

THE ROLES AND RESPONSIBILITIES OF INSPECTORS GENERAL WITHIN FINANCIAL REGULATORY AGENCIES

HEARING

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
ORGANIZATION, AND PROCUREMENT
OF THE
COMMITTEE ON OVERSIGHT
AND GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES
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CONTENTS

	Page
Hearing held on March 25, 2009	1
Statement of:	
Kepplinger, Gary L., general counsel, Government Accountability Office ..	10
Kotz, H. David, inspector general, U.S. Securities and Exchange Commis- sion; William Desarno, inspector general, National Credit Union Ad- ministration; A. Roy Lavik, inspector general, Commodities Futures Trading Commission; Vanessa K. Burrows, legislative attorney, Con- gressional Research Service; Clark Kent Ervin, director, Homeland Se- curity Program, Aspen Institute; and Danielle Brian, executive director, Project on Government Oversight	31
Brian, Danielle	78
Burrows, Vanessa K.	61
Desarno, William	48
Ervin, Clark Kent	74
Kotz, H. David	31
Lavik, A. Roy	55
Larson, Hon. John B., a Representative in Congress from the State of Connecticut	4
Letters, statements, etc., submitted for the record by:	
Brian, Danielle, executive director, Project on Government Oversight, prepared statement of	81
Burrows, Vanessa K., legislative attorney, Congressional Research Ser- vice, prepared statement of	63
Desarno, William, inspector general, National Credit Union Administra- tion, prepared statement of	51
Ervin, Clark Kent, director, Homeland Security Program, Aspen Insti- tute, prepared statement of	76
Kepplinger, Gary L., general counsel, Government Accountability Office, prepared statement of	13
Kotz, H. David, inspector general, U.S. Securities and Exchange Commis- sion, prepared statement of	35
Larson, Hon. John B., a Representative in Congress from the State of Connecticut, prepared statement of	7
Lavik, A. Roy, inspector general, Commodities Futures Trading Commis- sion, prepared statement of	57

THE ROLES AND RESPONSIBILITIES OF INSPECTORS GENERAL WITHIN FINANCIAL REGULATORY AGENCIES

WEDNESDAY, MARCH 25, 2009

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
ORGANIZATION, AND PROCUREMENT,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:35 p.m., in room 2247, Rayburn House Office Building, Hon. Diane Watson (chair of the subcommittee) presiding.

Present: Representatives Watson, Cuellar, Speier, Bilbray, Platts, Duncan, and Towns [ex officio].

Staff present: Bert Hammond, staff director; Valerie Van Buren, clerk; Adam Bordes, professional staff; Carla Hultberg, chief clerk, full committee; Jean Gosa, clerk, Domestic Policy Subcommittee and Information Policy, Census, and National Archives Subcommittee; Charles Phillips, minority chief counsel for policy; Dan Blankenburg, minority director of outreach and senior advisor; Adam Fromm, minority chief clerk and Member liaison; Stephen Castor, minority senior counsel; and Molly Boyd, minority professional staff member.

Ms. WATSON. I am sorry that the first thing I have to do is apologize for being so late.

But I want to say hello and good afternoon to all of you. This is the Subcommittee on Government Management, Organization, and Procurement of the Committee on Oversight and Government Reform. So I will now call you and myself to order.

Without objection, the Chair and the ranking minority member will have 5 minutes to make opening statements followed by opening statements not to exceed 3 minutes by any other Member who seeks recognition.

I would like to welcome you to our first subcommittee hearing this session, "The Roles and Responsibilities of the Inspectors General in the Financial Regulatory Community." As the chairwoman of the Subcommittee on Government Management, Organization, and Procurement, I look forward to working with Ranking Member Bilbray and the subcommittee members to ensure that our Federal bureaucracy is both effective and efficient in carrying out its responsibilities. I welcome our witnesses, especially my colleague Congressman John Larson. I look forward to hearing your testimony.

Today's hearing could not come at a more critical time for our panel, as our financial markets continue to struggle with mounting losses and insufficient capital reserves to meet the credit needs of our domestic economy. As we begin to implement newly established market stabilization programs across the financial regulatory community, we must also look ahead to ensure that our financial regulators have an effective Inspector General component as part of their agency operations. Personally, I believe no regulatory or market structure reforms will prove successful if our market regulators lack an independent and objective IG to oversee their activities.

The role of Inspectors General is an essential one for ensuring that our Federal agencies function both effectively and freely from undue political pressure or conflicting interests. These pervasive elements far too often creep into the culture of agencies, therefore compromising the very programs and staff that are charged with overseeing and enforcing the rule of law throughout the marketplace. In order to achieve this goal, we must ensure that our IGs are fully independent in their activities while also ensuring that they have adequate resources and legal authorities necessary for carrying out their duties. These elements are critical if we are to have faith in the regulatory mechanisms established to protect investors from reckless and fraudulent investment practices.

Last fall, Congressman Cooper worked to enact the Inspector General Reform Act of 2008 which provided significant improvements in the authorities and responsibilities granted to the IGs for carrying out their duties. These include new law enforcement authorities, increased budget autonomy, a unified Government-wide IG council, and additional reporting responsibilities to improve agency transparency. Today, however, many IGs are still appointed by their agency heads or commission chairs, thus opening some IG offices to potential conflicts of interest with the same agency leadership they are charged with overseeing. While this is a complicated issue with valid points on both sides, I believe it is one that merits a serious discussion in order to ensure the independence and reliability of agencies' IGs.

Today I hope that our panelists will be able to discuss their efforts to ensure that our market regulatory functions are being carried out efficiently by our agencies. Part of this must include how agency IGs are coordinating with the newly established Special IG for the Troubled Assets Relief Program [SIGTARP], in order to ensure that program funds are being spent appropriately and in accordance with the law. I am also hoping to hear about their ongoing activities to investigate where market regulators have failed in overseeing the very institutions that now require nearly \$1 trillion in government assistance in order to remain viable.

Furthermore, I look forward to hearing from Congressman Larson on his legislation, House of Representatives 885, the Improved Financial and Commodities Markets Oversight and Accountability Act. This bill would designate the IGs of several key financial market regulators to the level of Presidential appointments, therefore removing agency heads from having any role in the appointment or removal of an IG from office.

So once again, I want to thank our panelists and I want to thank the Members for coming today to join us. And we look forward to their testimony.

And at this point our co-chair, the minority leader, will have about 3 to 5 minutes for his statement.

Mr. BILBRAY. Madam Chair, I would just like to ask that my opening statement be introduced into the record.

Ms. WATSON. Without objection, so ordered.

Mr. BILBRAY. Thank you. And so, to get to the testimony as quickly as possible, let me just say that I appreciate you holding this hearing.

And I would like to thank the Congressman for basically drafting this bill because I think it is really critical that now is the time that we take a look at this whole IG issue. I mean, the act was originally initiated in 1978, back in the olden days when some of us were young and just getting into politics. It is time that we look at this very periodically to make sure the good intentions that we have tried to wreck in the past are actually working, especially now at a time with bailouts. You have rescues; you have big spending.

And Inspectors General are absolutely essential. I mean, if there was any concern in the past of when and where and how public funds were being used, right now the public has a hypersensitivity to it. And for good reason because of just the sheer numbers and the long-term impact that inefficiency can have.

I would just like to say that we always talk about how this is not Democrat or is not Republican or whatever. That is all great in abstracts. But this is one issue where we really don't know where the answer is. We need to probe. And it really is an example of where politics is more of an art than a science. It is not as exact as a lot of people like to think. And I hope that this hearing is the beginning of that probing to find where is the fine tuning, where is the nuance, where can we improve the system. I think the Congressman has one proposal that we need to look at seriously and then compare it to other options along the road. And I really think that a hearing like this is exactly how we can do it.

And I have to say, Madam Chair, I think a lot of people have been concerned that in crisis we do things quick, not well. And a lot of us, I know, are going back now and saying there were a lot of things done in the recent past that we wish we could go back and revisit. Here is a chance for us to get the facts, to work together, and to fine tune this before we ask the people of the United States to live with our decisions. And so I appreciate the ability to have this hearing. I appreciate the Congressman being here today. And I look forward to hearing all of the witnesses today so we can start that process of creating our work of art that hopefully will be something we will be proud of long after we are gone, especially one that makes sure that the voters are happy with the way we are handling their resources. This IG issue is obviously one of those issues that really is essential for us to do right if we are going to fulfill our responsibility of being the vanguards and the protectors of the taxpayers' money. And I appreciate the hearing again and yield back, Madam Chair.

Ms. WATSON. Thank you, Congressman Bilbray.

Congressman Cuellar, would you like to have an opening statement?

[Inaudible due to sound system malfunction.]

Ms. WATSON. Thank you. I would like to call on Congressman Platts at this time. Thank you for your leadership of this subcommittee. We appreciate the work that you do for the people.

Mr. PLATTS. Well, I thank you, Madam Chair. It certainly was a honor for 4 years to chair this subcommittee with now the full committee chair, then the ranking member, Mr. Towns from New York. I am honored to stay part of this effort.

Thank you for your hosting this hearing. One of the things we saw during those 4 years is the importance of IGs when it comes to truly ensuring efficiency and responsible operations of the Federal Government. And I want to commend our colleague, Mr. Larson, for his proposal for further enhancing the status and the independence of IGs of these five agencies, in particular given the challenges we are facing in our financial market. So I look forward to his testimony and to hopefully our successful movement of his legislation. Thank you, Madam Chair.

Ms. WATSON. Thank you. I now would like to welcome the chairman of the full committee, Mr. Towns, who decided to come and sit in with us on our first hearing. Would you like to make a statement?

Chairman TOWNS. Let me say first of all, I want to congratulate you. And I want to say that I think this is the best subcommittee of all, I want you to know that, because this is the one that, of course, I was ranking member on and one that I had an opportunity to Chair as well. I had the opportunity to work with Congressman Platts on many, many issues.

So I just want to say, Madam Chair, that I look forward to working with you. I would just like to yield back and wait to hear from Congressman Larson.

Ms. WATSON. Thank you so much. Let me call our committee to order. And we are honored to have with us as our first witness the Honorable John Larson. And thank you for your patience.

**STATEMENT OF HON. JOHN B. LARSON, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF CONNECTICUT**

Mr. LARSON. Thank you, Madam Chair.

[Inaudible due to sound system malfunction.]

Mr. LARSON. So let me thank you all again for this opportunity. And most importantly, let me thank your committee, as I think the chair adequately and eloquently stated the outset, for the work that you have done, the fine legislation that you have produced that Jim Cooper was a part of, and the pleasure of working with Ed Towns and the committee in terms of shaping this current legislation, House of Representatives 885, that we have before you. I would like to quickly, if the Chair would agree, submit a testimony from the Public Citizen in support of this legislation.

Ms. WATSON. Without objection, so ordered.

Mr. LARSON. I also would like to revise and extend my remarks and submit my testimony. I will summarize if I can so any questions that you might have, we can get to those as quickly as possible.

The need for this arose as we dealt with the issue of speculation more than a year ago in a nonpartisan basis, again recognizing the increased need for oversight and review. It was pointed out at the time that the CFTC did not have, it had an Inspector General, but it did not have independent status. That individual was hired by and reported directly to the CFTC. This committee waived jurisdiction but broadly supported it and this was taken to the floor and passed overwhelmingly, nonpartisanly. It unfortunately was not taken up in the Senate.

Upon discussion with Mr. Towns earlier this year and with his staff, we said, you know, this goes beyond the CFTC. And if we look at the kind of troubled waters, as Chairwoman Watson pointed out, that we find ourselves in today with all of these financial institutions and the ramifications therein, it became apparent to me and I think certainly to this committee and Mr. Towns that there was a need for us to make sure that our Inspectors General, a law that was first adopted in 1978 and upgraded last year by this committee, that we further augment and bolster their responsibility and their credibility with the American public to make sure that Inspectors General in critical agencies have independent status.

Now, under that legislation, there are two types of Igs. One is under Section 3 that has independent status. By that they are appointed by the President and confirmed by the U.S. Senate. Under Section 8, IGs also exist but in this case they are appointed by the president of the agency, the governing entity of the agency, and serve at the behest of that.

