cases did not involve sanctions against the respondents.

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