I think especially in these troubled times and with the problems that we face only exponentially growing, it is the desire of the public to make sure, especially as it relates to governmental entities, that they are doing their responsibility of oversight and review, which of course this committee is specifically charged with.

So this legislation is very simple. It says that we need to focus on the five agencies that have direct involvement in making sure that they are involved with the oversight of our financial institutions, both in the commodities and financial markets: the CFTC, the Board of Governors of the Federal Reserve, the National Credit Union Administration, the Pension Guaranteed Benefit Fund, and the Securities and Exchange Commission. All need to come under this kind of independent scrutiny that I think everyone in the U.S. Congress wants to see.

And all this bill does is augment the fine work that you have already done by giving them that kind of status that already exists in the law under Section 3 of that code. That would make these Inspectors General independent in status. It would expand their scope and their independence and give them additional resources. This committee went a long way toward providing resources last year and understood this early on. This gives added importance and independence in this day and age.

Now, how do I know that we need that and what kind of information do we have to back that up? We all know and can feel in our guts that intuitively this makes sense. But, in fact, we had the Congressional Research Service do a study and what that study showed was very clear. Amongst agencies that have an independ-

ent Inspector General appointed by the President and approved by the Senate, they are involved in more than 117 ongoing audits and investigations.

Amongst their same counterparts who are not appointed by the President but appointed by the agency and work at the direction of the agency, they have currently done 12 and have 11 that are under review. So in the case of independent Inspectors General appointed by the President and approved by the Senate, they do 10 times as many audits and reviews. At a time when every economist, every pundit, everyone who is looking at this situation says what we need and what we have needed all along is to make sure that we had greater oversight and review, I think this speaks volumes to the necessity for this legislation.

It is my hope along with Mr. Platts, and I was happy to hear him say that, and in working with Mr. Towns that we can expedite this legislative process. I believe this could probably be put on our consent calendar because of its nature and the gravity of this situation, as Chairwoman Watson has pointed out. I look forward to working with Chairman Towns and I thank him for his help and support and his committee's aid.

It was at their suggestion, I might add, that we look into expanding this because they had already done such a thorough job with the Cooper legislation last year. And with that, I will yield back the balance of my time and submit to any questions you might have.

[The prepared statement of Hon. John B. Larson follows:]

Testimony of Congressman John B. Larson
Subcommittee on Government Management, Organization, and Procurement
Committee on Oversight and Government Reform
March 25, 2009

Thank you, Chairwoman Watson and Ranking Member Bilbray, for allowing me to testify before the Subcommittee today and to address my concerns regarding the role of Inspectors General in light of our current economic crisis.

As the committee is likely aware, I recently introduced a bill entitled the “Improved Financial and Commodity Markets Oversight and Accountability Act,” HR 885. Last Congress, I introduced similar legislation which would have elevated the Inspector General (IG) of the Commodities Futures Trading Commission (CFTC) to a Section 3, independent IG. As we discussed various ways to fight the rampant speculation that was driving up the cost of oil, I introduced HR 6406, a measure that would have provided the CFTC – those who were charged with monitoring speculation – with a stronger Inspector General, one that was more independent and could hold the CFTC more accountable for their actions – or failure to take action. It was my belief then that the CFTC needed a watchdog – an entity designed to investigate any incompetence in leadership that may have gone uninvestigated or unreported. That legislation passed in the 110th Congress by voice vote on September 24, 2008, but unfortunately the Senate did not act on it.

But today we face a problem much larger than speculators in the oil market. Today, Wall St. is hemorrhaging, insurance executives cash undeserved bonuses and investment managers run Ponzi schemes; our problem is much deeper than the commodities market. That is why I have expanded my bill to include both commodities and financial markets: the CFTC, the Board of Governors of the Federal Reserve, the National Credit Union Administration (NCUA), the Pension Benefits Guaranty Corporation (PBGC), and the Securities and Exchange Commission (SEC). This bill would make these five federal agencies more independent and better able to investigate waste, fraud, and abuse within the agencies.

The need for these agencies to have more independent Offices of Inspectors General (OIGs) is clear. When the Congressional Research Service (CRS) sampled the number of closed and open investigations and audits by the five agencies affected by this bill, those with non-independent, or designated OIGs averaged only 12 closed investigations in 2008 with an average of 11 investigations remaining open at the end of the year. However, CRS also looked at independent, or established, OIGs of five agencies of comparable size;¹ these OIGs averaged 117 closed investigations, with 108 investigations remaining open by the close of 2008. These statistics demonstrate a positive correlation between the ability to conduct thorough investigations and provide extensive oversight and the independence of the OIG.

HR 885 is simple. It uses a legislative power already granted in the Inspector General Act of 1978. In the Inspector General Act, there are two main types of inspectors general: Section 3

¹ Agencies sampled include: the Agency for International Development (USAID), the Corporation for National and Community Service (CNCS), the Export Import Bank of the United States (EX-IM Bank), the Federal Deposit Insurance Corporation (FDIC), and the Railroad Retirement Board (RRB).

inspectors general, who are appointed by the President and confirmed by the Senate. These presidentially appointed IGs operate with a great deal of independence; they have their own, independent office, separate from the office of the agency's chairperson. The second main type of inspector general is a designated inspector general, described under Section 8G of the Inspector General Act. These OIGs do not operate wholly independent offices, but rather sit under the office of the agency chairperson. They are hired by the chairperson of the agency and can also be removed by the chairperson. All investigations must go through the agency chairperson, as well. My bill would elevate the five aforementioned designated inspectors general to presidentially appointed inspectors general.

This committee completed important work in the 110th Congress with the Inspector General Reform Act. I believe HR 885 is another important step to make the Inspector General Act more current and effective. This bill recognizes the importance of our financial and commodities markets and the role federal agencies like the SEC and Federal Reserve have in all of our lives, specifically during this current economic crisis. The Inspector General act determined which agencies would be significant enough to be granted an independent inspector general over 30 years ago. Times have changed and the economic crisis in which we have found ourselves has forced us to reconsider the importance of some of our financial regulatory agencies. This bill is not intended to punish any of these agencies; rather, it is intended to provide them with the oversight they need to do their jobs more effectively as each agency faces new challenges. I have talked to most of the heads of the affected agencies and all are supportive of more transparency in their agencies.

It is important not to take lightly the role these 5 agencies play in Americans' lives today. The PBGC oversees the current and future pensions of over 1.3 million Americans and is a safety valve for those who have worked their entire lives for a company that can no longer afford to fund their employees' pensions. The Federal Reserve just last week printed a trillion dollars! And the SEC was responsible for overseeing the transactions that lead to the Bernie Madoff scheme where investors and charities lost billions of dollars.

Today, when a majority of Americans are investors in the stock market, whether individually, through mutual funds, or through their pensions or 401Ks, we as Congress cannot be too vigilant in ensuring that there is oversight of these agencies safeguard their investments.

Elevating the Office of the Inspector General in several key financial and commodity-trading institutions is an important step toward a more transparent and accountable government. Whether it is in the energy market or the economy, our constituents demand and deserve greater government transparency.

Thank you for the important work you do on this committee and for allowing me to testify before you today.

Ms. WATSON. Thank you so much, Congressman. This concludes the Congressman's testimony. If any of the Members would like to raise a question, we will take about 5 minutes.

[Inaudible due to sound system malfunction.]

Ms. WATSON. So again, I must apologize. I will recess for a time for us to go to the floor and vote. Then we will come back here and we will go on with our panelists. So are there any questions from committee members for Mr. Larson?

Chairman TOWNS. Not a question, but I would just like to assure him that I look forward to working with him to make certain that we move this legislation forward. I think it is very, very much needed. And, of course, I agree with you. I think it is something we should be able to get on the consent calendar.

Ms. WATSON. Mr. Bilbray.

Mr. BILBRAY. Yes, I appreciate the item. Let me just say right off, one of the independent auditors who is handling the Agency for International Development, I will just tell you, and I have talked to the chairman about that, there is an agency that I think hasn't had enough auditing. I think in Afghanistan the big scandal is not going to be what has happened with the war but what hasn't happened with economic development. And with your encouragement of going from a few agencies, would you just discuss the aspect of rather than proving, expanding it in an evolutionary way, now it has been kind of encouraged to be revolutionary and sort of be much broader originally? Is there a degree of discomfort for the fact that we may regret that we haven't done one or the other? I mean done one first and then phased in the next?

Mr. LARSON. Well, I think this would be what President Obama has called the "fierce urgency of now." And as Chairwoman Watson pointed out, with the severity of the times we find ourselves in, indeed in uncharted waters, and the need for us to have more expertise, more oversight, and more independent hands on the wheel, whether it was benign neglect or whether it was someone asleep at the switch, I think the American public has demanded that we have this kind of independent oversight and review. As my grandfather Nolan used to say, trust everyone but cut the cards.

Mr. BILBRAY. Well, let me just say that, you know, there was that old saying that if you can keep your head cool and calm while everybody else is losing it, you obviously don't understand the magnitude of the problem. [Laughter.]

But a dirty little secret is everybody knows that I surf but they don't know I do a lot of sailing. And I remember somebody who was sailing in Mexico with me one time said, you know when we are in trouble and when we are in danger when Brian is quiet and introverted. I think sometimes keeping cool and not panicking, not just doing something is a very important part of a crisis.

I just want to make sure we make a diligent step here because I do worry about how quickly we are jumping to things because of crisis. And remember, the line that you have to do something is what one lemming says to the other before jumping off a cliff. So I want to make sure that we do have that. I think that you have a good, sound proposal here. I just think that those of us by definition on oversight have to make sure that it is not a cliff but actu-

ally a step up in the direction we want to go. And I yield back, Madam Chair.

Ms. WATSON. Thank you. We are now going to take a brief recess. We will reconvene, I imagine it will be around 3:30 p.m. So thank you so very much Mr. Larson.

Mr. LARSON. I thank the Chair, I thank the ranking member, and I thank our distinguished Chair and all the committee members for their time.

[Recess.]

Ms. WATSON. We are now going to start with the second panel. It is a policy of the Committee on Oversight and Government Reform to swear in all witnesses before they testify. I would like to ask Mr. Kepplinger, I think you are the first in this set, to rise and raise your right hand.

[Witness sworn.]

Ms. WATSON. Let the record reflect that the witness answered in the affirmative. I would now like to introduce Mr. Gary L. Kepplinger, who serves as the General Counsel of the Government Accountability Office. Prior to his appointment in 2006, he served as Deputy General Counsel and Managing Associate General Counsel in charge of accounting, appropriations, information management, and special investigation matters. And I ask that the current witness give a brief summary of your testimony. Keep the summary, if you can, under 5 minutes in duration. Your complete written statement will be included in the hearing record. Thank you and you may begin.

**STATEMENT OF GARY L. KEPPLINGER, GENERAL COUNSEL,
GOVERNMENT ACCOUNTABILITY OFFICE**

Mr. KEPPLINGER. Thank you, Madam Chairwoman. It is always a challenge for me to stay under 5 minutes but I am going to give it my best shot.

Our Nation is currently in the midst of one of the worst financial crises since the Great Depression. As we recently reported, the current U.S. financial regulatory system has relied on a fragmented and complex arrangement of Federal and State regulators that has not kept pace with major developments in financial markets and products, let alone with their associated risks. It is now quite apparent that the U.S. financial regulatory system is ill suited to meet the Nation's needs in the 21st century and that significant reforms are critically needed. Both the Congress and the administration are considering a number of options aimed at strengthening the financial regulatory system to reduce the likelihood that the Nation will experience a similar financial crisis in the future. Effective oversight is an important part of any consideration in modernizing our current outdated system.

House of Representatives 885, the Improved Financial and Commodity Markets Oversight and Accountability Act, would provide for the Inspectors General at selected financial regulatory agencies, namely the Board of Governors of the Federal Reserve System; the Commodity Futures Trading Commission; NCUA, the National Credit Union Administration; Penny Benny, the Pension Benefit Guarantee Corp.; and the Securities and Exchange Commission, to be appointed by the President with Senate confirmation. These IGs

are currently appointed by their agency heads and can be removed by their agency heads with advanced notification to the Congress. In our opinion, House of Representatives 885 would enhance the independence of these IGs either under the current financial regulatory system or a modernized system.

In the past, Congress has taken actions to convert IGs from appointment by their agency heads to appointment by the President as a way to enhance independence. On the heels of the savings and loan and banking crisis two decades ago, Congress converted the IG at the Federal Deposit Insurance Corporation from agency appointment to appointment by the President due to the perceived limitation of the IG's independence resulting from the appointment process. In another example, Congress converted the Tennessee Valley Authority IG from appointment by the agency head to appointment by the President because of concerns about management interference with the IG's oversight. And there are others. In both of the examples I talked about, Congress recognized that changes in the appointment of the IGs would enhance their independence.

As we have noted in prior reports and testimony, independence is one of the most important elements of an effective IG function. Professional auditing standards, the Generally Accepted Government Auditing Standards [GAGAS] that are issued by the Comptroller General, recognize that audit organizations located in government entities, including IGs appointed by their agency heads, can meet the requirement for organizational independence. Much of the IG Act provides specific protections for IGs to ensure that the audit and investigative functions located within the agency being reviewed is insulated from inappropriate management pressure. However, the difference in the appointment and removal processes between Presidentially appointed IGs and those appointed by their agency heads results in a clear difference in the level of IG organizational independence. In this regard, I think we would all agree with the common sense proposition that the further removed the appointment source is from the entity to be audited, the greater the level of independence. And I think the flip of that is similar with respect to the removal authority.

The recently enacted IG Reform Act of 2008 amends the IG Act to further enhance the independence of the IGs. The agency appointed IGs will now be required to be selected without regard to political affiliation and solely on the basis of integrity and defined abilities, just like IGs appointed by the President.

In addition, the Reform Act enhances the independence of the IGs by requiring notification to the Congress of the reasons for an IG removal or transfer at least 30 days prior to any such action rather than after the fact notification. The Reform Act also created the Council of IGs on Integrity and Efficiency to replace the administratively created councils that governed the Presidentially appointed IGs and those of agency heads. The new IG Council is expected to aid the IG community and foster Government-wide efforts to coordinate and improve IG oversight.

Currently, considerable debate is underway over whether and how current financial regulatory systems should be changed, including calls for consolidating regulatory agencies, broadening certain regulators' authorities, or subjecting certain products or enti-

ties to more regulation. A strong, independent, and coordinated IG oversight and accountability function should be an important element of this reform.

That is the end of my statement. I would be happy to take any questions, Madam Chair.

[The prepared statement of Mr. Keplinger follows:]

United States Government Accountability Office

GAO

Testimony
Before the Subcommittee on Government
Management, Organization, and
Procurement, House Committee on
Oversight and Government Reform

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INSPECTORS GENERAL

**Independent Oversight of
Financial Regulatory
Agencies**

Statement of Gary L. Keplinger
General Counsel



GAO-09-524T

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss H.R. 885, *Improved Financial and Commodity Markets Oversight and Accountability Act*. As you know, this proposed legislation recently referred to your subcommittee is intended to enhance the independence of inspectors general (IG) in key financial regulatory agencies including the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the National Credit Union Administration, the Pension Benefit Guaranty Corporation, and the Securities and Exchange Commission. In numerous reports and testimonies over the last several years, we have discussed the key role that IGs play in federal agency oversight.¹

The Inspector General Act of 1978,² created offices of inspector general at major departments and agencies with IGs who are appointed by the President, confirmed by the Senate, and may be removed only by the President with notice to the Congress stating the reasons. (See app. I.) The IGs are to prevent and detect fraud and abuse in their agencies' programs and operations; conduct audits and investigations; and recommend policies to promote economy, efficiency, and effectiveness. In 1988, the 1978 IG Act was amended to establish additional IG offices in designated federal entities (DFE) defined by the act.³ Generally, the DFE IGs have the same authorities and responsibilities as those originally established by the IG Act but there is a clear distinction—they are appointed and may be removed by their agency heads rather than by the President and are not subject to Senate confirmation. (See App. II.) In the now more than three decades since passage of the IG Act, the IGs have been instrumental in enhancing government accountability.

Our nation is currently in the midst of one of the worst financial crises ever. As we recently reported, the current U.S. financial regulatory system

¹GAO, *Inspectors General: Opportunities to Enhance Independence and Accountability*, GAO-07-1089T (Washington, D.C.: July 11, 2007); GAO, *Inspectors General: Proposals to Strengthen Independence and Accountability*, GAO-07-1021T (Washington, D.C.: June 20, 2007); GAO, *Highlights of the Comptroller General's Panel on Federal Oversight and the Inspectors General*, GAO-06-931SP (Washington, D.C.: September 11, 2006); GAO, *Inspectors General: Enhancing Federal Accountability*, GAO-04-117T (Washington, D.C.: October 8, 2003); GAO, *Inspectors General: Office Consolidation and Related Issues*, GAO-02-575 (Washington, D.C.: August 15, 2002).

²Pub. L. No. 95-452, 92 Stat. 1101 (Oct. 12, 1978) (codified, as amended, at 5 U.S.C. App.).

³Pub. L. No. 100-504, 102 Stat. 2515 (Oct. 18, 1988) (5 U.S.C. App.).

has relied on a fragmented and complex arrangement of federal and state regulators—put into place over the last 150 years—that has not kept pace with major developments in financial markets, products, and associated risks in recent decades.⁴ It has become apparent that the U.S. financial regulatory system is ill suited to meet the nation's needs in the 21st century, and significant reforms to the U.S. financial regulatory system are critically and urgently needed. We have included modernization of the outdated U.S. financial regulatory system as a high-risk area in our recent report of high-risk designations across the federal government.⁵

Currently, both the administration and the Congress are considering many options aimed at strengthening the financial regulatory system. H.R. 885 would provide for the inspectors general for selected financial regulatory agencies to be appointed by the President with Senate confirmation. Those IGs currently are appointed by their agency heads and may be removed by their agency heads.

Today, I will discuss (1) the legislative proposals in H.R. 885, (2) the key principles and importance of auditor and IG independence, and (3) current coordination mechanisms in place for IG offices. My testimony today draws primarily on prior GAO reports and testimonies conducted in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Provisions of H.R. 885

Currently, the IGs at the Federal Reserve Board, Commodity Futures Trading Commission, Securities and Exchange Commission, National Credit Union Administration, and the Pension Benefit Guaranty Corporation are appointed to their offices by their agency heads and may be removed from office by their respective agency heads. H.R. 885, *Improved Financial and Commodity Markets Oversight and Accountability Act*, would provide for the conversion of these IGs from

⁴GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, GAO-09-216 (Washington, D.C.: Jan 8, 2009).

⁵GAO, *High-Risk Series: An Update*, GAO-09-271 (Washington, D.C.: January 2009).

appointment by their respective agency heads to appointment by the President with confirmation by the Senate. Likewise, after this conversion, these IGs may be removed only by the President with advance notification to the Congress of the reasons. We believe that the differences in the appointment and removal processes between presidentially appointed IGs and those appointed by their agency heads result in a clear difference in the level of independence of the IGs. A general tenet to keep in mind is that the further removed the appointment source is from the entity to be audited, the greater the level of independence.

In the past, the Congress has taken actions to convert IGs from appointment by their agency heads to appointment by the President with Senate confirmation as a way to enhance IG independence. For example, on the heels of the savings and loan and banking crisis, over two decades ago, the role of the Federal Deposit Insurance Corporation's (FDIC) IG became increasingly important in providing oversight. Due to the perceived limitation of the FDIC IG's independence resulting from agency appointment, the Congress converted the IG from agency appointment to appointment by the President with Senate confirmation.⁶ In another example, the Congress took action to convert the Tennessee Valley Authority (TVA) IG to appointment by the President with Senate confirmation because of concerns about interference by TVA management.⁷ In both cases, Congress recognized that the IG's independence would be enhanced by the presidential appointment. The change from agency appointment to appointment by the President has been recognized by Congress since the advent of the IG concept as strengthening the critical element of IG independence. As we have noted in prior reports and testimony, we believe independence is one of the most important elements of an effective IG function.

Auditor and IG Independence

We believe that the differences in the appointment and removal processes between presidentially appointed IGs and those appointed by agency heads result in a clear difference in the organizational independence of the IGs. The IG Act, as amended (IG Act),⁸ requires IGs to perform audits in

⁶Resolution Trust Corporation Completion Act, Public Law 103-204, Dec. 17, 1993.

⁷Pub. L. No. 106-422, 114 Stat. 1872 (Nov. 1, 2000).

⁸Codified at 5 U.S.C. App.

compliance with *Government Auditing Standards*⁹ and authorizes IGs to conduct inspections and investigations.¹⁰ These standards recognize the methods for external appointment and removal of the IG as key independence considerations to enable internal IG offices to report their work externally. Those offices with IGs appointed by the President are more closely aligned with the independence standards for external audit organizations,¹¹ while those offices with IGs appointed by the agency head are more closely aligned with the independence standards for internal audit organizations.¹²

In 1988, IG Act amendments created the DFE IGs, including those covered by H.R. 885, with a clear distinction in their appointment—they are appointed and removed by their entity heads rather than by the President and are not subject to Senate confirmation. Organizational independence differs between the offices of presidentially appointed IGs and other IGs who are agency appointed. The DFE IGs, while generally covered by many of the same provisions of the IG Act as the IGs appointed by the President with Senate confirmation, are more closely aligned to independence standards for internal auditors than to those for external auditors. At the

⁹GAO, *Government Auditing Standards, July 2007 Revision*, GAO-07-731G (Washington, D.C.: July 2007), issued by the Comptroller General of the United States.

¹⁰Professional standards for the IGs have been issued by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency.

¹¹External auditors report externally, meaning that their audit reports are disseminated to and used by third parties. Under professional standards, external audit organizations are organizationally independent when they are organizationally placed outside of the entity under audit. In government, this is achieved when the audit organization is in a different level of government (for example, federal auditors auditing a state government program) or different branch of government within the same level of government (for example, legislative auditors such as GAO auditing an executive branch program).

¹²Under internal auditing standards, internal auditors are generally limited to reporting internally to the organization that they audit, except when certain conditions are met, such as when mandated by statutory or regulatory requirements. (See the Institute of Internal Auditors, *International Professional Practices Framework* (Almonte Springs, Fla: Jan. 2009). Internal audit organizations are organizationally placed within the organization they audit and are defined as being organizationally independent under professional auditing standards if the head of the audit organization (1) is accountable to the head or deputy head of the government entity or to those charged with governance; (2) reports audit results both to the head or deputy head of the government entity and to those charged with governance; (3) is located organizationally outside the staff or line-management function of the unit under audit; (4) has access to those charged with governance; and (5) is sufficiently removed from political pressures to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal.

same time, *Government Auditing Standards* recognizes that additional statutory safeguards exist for DFE IG independence for reporting externally. These safeguards include establishment of the IG by statute, communication of the reasons for removal of the head of an audit organization to the cognizant legislative oversight body, statutory protections that prevent the audited entity from interfering with an audit, statutory requirements for the audit organization to report to a legislative body on a recurring basis, and statutory access to records and documents related to agency programs.

Independence is one of the most important elements of an effective IG function. In fact, much of the IG Act provides specific protections to IG independence that are unprecedented for an audit and investigative function located within the organization being reviewed. These protections are necessary in large part because of the unusual reporting requirements of the IGs, who are both subject to the general supervision and budget processes of the agencies they audit, and also expected to provide independent reports of their work externally to the Congress and the public.

Independence is also the cornerstone of professional auditing. Without independence, an audit organization cannot fully provide independent audits, perspectives, and assessments. Likewise, an IG who lacks independence cannot effectively fulfill the full range of requirements for the office. Lacking this critical attribute, an audit organization's work might be classified as studies, research, consulting, or reviews, rather than independent audits.

Government Auditing Standards states, "In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be free from *personal, external, and organizational* impairments to independence, and must avoid the appearance of such impairments to independence. Auditors and audit organizations must maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and be viewed as impartial by objective third parties with knowledge of the relevant information." (Emphasis added.)

- **Personal independence** applies to individual auditors at all levels of the audit organization, including the head of the organization. Personal independence refers to the auditor's ability to remain objective and maintain an independent attitude in all matters relating to the audit, as well as the auditor's ability to be recognized by others as independent. The

auditor needs an independent and objective state of mind that does not allow personal bias or the undue influence of others to override his or her professional judgments. This attitude is also referred to as intellectual honesty. The auditor must also be free from direct financial or managerial involvement with the audited entity or other potential conflicts of interest that might create the perception that the auditor is not independent.

- **External independence** refers to both the auditor's and the audit organization's freedom to make independent and objective judgments free from external influences or pressures. Examples of impairments to external independence include restrictions on access to records, government officials, or other individuals needed to conduct the audit; external interference over the assignment, appointment, compensation, or promotion of audit personnel; restrictions on funds or other resources provided to the audit organization that adversely affect the audit organization's ability to carry out its responsibilities; or external authority to overrule or to inappropriately influence the auditors' judgment as to appropriate reporting content.
- **Organizational independence** refers to the audit organization's placement in relation to the activities being audited. Professional auditing standards have different criteria for organizational independence for external and internal audit organizations. The IGs, in their statutory role of providing oversight of their agencies' operations, represent a unique hybrid of external and internal reporting responsibilities.

The implementation of the IGs' reporting relationships with their respective agency heads can also significantly affect the independence of the IGs. Generally, the IGs represent a hybrid of external auditing and internal auditing in their oversight roles for federal agencies. The IG offices, having been created to perform a unique role in overseeing federal agency operations, have characteristics of both external audit organizations and internal audit organizations. For example, the IGs have external reporting requirements consistent with the reporting requirements for external auditors, while at the same time they are part of their respective agencies.

IGs also have a dual reporting responsibility to the Congress and their agency heads. The IGs' external reporting requirements in the IG Act include reporting the results of their work in semiannual reports to the Congress. Under the IG Act, the IGs are to report their findings without alteration by their respective agencies, and public reports are to be made available on each IG's website. The IG Act also directs the IGs to keep agency heads and the Congress fully and currently informed of any

problems, deficiencies, abuses, fraud, or other serious problems relating to the administration of programs and operations of their agencies. Also, the IGs are required to report particularly serious or flagrant problems, abuses, or deficiencies immediately to their agency heads, who are required to transmit the IG's report to the Congress within 7 calendar days.

The IG Act also provides specific protections to IG independence, including a prohibition on the ability of the agency head to prevent or prohibit the IG from initiating, carrying out, or completing any audit or investigation. This prohibition is directed at helping to protect the IG office from external forces that could compromise independence. The IG's personal independence and the appearance of independence to knowledgeable third parties is also critical when the IG makes decisions related to the nature and scope of audit and investigative work performed by the IG office. The IG must determine how to utilize the IG Act's protection of independence in conducting and pursuing the audit and investigative work. The IG's personal independence is necessary to make the proper decisions in such cases.

The IG Act provides the IGs with protections to external independence by providing access to all agency documents and records; prompt access to the agency head; the ability to select and appoint IG staff; the authority to obtain services of experts; and the authority to enter into contracts. The IG may choose whether or not to exercise the act's specific authority to obtain access to information that is denied by agency officials. Again, each IG must make decisions regarding the use of the IG Act's provisions for access to information, and the IG's personal independence becomes key in making these decisions.

The IG Reform Act of 2008 (Reform Act), enacted on October 14, 2008, amends the IG Act to further enhance the independence of the IGs, among other things.¹³ To illustrate, the 1978 IG Act requires that the IGs nominated by the President be selected without regard to political affiliation and solely on the basis of integrity and defined abilities. However, these criteria were not included as a provision in the legislation that created the DFE IGs. The Reform Act extends these qualification criteria to apply also to the selection of the DFE IGs. In addition, the

¹³Many of the provisions in the Reform Act were discussed by a panel hosted by the Comptroller General during May 2006. The discussion included the appointment and removal of IGs, an IG council established by statute, and areas related to IG independence and effectiveness. See GAO-06-931SP.

independence of all the IGs under the Reform Act amendments is enhanced by changes to the timing of notification to Congress of an IG removal or transfer—to at least 30 days before any planned removal of an IG under the IG Act, rather than merely an after-the-fact notice of prior removal.

IG Coordination

Prior to the passage of the IG Reform Act in 2008, the IGs' coordinating structure included two separate administratively established organizations: the IGs appointed by the President with Senate confirmation belonged to the President's Council on Integrity and Efficiency (PCIE), and the DFE IGs formed the Executive Council on Integrity and Efficiency (ECIE). Both councils have been chaired by the Deputy Director for Management in the Office of Management and Budget and were established by Executive Order to coordinate the IGs' activities across the government.¹⁴ In our 2002 report, we had suggested that the Congress consider establishing an IG council by statute that includes stated roles and responsibilities, designated funding sources, and provisions for coordination with other federal oversight organizations.¹⁵

The IG Reform Act created an independent establishment in the executive branch, called the Council of IGs on Integrity and Efficiency, to replace the PCIE and ECIE, and to aid the IG community and foster government wide efforts to coordinate and improve oversight. This includes the establishment of a revolving fund to be used for council functions and duties with amounts in the fund coming from executive branch agencies. This new IG coordinating structure is to become effective 180 days after the date the Reform Act became law.

Other recent efforts involve the coordination of financial regulatory IGs. On October 3, 2008, the President signed into law the Emergency Economic Stabilization Act of 2008 (EESA), which established the Office of Financial Stability within the Department of the Treasury and authorized the Troubled Asset Relief Program (TARP). The Special IG for TARP (SIG TARP), created by EESA, who is appointed by the President with Senate confirmation, has announced efforts to coordinate with other

¹⁴The IG Act has required IGs to coordinate with the Comptroller General to avoid duplication and ensure effective coordination and cooperation. 5 U.S.C. App. § 4(c).

¹⁵GAO, *Inspectors General: Office Consolidation and Related Issues*, GAO-02-575 (Washington, D.C.: Aug. 15, 2002).

IGs who operate in areas related to TARP activities. The coordination group referred to as the TARP-IG Council was established administratively by the SIG TARP and includes the IGs at the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Securities and Exchange Commission, the Department of Housing and Urban Development, the Department of the Treasury, and the Treasury IG for Tax Administration, as well as representatives from GAO. The TARP-IG Council seeks to coordinate the activities of the IGs, establish protocols, and share ideas for comprehensive audits and investigations, while avoiding unnecessary or duplicative burdens on those charged with managing TARP.

The SIG TARP also announced the formation of a broad, multi agency task force designed to deter, detect, and investigate instances of fraud in the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF) program, which is intended to make credit available to consumers and small businesses. The task force was created in coordination with the Federal Reserve Board IG and will include the Federal Bureau of Investigation, the Financial Crimes Enforcement Network, U.S. Immigration and Customs Enforcement, the Internal Revenue Service's Criminal Investigation, the Securities and Exchange Commission, and the U.S. Postal Inspection Service.

With the growing complexity of the federal government, the severity of the problems it faces, and the fiscal constraints under which it operates, it is important that independent, objective, and reliable IG structures be in place at federal agencies to ensure adequate audit and investigative coverage of federal programs and operations. The current crisis in the financial markets is illustrative of the significant challenges facing the federal government. As the administration and the Congress continue to take actions to address the immediate financial crisis, creating a regulatory system that reflects new market realities is a key step to reducing the likelihood that the United States will experience another financial crisis and enhancing oversight of the direction and implementation of current initiatives. As a result, considerable debate is under way over whether and how the current regulatory system should be changed, including calls for consolidating regulatory agencies, broadening certain regulators' authorities, or subjecting certain products or entities to more regulation. Strong independent oversight and accountability functions of the inspectors general at the regulatory agencies will be an important element of this reform.

Coordination of the financial regulatory agencies' IGs is especially important during the current financial crisis. The fragmented and complex arrangement of federal and state regulators makes the communication and coordination of IGs at the regulatory agencies challenging but critical to providing effective oversight as significant reforms in the U.S. financial regulatory system evolve.

This completes my formal statement, Mr. Chairman. I would be pleased to answer any questions that you or the Subcommittee members may have at this time.

Appendix I: Federal Agencies and Departments with IGs Established by the IG Act of 1978, as Amended, and Appointed by the President

Agency for International Development
Corporation for National and Community Service
Department of Agriculture
Department of Commerce
Department of Defense
Department of Education
Department of Energy
Department of Health and Human Services
Department of Homeland Security
Department of Housing and Urban Development
Department of the Interior
Department of Justice
Department of Labor
Department of State
Department of Transportation
Department of Treasury
Department of Veterans Affairs
Environmental Protection Agency
Export-Import Bank
Federal Deposit Insurance Corporation
Federal Emergency Management Agency
General Services Administration
National Aeronautics and Space Administration
Nuclear Regulatory Commission
Office of Personnel Management
Railroad Retirement Board
Small Business Administration
Social Security Administration
Tennessee Valley Authority
Treasury Inspector General for Tax Administration

Appendix II: Designated Federal Entities Defined by the IG Act with IGs Appointed by Their Agency Heads

Amtrak
 Appalachian Regional Commission
 Broadcasting Board of Governors*
Commodity Futures Trading Commission
 Consumer Product Safety Commission
 Corporation for Public Broadcasting
 Denali Commission
 Election Assistance Commission
 Equal Employment Opportunity Commission
 Farm Credit Administration
 Federal Communications Commission
 Federal Election Commission
 Federal Housing Finance Board
 Federal Labor Relations Authority
 Federal Maritime Commission
Federal Reserve Board
 Federal Trade Commission
 Legal Services Corporation
 National Archives and Records Administration
National Credit Union Administration
 National Endowment for the Arts
 National Endowment for the Humanities
 National Labor Relations Board
 National Science Foundation
 Peace Corps
Pension Benefit Guaranty Corporation
 Postal Regulatory Commission
Securities and Exchange Commission
 Smithsonian Institution
 United States International Trade Commission
 United States Postal Service

*The Broadcasting Board of Governors is a designated federal entity with oversight provided by the Department of State IG.

Highlighted entities are included in H.R. 885.

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Ms. WATSON. We are attempting, as you have heard, to really improve the efficacy of this particular position. Is there anything else that you would suggest to make this a more independent agency and a more reliable one? It is all going to come down with your evaluations and your recommendations, so what are we missing that you would like to see?

Mr. KEPPLINGER. We have approached the issue also from a slightly different perspective. A number of the IGs, CFTC, SEC, I think they are relatively small in size. Another approach would be to consolidate those audit functions into existing, Presidentially appointed IGs. We had offered the concept before that you could make CFTC and SEC part of the Treasury IG and NCUA part of the FDIC IG's Office and Penny Benny part of the Department of Labor IG Office. Those are all Presidentially appointed IGs. We had in the past recommended that the IG at the Federal Reserve be Presidentially appointed because of the significance of the functions and the activities of that agency and its size.

Ms. WATSON. What bothers me is the politicizing of the IG reports and also the fact that the ideology from the administration is part and parcel of the IGs' function and office. So when you say political appointment, how can we guard against politicizing that particular position and the ideology that person might carry that aligns itself with the President?

Mr. KEPPLINGER. I am a lawyer. I approach things as a lawyer. I would note that with respect to the DFEs, as a result of your colleagues, Mr. Cooper and Senator McCaskill's effort, that the DFE IGs, those that are agency head appointed, they are now supposed to be appointed without regard to political affiliation and solely on the basis of integrity and the defined abilities that would be relevant to an IG. That has been the law with respect to Presidential IGs since 1978. It was made explicit for DFEs in 2008.

Ms. WATSON. The turmoil that we are in at the current time and the fact that we are at a crisis unseen before, maybe even worse than it was at the end of the 1920's and 1930's, my concern is that the IG report be absolutely impeccable and represent the facts as they are found. Is there an evaluation component that we can add in that might help? I know you do recommendations at the end of your reports.

Mr. KEPPLINGER. I am the General Counsel in an audit organization and I agree with you 110 percent, Madam Chair, that the objectivity and the credibility of the audit organization is its most important asset. And we at GAO are very, very, very, very protective of our objectivity and credibility. With respect to the IGs and the audit communities, there is now the Council of IGs for Integrity and Efficiency that has an integrity committee that looks at wrongdoing amongst the IGs. There are also peer reviews of their organizations and their activities. I believe it is on a 3-year cycle. And, you know, that should go a long way to ensuring the quality of the work of the auditors.

Ms. WATSON. Thank you for that. I would like to announce the presence of Congresswoman Jackie Speier who hails out of California, one of my colleagues many, many years ago in one of my other lives. Welcome to the committee and I welcome your presence here. Would you like to address Mr. Kepplinger with questions?

Ms. SPEIER. Thank you, Madam Chair. I am honored to serve on this committee with you. Mr. Kepplinger, I couldn't be more in agreement with you, maybe more violently so, than you have already expressed. I believe strongly that the Inspector General function in this country has to be made stronger and more independent than it is right now. And I would agree with you that we should get rid of the agency appointed Inspectors General. I read in the analysis, Madam Chair, that there actually have been examples where recent investigations of IG Offices at the National Aeronautic and Space Administration and the Department of Commerce have raised some concerns because there just is a closeness that exists when you are actually appointed by that entity.

It brings to mind a case in California, I believe after you left, where there were horrendous problems in the Department of Corrections. The investigations unit at the Department of Corrections was not operating properly. And I carried legislation to create an Inspector General that was independent of the department and that was appointed by the Governor for a specific timeframe so that if the Governor didn't like the kinds of inspections or the reports that the Inspector General came up with, that would not prevent the Inspector General from continuing to be in office. So I do applaud that kind of an approach.

I think we really should get rid of the appointed Inspectors General from the departments. I am curious, Mr. Kepplinger, what your feelings are about term limits or at least a fixed term, I should say? And you can bleed a particular agency or starve a particular entity by just not giving it enough resources, so how do you guarantee the independent funding of an Inspector General's Office that is adequate to do the job?

Mr. KEPPLINGER. Ms. Speier, there are I think about three questions in there and hopefully my memory will permit me to answer all three. First, with respect to the issue of the appointment, you know, it is a two sided coin, independence. To a certain extent, once you are appointed and you have the position, your real concern is more often focused on who can remove you. And my point has been the further removed you are from the entity you are auditing, the more independent you are going to be. So I think we are in violent agreement, maybe not mob violent, but violent agreement.

With respect to the issue of term limits, the IGs are, I think, fairly characterized as executive branch employees. Term limits that limit the President's authority to oversee and to remove could pose significant issues in terms of the Executive's authority. There are, certainly, the Comptroller General who has as a unique position and other legislative Article 1 entities like the Court of Claims who have term positions. There are only a few.

Well, the one executive branch position that has a term that I can think of is the Director of FBI. And that is because of the desire, and I think it is a political accommodation, not necessarily a legal one, but it is a political accommodation, between the two Branches that the FBI's need to be independent, credible, and objective in its investigations and enforcement actions, if you will, argue in favor for a term limit. I think it is a 7-year term for the Director of the FBI.

Now, you had one other question and it is escaping my memory at this point. I was happy to see people up here with the purple banners in favor of Alzheimer's because at times I feel I have early stage dementia. But if you can remember your third question, I had a response for it.

Ms. SPEIER. It was the funding issue and how you can starve an Inspector General's Office as a way of putting them out of business?

Mr. KEPPLINGER. Well, I would commend again Mr. Cooper and Senator McCaskill because in the 2008 Reform Act a process was put in place to make the IGs' articulation of their funding needs transparent through the budget process.

Ms. SPEIER. But let us say that an Inspector General is doing very good work but is embarrassing an administration. The budget for that Office could be reduced in a way that would then limit the ability of that Inspector General to do his or her job.

Mr. KEPPLINGER. Under the Reform Act, the IGs' comments about their funding needs is part of the President's budget when submitted for the IG's account so it has transparency. And presumably it would be a matter for the appropriations process to deal with what is the right amount.

Ms. SPEIER. Thank you.

Ms. WATSON. Thank you very much. I would like now to go to our Member from Tennessee, Mr. Duncan.

Mr. DUNCAN. I have just a couple of questions since I just got here. Let me ask you, Mr. Kepplinger, are there any powers that a Presidentially appointed IG has that other Inspectors General do not have?

Mr. KEPPLINGER. No, generally I think they have the same scope of authority.

Mr. DUNCAN. All right.

Mr. KEPPLINGER. There are a few exceptions but even those exceptions cut across Presidential appointees and agency head appointees.

Mr. DUNCAN. All right. And I have noticed that with the exception of the top Cabinet members, it sometimes takes an awfully long time to get people appointed, like U.S. attorneys and so forth. It seems that they put them through a needlessly lengthy investigation of 13 or 14 months sometimes. How long has it generally taken to get a Presidentially appointed IG into office? Do you know?

Mr. KEPPLINGER. Off the top of my head, I do not know.

Mr. DUNCAN. All right. Thank you very much.

Ms. WATSON. Thank you so much. And thank you, Mr. Kepplinger for coming. I have one more question and it is a short one. Do we have enough protection in the long run for whistleblowers?

Mr. KEPPLINGER. My response is yes. And I haven't, Madam Chair, made a study of this except in one regard. Legislation passed in the last Congress established a statutory IG in GAO. This was a first for us. And in the process of doing that, we transferred the whistleblower protections that are currently in place for the IGs into our own statute and made them applicable for our employees and our IG. At the time, my sense was that those were really quite adequate. But leaving open the possibilities that there

is always an opportunity for improvement, my general response would be yes, I think they are adequate. But I don't say that with a heck of a lot of confidence or prior review of that issue. OK?

Ms. WATSON. The committee would like to thank you for your time and the information you have shared with us. Thank you very much.

Mr. KEPPLINGER. Thank you very much. It was my pleasure. Thank you.

Ms. WATSON. Thank you. OK, it is now time to turn to the third and the last panel. If they would come up to the table, I will swear them in. Right now we are in recess for a couple of minutes while the current witnesses come to the table.

[Recess.]

Ms. WATSON. It is the policy of the Committee on Oversight and Government Reform to swear in all witnesses before they testify. All of you are in place now. Would you raise your right hands?

[Witnesses sworn.]

Ms. WATSON. Thank you. You may be seated. Let the record reflect that the witnesses answered in the affirmative. I would now like to take a moment to introduce our panel. Before we begin, I will note for the record that Ms. Elizabeth A. Coleman, the Inspector General of the Board of Governors of the Federal Reserve System was invited to testify today but was unable to join us. She did, however, submit a statement for the record. Without objection, we will enter that into the record.

First I would like to introduce Mr. H. David Kotz. He is the Inspector General of the Securities and Exchange Commission. There he conducts audits and investigations of both agency functions and self-regulatory organization activities. Prior to his service at the SEC, he served as the Inspector General of the Peace Corps and as Assistant General Counsel.

The next is Mr. William DeSarno. He is the inspector general of the National Credit Union Administration. There he developed his Office's first strategic plan and oversees all, including planning, budget, and staffing, issues. Mr. DeSarno began his NCUA career in 1997 as Assistant Inspector General for Audits and was named Inspector General in 2005.

Then there is Mr. A. Roy Lavik. He is the Inspector General of the Commodities Futures Trading Commission. He has over 25 years of Federal experience primarily in the area of anti-trust and regulatory law. He has served in his current position since 1990. Prior to his time at CFTC, he worked at both the Federal Reserve Board and the Federal Trade Commission.

And next we have Ms. Vanessa K. Burrows, a Legislative Attorney in the American Law Division of the Congressional Research Service. There she serves as an issue expert on matters relating to Inspectors General throughout the Government.

And then Mr. Clark Kent Ervin—Clark Kent, I love that—Mr. Clark Kent Ervin, the director of the Aspen Institute's Homeland Security Program. He joined the Institute in 2005. Before doing so, he served as the first Inspector General of the U.S. Department of Homeland Security from January 2003 to December 2004. Prior to his service at DHS, he served as the Inspector General of the U.S. Department of State and the Broadcasting Board of Governors.

And finally, Ms. Danielle Brian serves as the executive director of the Project on Government Oversight [POGO], a non-profit, non-partisan watchdog organization that works with whistleblowers and government insiders to expose corruption, fraud, and abuse of power. She began her career with POGO in 1986 and has degrees from Smith College and Johns Hopkins University.

I will ask that each of the witnesses now give a brief summary of their testimony and to keep this summary, if you can, under 5 minutes in duration. Your complete written testimony will be included in the hearing record. And so we will start now with Mr. Kotz. Please proceed.

STATEMENTS OF H. DAVID KOTZ, INSPECTOR GENERAL, U.S. SECURITIES AND EXCHANGE COMMISSION; WILLIAM DESARNO, INSPECTOR GENERAL, NATIONAL CREDIT UNION ADMINISTRATION; A. ROY LAVIK, INSPECTOR GENERAL, COMMODITIES FUTURES TRADING COMMISSION; VANESSA K. BURROWS, LEGISLATIVE ATTORNEY, CONGRESSIONAL RESEARCH SERVICE; CLARK KENT ERVIN, DIRECTOR, HOMELAND SECURITY PROGRAM, ASPEN INSTITUTE; AND DANIELLE BRIAN, EXECUTIVE DIRECTOR, PROJECT ON GOVERNMENT OVERSIGHT

STATEMENT OF H. DAVID KOTZ

Mr. KOTZ. Good afternoon. Thank you for the opportunity to testify today before this subcommittee as the Inspector General of the Securities and Exchange Commission. In my testimony today, I am representing the Office of Inspector General. The views I express are those of my Office and do not necessarily reflect the views of the Commission or any Commissioners.

The mission of the Office of Inspector General is to promote the integrity, efficiency, and effectiveness of the critical programs and operations of the SEC. This mission has become increasingly important in light of the current economic crisis facing our Nation. My philosophy as an Inspector General is to focus on the significant issues and high risk areas, looking at big picture items relating to whether the programs and operations in the agency are working effectively rather than simply identifying isolated minor infractions or procedural violations. I believe that this approach is particularly important in light of current market conditions and the significant challenges facing the SEC and other governmental agencies that regulate our financial markets.

I believe it is more important than ever that financial regulatory agencies such as the SEC have an independent, effective, and fully funded Office of Inspector General to assist the Commission in confronting these challenges. I am proud to report that over the past 14 months that I have served as the SEC's Inspector General, our Office has risen to these challenges and then some. Notwithstanding a small staff, we have issued numerous audit and investigative reports discussing issues critical to SEC operations and the investing public and making significant recommendations for improvement. Many of these reports have been critical of SEC operations, programs, and management. And I have not always been the most popular individual at my agency. Nonetheless, I feel it is my duty

to the Commission, the Congress, and the investing public, particularly in these challenging times to conduct independent audits and investigations and to issue thoughtful, unbiased, and frank reports.

I will provide you just a few examples of recent activities undertaken by my Office, some at the request of congressional committees. In September 2008, our audit unit issued a comprehensive report analyzing the Commission's oversight of the SEC's Consolidated Supervised Entities [CSE], program which included Bear Stearns, Goldman Sachs, Morgan Stanley, Merrill Lynch, and Lehman Brothers. The audit identified significant deficiencies in the CSE program and provided 26 recommendations to improve the Commission's oversight of the CSE firms.

In response to the report's findings, former SEC Chairman Christopher Cox announced the end of the CSE program and promised to review and move to aggressively implement the report's recommendations. The Office of Inspector's General audit unit also issued a second report during that same time period analyzing the Commission's Broker-Dealer Risk Assessment Program and made several recommendations to improve that program.

More recently, my Office has issued several other significant audit reports. In February we issued an audit report that analyzed the \$178 million in disgorgement waivers that the Division of Enforcement had granted between October 2005 and May 2008. We found that proper procedures were not always followed in recommending these waivers and provided several recommendations designed to improve the process. Just last week we issued a comprehensive audit report on Enforcement's practices and procedures for responding to and processing naked short selling complaints. Our report concluded that Enforcement's existing complaint receipt and processing procedures hinder its ability to respond effectively to naked short selling complaints and that Enforcement's procedures result in naked short selling complaints being treated differently than other types of complaints. We are also currently working on several additional audit reports that we plan to issue in the upcoming month that address issues currently of concern to the Commission and the investing public, including a comprehensive analysis of the SEC's oversight of the credit reporting agencies which may have played a critical role in the current economic crisis.

We also have a vibrant and vigorous investigative unit that under my direction is conducting or has completed over 50 comprehensive investigations of allegations of violations of statutes, rules, regulations, and other misconduct. These investigative reports have been issued without management influence or pressure and have focused on all levels of employees including senior SEC staff. In addition, we are currently conducting a comprehensive investigation and evaluation of matters related to Bernard Madoff and affiliated entities.

In late December 2008, former SEC Chairman Chris Cox contacted me and asked my Office to undertake an investigation into complaints received by the SEC regarding Mr. Madoff going back 10 years and the reasons why the agency found these complaints lacked credibility. Since that time, we have been working at a rapid pace to perform this important work and have made substantial

progress to date. We have determined that the matters that must be analyzed regarding the Madoff investigation go well beyond the specific issues that former Chairman Cox asked us to investigate. Therefore, our oversight efforts will include an evaluation of broader issues regarding the overall operations of the SEC. We intend to provide overarching and comprehensive recommendations to ensure that the SEC is able to fulfil its mission.

In order to strengthen the oversight of Federal financial regulatory structure as a whole, my Office works in tandem with other Federal financial regulatory IGs to provide coordinated oversight. For example, I currently serve on the Troubled Assets Relief Program [TARP], Inspector General Council along with the Special IG from the TARP and IGs from several financial regulatory agencies as well as the GAO which meets to discuss coordination of TARP related activities and oversight efforts. I also meet separately every month with additional Federal financial regulatory IGs to discuss coordinated oversight efforts among the financial regulatory IG community.

I greatly appreciate the subcommittee's interest in assisting the IGs in performing their critical work. The recently enacted amendments to the Inspector General Act made great strides in enhancing Inspector General independence and ensuring that the Inspectors General receive sufficient appropriated funds to achieve their mission. The improvements in this legislation include the requiring of advance notice to Congress of the removal of an IG as well as provisions establishing pay parity on the part of both Presidentially appointed and Designated Federal Entity [DFE] IGs.

Since I began my tenure as Inspector General of the SEC in December 2007, my Office's staffing levels have increased by nearly 80 percent and I have requested an increase of our overall budget of nearly 30 percent for fiscal year 2009, which I understand will be processed as soon as the funds become available. Notwithstanding these increases, additional resources would greatly assist my Office in continuing its important work. I specifically suggest that to the extent Congress provides additional appropriations to agencies such as the SEC for increased enforcement efforts, there be a commensurate and proportionate funding to the corresponding Office of Inspector General to provide for oversight of the additional funds allotted to the agency.

Additionally, the legislation recently passed by the Senate to provide the Special Inspector General for the TARP [SIGTARP], with additional authorities and responsibilities is illustrative of measures that may be enacted to enhance Inspector General independence and effectiveness. For example, the SIGTARP legislation requires the Secretary of the Treasury to take action to address deficiencies identified by a report or investigation of the SIGTARP or to certify to the appropriate committees of Congress that no action is necessary or appropriate.

Finally, I respectfully offer my opinion that converting IGs from DFE to Presidentially appointed is not necessary and in my view would not improve the current level of DFE IG oversight. Having been an Inspector General at two DFEs, at the Peace Corps and now at the SEC, I can state without any hesitation that one can be a completely independent and effective Inspector General within

the DFE structure. Although I have issued numerous reports at both agencies that have been critical of those agencies' operations and management, no one has ever attempted to impair or question my independence. In my personal situation at the SEC, my Office's reports and approach to oversight have not diminished in any way with the recent change in administration or appointment of a new SEC chairman. I can report that politics play absolutely no role in my Office's decisions. For this reason, I do have some concerns that converting the Inspector General of the SEC or the IGs of other financial regulatory agencies from DFE to Presidentially appointed IGs could result in unnecessarily politicizing the Office of Inspector General. There are additional potential drawbacks to the Presidentially appointed IG process including the often lengthy vetting and confirmation process that may lead to the IG position being vacant for a significant period of time. During this time of financial crisis, it is more important than ever that there is continuity of the operations and oversight activities currently undertaken by IGs of financial regulatory agencies.

In conclusion, I greatly appreciate this subcommittee's interest in the SEC and my Office. I believe that the subcommittee's and Congress's involvement with the SEC is extremely important to strengthen the accountability and the effectiveness of the Commission. Thank you.

[The prepared statement of Mr. Kotz follows:]

**Testimony of H. David Kotz
Inspector General of the
Securities and Exchange Commission**



**Before the Subcommittee on Government
Management, Organization, and Procurement,
Committee on Oversight and Government Reform,
U.S. House of Representatives**

**Wednesday March 25, 2009
2:00 p.m.**

Introduction

Good afternoon. Thank you for the opportunity to testify today before this Subcommittee on the subject of "The Roles and Responsibilities of Inspectors General within Financial Regulatory Agencies" as the Inspector General of the Securities and Exchange Commission ("SEC" or "Commission"). I appreciate the interest of the members of the Subcommittee in the SEC and the Office of Inspector General at this critical time for the financial markets. In my testimony today, I am representing the Office of Inspector General, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

I would like to begin my remarks this afternoon by discussing the role of my Office and, in particular, the increased oversight efforts we have undertaken since I was appointed as the Inspector General of the SEC a little over one year ago, in late December 2007.

The mission of the Office of Inspector General is to promote the integrity, efficiency and effectiveness of the critical programs and operations of the SEC. This mission has become increasingly important in light of the current economic crisis facing our nation. I firmly believe that this mission is best achieved by having a vigorous and independent Office of Inspector General to investigate and audit Commission activities and to keep the Commission and Congress informed of significant issues and findings.

The SEC Office of Inspector General includes the positions of the Inspector General, Deputy Inspector General, Counsel to the Inspector General, and has staff in two major areas: Audits and Investigations.

Our audit unit conducts, coordinates and supervises independent audits and

inspections related to the Commission's internal programs and operations. The primary purpose of conducting an audit is to review past events with a view toward ensuring compliance with applicable laws, rules and regulations and improving future performance. Upon completion of an audit or evaluation, the OIG issues an independent report that identifies any deficiencies in Commission operations, programs, activities, or functions and makes recommendations for improvements in existing controls and procedures.

The Office's investigations unit responds to allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff and contractors. We carefully review and analyze the complaints we receive and, if warranted, conduct a preliminary inquiry or full investigation into a matter. The misconduct investigated ranges from fraud and other types of criminal conduct to violations of Commission rules and policies and the Government-wide conduct standards. The investigations unit conducts thorough and independent investigations into allegations received in accordance with the applicable Quality Standards for Investigations. Where allegations of criminal conduct are involved, we notify and work with the Department of Justice and the Federal Bureau of Investigation as appropriate.

Audit Reports

My philosophy as an Inspector General is to focus on the significant issues and high risk areas, i.e, looking at "big picture" items, relating to whether the programs and operations in the Agency are working effectively, rather than simply identifying isolated minor infractions or procedural violations. I believe that this approach is particularly important in light of the significant challenges facing the SEC and the other government

agencies that regulate our financial markets. In this time of financial crisis, it is my view that as the agency charged with being the investor's advocate and protecting the integrity of our capital markets, the SEC must engage in critical self-analysis and address a number of difficult and complex issues. Current market conditions have created many new and unexpected challenges that need to be addressed and examined expeditiously. Therefore, it is more important than ever that financial regulatory agencies such as the SEC have an independent, effective and fully-funded Office of Inspector General to assist the Commission in confronting these challenges.

I am proud to report that over the past 14 months that I have served as the SEC's Inspector General, our Office has risen to these challenges and then some. Notwithstanding a small staff, over this short period of time, we have issued numerous detailed audit and investigative reports discussing issues critical to SEC operations and the investing public and making significant recommendations for improvement. Many of these reports have been critical of SEC operations, programs and management, and I have not always been the most popular individual at my agency. Nonetheless, I feel it is my duty to the Commission, the Congress and the investing public, particularly in these challenging times, to conduct independent audits and investigations and to issue thoughtful, unbiased and frank reports. Thus, whenever we find that criticism of the SEC is warranted and supported by the facts, we do not hesitate to report the facts and conclusions as we find them.

I will provide you with just a few examples of recent activities undertaken by my Office, some at the request of Congressional Committees. In September 2008, our audit unit issued a comprehensive report analyzing the Commission's oversight of the SEC's

Consolidated Supervised Entity (CSE) program, which included Bear Stearns, Goldman Sachs, Morgan Stanley, Merrill Lynch and Lehman Brothers. In order to give enhanced credibility to our findings, we retained the services of a recognized expert on capital markets, and market microstructure in particular. Our report provided a detailed examination of the adequacy of the Commission's monitoring of Bear Stearns, including the factors that led to its collapse. The audit identified deficiencies in the CSE program that warranted improvement and provided 26 recommendations that, if implemented, would have significantly improved the Commission's oversight of the CSE firms. In response to the report's findings, former SEC Chairman Christopher Cox announced the end of the CSE program and promised to review and move to aggressively implement the report's recommendations.

The Office of Inspector General's audit unit also issued a second report during the same time period, analyzing the Commission's Broker-Dealer Risk Assessment program. This program operates pursuant to SEC rules requiring broker-dealers that are part of a holding company structure with at least \$20 million in capital to register with the Commission, and provide information on the broker-dealer, the holding company, and other entities within the holding company system. The audit found that the SEC was not fulfilling all of its obligations in connection with the Broker-Dealer Risk Assessment Program and made several recommendations to improve the program.

Just recently, my Office has issued several other significant audit reports. In February, we issued an audit report that analyzed the \$178 million in disgorgement waivers that the Division of Enforcement (Enforcement) granted between October 2005 and May 2008. These waivers of disgorgements required to be paid by individuals or

entities that violate the Federal securities laws were granted based upon an assertion by a defendant of an inability to pay. We found that proper procedures were not always followed in recommending waivers, and the SEC did not always ensure there was appropriate documentation to confirm representations made by defendants concerning their financial condition. We provided several recommendations designed to improve the process.

Just last week, we issued a comprehensive audit report on Enforcement's practices and procedures for responding to and processing naked short selling complaints. Our report concluded that Enforcement's existing complaint receipt and processing procedures hinder its ability to respond effectively to naked short selling complaints and referrals, and Enforcement's procedures result in naked short selling complaints being treated differently than other types of complaints received by Enforcement. We also analyzed in a broader sense Enforcement's complaints, tips and referral process and provided numerous recommendations to improve the manner in which Enforcement receives and processes complaints.

We are also currently working on several additional audit reports that we plan to issue in the upcoming months that address issues currently of concern to the Commission and the investing public, including a comprehensive analysis of the SEC's oversight of the Nationally Recognized Statistical Rating Organizations. These rating organizations, also referred to as credit rating agencies, may have played a critical role in the current economic crisis and some of the financial frauds in the earlier part of this decade. We intend to identify processes that will aid with the Commission's oversight of these credit reporting agencies.

Investigative Reports

We also have a vibrant and vigorous investigative unit that under my direction is conducting, or has completed, over 50 comprehensive investigations of allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff members and contractors. Several of these investigations involved senior-level Commission staff and represent matters of great concern to the Commission, Congressional officials and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including removals from the Federal service. Specifically, over the past year, we have issued investigative reports regarding a myriad of allegations, including claims of improper preferential treatment given to prominent persons, retaliatory termination, Enforcement's failure to vigorously pursue an Enforcement investigation, conflict of interest and solicitation of favors from an outside contractor, perjury by supervisory Commission attorneys, misrepresentation of professional credentials, falsification of personnel forms, and the misuse of official position and government resources. These investigative reports have been issued without management influence or pressure, and have focused on all level of employees and contractors, including senior SEC staff. Where appropriate, we have also referred our investigative findings to the Department of Justice for possible criminal prosecution. We are continuing to follow up with the Department and the Federal Bureau of Investigation on several ongoing criminal matters.

Bernard Madoff Investigation

In addition to the work I just described, we are conducting a comprehensive investigation and evaluation of matters related to Bernard Madoff and affiliated entities.

On the late evening of December 16, 2008, former SEC Chairman Christopher Cox contacted me and asked my Office to undertake an investigation into complaints received by the SEC regarding Mr. Madoff, going back ten years, and the reasons why the agency found these complaints lacked credibility. The Chairman also asked that we inquire into the SEC's internal policies that govern when allegations of fraudulent activity should be brought to the Commission's attention, whether those policies were followed in the Madoff matter, and whether improvements to those policies are necessary. In addition, Chairman Cox requested that the investigation include a review of all SEC staff contact and relationships with the Madoff family and firm, and any impact such relationships had on staff decisions regarding the firm.

Early on December 17, 2008, we opened an official investigation into the Madoff matter. Since that time, we have been working at a rapid pace to perform this important work and have made substantial progress to date.

Based upon the work conducted to date, we have determined that the matters that must be analyzed regarding the SEC and Bernard Madoff go well beyond the specific issues that former Chairman Cox asked us to investigate. Therefore, in addition to conducting a thorough and comprehensive investigation of issues raised by former Chairman Cox, our oversight efforts will include an evaluation of broader issues regarding the overall operations of Enforcement and the Office of Compliance, Inspections and Evaluations as they relate to the specific questions we are examining. As a result of those efforts, we intend to provide overarching and comprehensive recommendations to ensure that the Commission fulfills its mission of protecting

investors, facilitating capital formation and maintaining fair, orderly and efficient markets.

At the conclusion of our investigative efforts related to the Madoff matter, in addition to recommending disciplinary action for specific individuals as may be appropriate, we plan to provide concrete and specific recommendations to ensure the SEC has sufficient systems and resources to enable it to respond quickly and effectively to complaints and detect fraud through its examinations and inspections.

Coordinated Efforts Among Financial Regulatory IGs

In addition to the work conducted by the Office of Inspector General at the SEC, in order to strengthen the oversight of the Federal financial regulatory structure as a whole, we work in tandem with other Federal financial regulatory Inspectors General to provide coordinated oversight. For example, I currently serve on the Troubled Asset Relief Program (TARP) Inspector General Council, along with the Special Inspector General for the TARP, Neil Barofsky, and Inspectors General from the Department of Treasury, Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board, the Department of Housing and Urban Development, the Federal Housing Finance Agency, the Small Business Administration, and representatives of the GAO. We meet on a monthly basis to discuss coordination of TARP-related activities and oversight efforts.

I also meet every month with the Inspectors General for the Department of Treasury, FDIC, Federal Reserve Board, the Pension Benefit Guaranty Corporation, the Federal Housing Finance Board, the Commodity Futures Trading Corporation, and the National Credit Union Administration to discuss coordinated oversight efforts among the financial regulatory IGs. I believe that these coordinated efforts are crucial to ensure a

united and common approach to the oversight of the Federal financial regulators during this time of economic crisis.

Congressional Efforts to Assist Inspectors General

I greatly appreciate the Subcommittee's interest in assisting the Inspectors General in performing their critical work and the willingness in particular to assist the efforts of my Office. With increasing pressure on the Federal financial regulators, having sufficient funds and resources to conduct oversight, as well as the requisite degree of independence, is more vital than ever.

The recently-enacted amendments to the Inspector General Act made great strides in enhancing Inspector General independence and ensuring that the Inspectors General receive sufficient appropriated funds to achieve their mission. In particular, Section 8 of the Inspector General Reform Act requires agencies to include in their budget submissions to the Office of Management and Budget (OMB) a specific breakout for Inspector General funding, as well as any comments of the affected Inspector General with respect to the proposal. Furthermore, OMB must include in the President's budget, among other things, the amount of funding requested by the President for each IG and any comments by an Inspector General who determines that the budget submitted by the President would substantially inhibit the performance of the Inspector General's mission. Other significant improvements to enhance Inspector General independence made by the Inspector General Reform Act include Section 3's requirement of 30 days advance notice to Congress of the removal or transfer of an Inspector General, as well as the provisions prohibiting cash awards or bonuses to Inspectors General and establishing the pay of both Presidentially-appointed and Designated Federal Entity (DFE) Inspectors General.

Since I began my tenure as Inspector General of the SEC in December 2007, my Office's staffing levels have increased by nearly 80%, and I have requested an increase of our overall budget of nearly 30% for Fiscal Year 2009, which I understand will be processed as soon as the funds are available. Notwithstanding these increases, additional resources would greatly assist my Office in continuing its important work. I specifically suggest that to the extent Congress provides additional appropriations to agencies such as the SEC for increased enforcement efforts, there be a commensurate and proportionate funding to the corresponding Offices of Inspectors General to provide for oversight of the additional funds allotted to the agency. There may also be other mechanisms pursuant to which appropriated funds may be directed specifically to an Office of Inspector General for oversight efforts.

Additionally, the legislation recently passed by the Senate to provide the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) with additional authorities and responsibilities is illustrative of other types of measures that may be enacted to enhance Inspector General independence and effectiveness. For example, the SIGTARP legislation requires the Secretary of the Treasury to take action to address deficiencies identified by a report or investigation of the SIGTARP, or to certify to the appropriate Committees of Congress that no action is necessary or appropriate. That legislation also provides the SIGTARP with enhanced audit, investigation and personnel authorities.

Finally, I respectfully offer my opinion that converting Inspectors General from DFE Inspectors General to Presidentially-appointed Inspectors General is not necessary and, in my view, would not improve the current level of DFE Inspector General

oversight. Having been an Inspector General at two DFEs, at the Peace Corps and now at the SEC, I can state without any hesitation, that one can be a completely independent and effective Inspector General within the DFE structure. Although I have issued numerous reports at both agencies that have been critical of those agencies' operations and management and often controversial, no one has ever attempted to impair, or question, my independence. I believe that DFE Inspectors General are able to fulfill their duties to provide meaningful and independent oversight free from any outside influences, including political ones.

In my personal situation, my Office's reports and approach to oversight have not diminished in any way with the recent change in administration and appointment of a new SEC Chairman. I can report that politics play absolutely no role in my Office's decisions and, as a DFE Inspector General, I am completely unaffected by political considerations or processes. For this reason, I do have some concerns that converting the Inspector General of the SEC, or the Inspectors General of other financial regulatory agencies, from DFE to Presidentially-appointed Inspectors General could result in an unnecessary "politicization" of the Office of Inspector General. There are additional potential drawbacks to the Presidentially-appointed Inspector General process, including the often lengthy vetting and confirmation process that may lead to the Inspector General position being vacant for a significant period of time. During this time of financial crisis, it is more important than ever that there is continuity of the operations and oversight activities currently undertaken by Inspectors General of financial regulatory agencies.

Concluding Remarks

In conclusion, I greatly appreciate the Subcommittee's interest in the SEC and my Office. I believe that the Subcommittee's and Congress's involvement with the SEC is extremely important to strengthen the accountability and effectiveness of the Commission. I also believe very strongly that a dynamic and effective Office of Inspector General is critical to achieving the mission of all Federal agencies, including the SEC. I take very seriously my Office's responsibility to detect and report waste, fraud and abuse, as well as the concern and interest of this Subcommittee in the efficiency and effectiveness of my Office and the SEC. Thank you.

Ms. WATSON. Before we proceed, I have a question. You said something when you were referring to complaints that you were receiving from, I guess, whistleblowers, people on staff, and so on. You said they lacked credibility. Now, did I hear you correctly? Would you expand and explain what you said about the credibility?

Mr. KOTZ. Sure. In connection with the Madoff investigation, what we are investigating in the Bernard Madoff investigation is why is it that the SEC, not our Office but the SEC Enforcement Division, received complaints. There was one whistleblower, Harry Markopolos, who came forward with a complaint stating that he believed that Bernard Madoff was engaged in illegal activity and that complaint went to the SEC. It didn't go to the IG's Office, it went to the SEC.

And obviously the SEC did not find that there was a Ponzi scheme because that did not come out until Bernard Madoff confessed on December 11th. So our investigation is to look at why it was that the SEC received these complaints and nevertheless was unable to find the Ponzi scheme. And that was the concern about credibility.

Ms. WATSON. That came from the SEC?

Mr. KOTZ. Yes, right.

Ms. WATSON. OK. I just wanted to place it where it should be.

Mr. KOTZ. Yes, yes.

Ms. WATSON. Thank you.

Mr. KOTZ. Thank you.

Ms. WATSON. We will now proceed to Mr. DeSarno.

STATEMENT OF WILLIAM DESARNO

Mr. DESARNO. Chairwoman Watson and members of the subcommittee, I appreciate this opportunity to come before you today and testify on matters concerning the independence and authority of Designated Federal Entity Inspectors General, including House of Representatives 885. I thank you for calling this hearing and for your support of the IG community.

My name is William DeSarno, inspector general of the National Credit Union Administration, whose primary mission is to ensure the safety and soundness of federally insured credit unions. I was appointed to the IG position at NCUA in 2005 after having served since 1997 as assistant IG for Audits and then deputy IG at NCUA. Previously I was an audit manager at the Department of the Treasury, Office of Inspector General and before that an audit manager at what is now the Government Accountability Office. Finally, I began my Federal career 41 years ago in the U.S. Army where I served in Vietnam.

The NCUA Board appointed its first IG in 1989 in the wake of the 1988 amendments to the IG Act of 1978 which created statutory IGs at smaller Federal entities. The NCUA Board and the OIG have worked hard over this 20 year period to establish a relationship built on mutual respect and trust. House of Representatives 885 would amend the IG Act to make the IG at the NCUA an establishment IG appointed by the President and confirmed by the Senate. I do not believe that this change in the IG status at NCUA would enhance either the independence or the effectiveness of the

IG. Rather, I believe it would work to the detriment of the IG role at NCUA.

My independence as IG at NCUA has not been hampered because I was appointed by the NCUA Board. To the contrary, the Board has never attempted to interfere with an IG audit or investigation. Indeed, the NCUA Board has consistently expressed high expectations for oversight, stated its intolerance of fraud and abuse, and paid close attention to IG findings.

The NCUA OIG, while small, has historically been adequately staffed and with adequate resources to carry out its statutory obligations. My Office formulates its own budget and has a separate line item in the agency's budget. The NCUA Board has consistently supported my staffing needs.

The NCUA IG has had its own counsel since 1990 who reports exclusively to the Inspector General. The NCUA Board has also consistently approved funding for contract help when I have requested it. And let me also add that our audit and investigation reports are in no way filtered through either the Board or the chairman's office prior to issuance.

Prior to the enactment of the IG Reform Act, the only area where the NCUA IG did not enjoy similar stature with other senior managers at NCUA was in the area of pay where the IG was paid significantly less than other NCUA senior staff. This situation was further exacerbated because the IG did not accept bonuses or cash awards as other NCUA senior managers regularly did. With the agency's implementation of the IG Reform Act's pay provisions, the IG salary was elevated to the average of the other senior managers and the pay disparity was resolved. Were House of Representatives 885 to pass, the Presidentially appointed IG's pay would be significantly less than the average total compensation of NCUA's senior level managers. Moreover, a Presidentially appointed NCUA IG could end up with an annual salary less than some of his or her subordinates in the OIG. This is precisely the outcome the IG Reform Act of 2008 sought to and did correct.

Due to the current challenges facing the entire financial services industry, the NCUA OIG has a critical role in its oversight and accountability functions. For example, my Office has seen a growing material loss review workload in the past year. This work is mandated by the Federal Credit Union Act and the OIG currently has an unprecedented number of reviews either underway or in the planning process. We have redirected most of our audit resources to this review work. Were a Presidential appointee to replace an IG who is familiar with the unique nature of the credit union industry as well as the day to day functioning of an IG Office, the potential disruption to OIG operations in completing this critical work would, I believe, be significant.

A final concern I have should House of Representatives 885 change the appointment status of DFE IGs is that the selection process risks politicization which would significantly threaten IG independence. Congress required that IGs be nonpartisan and that the President appoint them without regard to political affiliation. In the 20 years that the IG concept has existed at NCUA, the NCUA Board has never appointed an IG on the basis of political affiliation.

In conclusion, while I do not speak for the NCUA Board or the other DFE IGs, I do not believe that House of Representatives 885 would enhance the independence already afforded the NCUA IG. With the greater protections and enhanced independence afforded IGs by the IG Reform Act of 2008, the NCUA IG is well suited to carry out the responsibilities mandated by the act. Thank you again for the opportunity to appear before this subcommittee and I would be pleased to answer any questions you might have.

[The prepared statement of Mr. DeSarno follows:]

Testimony of
Honorable William A. DeSarno
Inspector General of the National Credit Union Administration

**Before the
Government Management, Organization, and Procurement Subcommittee
Oversight and Government Reform Committee**

Wednesday, March 25, 2009

Chairwoman Watson, Ranking Member Bilbray, and Members of the Subcommittee:

I appreciate this opportunity to come before you today and testify on matters concerning the independence and authority of designated Federal entity (DFE) Inspectors General (IG), including H.R. 885, the “Improved Financial and Commodity Markets Oversight and Accountability Act.” I thank you for calling this hearing and for your support of the IG community.

I am William DeSarno, Inspector General of the National Credit Union Administration (NCUA), whose primary mission is to ensure the safety and soundness of federally-insured credit unions. I was appointed to the IG position at NCUA in 2005 after having served, since 1997, as Assistant IG for Audits and then Deputy IG at NCUA . Previously, I was an Audit Manager at the Department of the Treasury Office of Inspector General (OIG) and, before that, an Audit Manager at what is now the General Accountability Office (GAO). Finally, I began my federal career 41 years ago in the United States Army, where I served in Vietnam.

As an IG at a small financial regulator, my role at NCUA is unique. To illustrate—at the NCUA, although we are an integral part of the agency, unlike any other NCUA central or regional office, our legislative underpinning requires us to operate as an independent and objective unit at the same time. Within that framework, we have two essential roles: through a comprehensive program of audits, evaluations, and investigations, we (1) independently analyze and report on significant management and performance challenges facing NCUA; and (2) foster integrity, accountability, and excellence in NCUA programs and operations. The

NCUA Board provides the supportive structure within which we are able to carry out our statutory responsibilities under the Inspector General Act (IG Act). We report our results both to the NCUA Board and to the congressional committees with related oversight responsibilities.

The NCUA Board appointed its first IG in 1989, in the wake of the 1988 amendments to the IG Act of 1978, which created statutory IGs at smaller, federal entities. The NCUA Board and the OIG have worked hard over this 20 year period to establish a relationship built on mutual respect and trust. As you know, a good working relationship between the IG and the agency head is essential. My effectiveness as IG is contingent upon the value that the NCUA Board attaches to IG oversight, its responsiveness to IG findings and recommendations, the regularity of IG access to the top of the organization and, most importantly, the Board's unflinching support of the IG's independence. Likewise, I have a high regard for the NCUA Board and its senior managers, our working relationships, and the absolute respect they demonstrate for the independence of my office.

H.R. 885 would amend the IG Act to make the IG at the NCUA an establishment IG appointed by the President and confirmed by the Senate. I do not believe that this change in the IG's status at NCUA would enhance either the independence or the effectiveness of the IG. Rather, I believe that it would work to the detriment of the IG role at NCUA. My independence as IG at NCUA has not been hampered because I was appointed by the NCUA Board. To the contrary, the Board has never attempted to interfere with an IG audit or investigation. Indeed the NCUA Board has consistently expressed high expectations for oversight, stated its intolerance of fraud and abuse, and paid close attention to IG findings.

From an organizational perspective, the NCUA OIG while small, has historically been adequately staffed and with adequate resources to carry out its statutory obligations. My office formulates its own budget and has a separate line item in the agency's budget. The NCUA Board has consistently supported my staffing needs. The NCUA IG has had its own counsel since 1990 who reports exclusively to the IG. In addition, my staff consists of a Deputy IG for Audits, a Director of Investigations, two Senior Auditors, a Senior Information Technology Auditor, and an Office Manager. And, with our recently increased material loss review workload, the NCUA Board, while balancing ongoing internal budget constraints, approved our hiring an additional auditor, who will join our staff next week. The NCUA Board has also consistently approved funding for contract help when I have requested it.

Prior to the enactment of the IG Reform Act, the only area where the NCUA IG did not enjoy similar stature with the other senior managers at NCUA was in the area of pay, where the IG was paid significantly less than other NCUA senior staff. This situation was further exacerbated because the IG did not accept bonuses or cash awards, as other NCUA senior managers regularly did. With the agency's implementation of the recently enacted IG Reform Act's pay provisions, the NCUA IG's salary was elevated to the average of the other senior managers and the pay disparity was resolved. This only served to enhance the IG's stature among similarly situated NCUA office and regional directors. Were H.R. 885 to pass, the presidentially appointed IG's pay would be significantly less than the average total compensation of NCUA's senior level managers. Moreover, a presidentially appointed NCUA IG could end up with an annual salary less than some of his or her subordinates in the OIG. Reverting back to the pay disparity for IGs would discourage individuals from seeking appointment as Inspector General and remaining in the job, as well as reinstitute morale problems. This is precisely the outcome the IG Reform Act of 2008 sought to—and did—correct.

Due to the current challenges facing the entire financial services industry, the NCUA OIG has a critical role in its oversight and accountability functions. For example, my office has seen a growing material loss review workload in the past year. This work is mandated by the Federal Credit Union Act, and the OIG currently has an unprecedented number of reviews either underway or in the planning process. We have redirected most of our audit resources to this review work. Were a presidential appointee to replace an IG who is familiar with the unique nature of the credit union industry, as well as the day-to-day functioning of an IG office, the potential disruption to OIG operations in completing this critical work would, I believe, be significant.

A final concern I have should H.R. 885 change the appointment status of DFE IGs, is that the selection process risks politicization, which would significantly threaten IG independence. To ensure that IGs are objective and independent, Congress required that IGs be nonpartisan, and that the President appoint them without regard to political affiliation. In the 20 years that the IG concept has existed at NCUA, the NCUA Board has never appointed an IG on the basis of political affiliation.

I believe the current NCUA Board is committed to protecting the IG's independence and effectiveness in this period of financial regulatory transformation, and that the agency and the credit union industry as a whole would be served best by maintaining the NCUA IG's current status.

In conclusion, while I do not speak for the NCUA Board or for the other DFE IGs, I do not believe that H.R. 885 would enhance the independence already afforded the NCUA IG. With the greater protections and enhanced independence afforded IGs by the IG Reform Act of 2008, the NCUA IG is well situated to carry out the responsibilities mandated by the IG Act.

Thank you again for the opportunity to appear before the Subcommittee. I would be pleased to answer any questions you may have.

Ms. WATSON. Thank you so much. Mr. Lavik.

STATEMENT OF A. ROY LAVIK

Mr. LAVIK. I appreciate as the others do the opportunity to come before you all and give our view of the legislation and what we think is probably happening. And again, I will stand ready for questions. I don't think, given the time and so on that I will regurgitate my statement here. But let me just concentrate on a couple of things.

One is the independence issue. And I can only speak for my own agency, not for the others. But for example, some time ago we investigated the chairman of our agency because there was a question of whether she had replaced someone at the behest of the White House or whether it was because of her own feelings about the situation. It was someone who we found was not, she just didn't like the head of the enforcement. But that shows you that we certainly were independent. I will give her much credit. She is now Mr. Kotz's boss in a sense. She is now chairman of the SEC, a very good person.

We also more recently looked in at the behest of four Senators on the question of the huge price increase for barrels of oil this last July. It was called an interim report and was issued by CFTC staff and staff from other economic regulatory agencies. And what we found there is that in fact there had been a change in classification of one of the large oil companies into what is called speculative. That is a bad word these days. I am not so sure it should always be bad, but it is and at least it should be explained readily what was going on.

We found that the agency had reclassified appropriately. The problem was that unless you were an expert in the field, someone who is constantly in it, you would not have understood the push and the shove of that. And we noted that in our report to the four Senators that there had been an inadequate explanation. I cite this again as an indication of independence. This was lobbying the chairman, not just the CFTC but other entities.

The other thing I would say about House of Representatives 885 is, there is an old cliché, you get what you pay for. And that is not always true. We had a chairman just prior to that who was willing to take the pay salary because he made a hell of a lot of money in the investment banking business. You can find that. But there are those of us who haven't and have kids in college and so on. Pay is a big consideration.

I can tell you at my agency, and I think it is true of others but I will let them speak themselves, and I can be objective about this because I am at such an age I probably won't be around for more than another year or two, but my pay would be decreased on the order of about \$40,000 a year. And that is relative to the other people at the CFTC. Now, if that is Congress's will, that is fine. I mean, that is your responsibility.

But it seems to me, as you might guess given my advice, perverse. If you want to have good people, generally you have to pay for it. And I think cutting someone's salary \$40,000, and again, I can be semi-objective because I don't plan to be around much longer, but I think this is something you ought to really think

about and make your decision. That is all I really have to say. If you have any questions, whenever it will be fine.
[The prepared statement of Mr. Lavik follows:]



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Testimony

**Written Testimony of Inspector General A. Roy Lavik
before the House Subcommittee on Government
Management, Organization and Procurement,
Committee on Oversight and Government Reform
United States House of Representatives
March 25, 2009**

Chairman Watson, Ranking Member Bilbray, and other Subcommittee Members, thank you for inviting me to testify before the Subcommittee. I am Roy Lavik, Inspector General for the Commodity Futures Trading Commission (CFTC or Commission). I appreciate the opportunity to discuss my role as the Inspector General at an Agency charged with regulating financial futures markets (among other markets), and to address both specific and strategic challenges facing my Office during the current economic crisis. I will also briefly address House Bill 885, which if adopted will convert my Office to a Presidential Appointment.

CFTC and OIG Mission

Congress created the CFTC in 1974 as an independent agency with the mandate to regulate commodity futures and options markets in the United States. Broadly stated, the Commission's mission is two-fold: to protect the public and market users from manipulation, fraud, and abusive practices and to ensure open, competitive and financially sound markets for commodity futures and options.

The CFTC Division of Enforcement investigates alleged violations of the Commodity Exchange Act and regulations, including allegations of fraud, market manipulation and other illegal activity by market professionals and participants. The Division of Enforcement currently has 141 employees.

If the CFTC is the watchdog for the futures industry, the OIG is watching the watchdog. My Office conducts and supervises audits and investigations of programs and operations of the CFTC, and recommends policies to promote economy, efficiency and effectiveness in CFTC programs and operations and to prevent and detect fraud and abuse. My Office has a full time professional staff of three, including myself.

The current economic crisis has presented both specific challenges and potential strategic challenges for my Office. During the summer my Office undertook an investigation into allegations of improper conduct by Agency employees related to the recent turmoil in the crude oil market. The passage of the Emergency Economic Stabilization Act in October 2008 and the revelation of the Bernard Madoff Ponzi scheme in December 2008 both raise important issues for my Office.

Investigation into the Interim Report on Crude Oil

In 2008, NYMEX Crude Oil futures prices rose from under \$100.00 per barrel in January 2008 to over \$145 per barrel in July. In the wake of these unprecedented price movements, allegations arose concerning an Interim Report on Crude Oil issued by Commission staff on July 22. My Office conducted an investigation into those allegations during August and September of last year.

Specifically, four United States Senators alleged that the report was based on flawed and incomplete information, was based on flawed analyses of the crude oil market, and was timed to influence a key Senate vote on a bill to regulate futures trading. The allegations stemmed from the fact that the report followed a significant reclassification of crude oil futures positions with potential to influence the report's analysis, and preceded the Senate vote by three days.

My Office interviewed 44 individuals representing the CFTC and other contributors to the report, and reviewed email and multiple drafts of the report and supporting documentation. All interviews and information we reviewed indicated that the report used the updated crude oil futures position data.

We also concluded that while the analytical method – Granger Causality – did have limitations, those limitations were clearly disclosed in the Interim Report. Finally, we concluded that because the Interim Report release date was delayed due to the position reclassification, the release date coincided with the Senate vote as a matter of coincidence rather than by design.

Nevertheless, we faulted the Agency for failing to disclose the position reclassification in an effective manner. The position reclassification was significant and the Commission did not publish a clear explanation of what the reclassification entailed, nor how it would be treated in the Interim Report and other studies. Instead, the position reclassification was announced in a manner consistent with other smaller reclassifications, meaning it was disclosed in a manner that only those familiar with the CFTC weekly Commitment of

Traders Reports would likely understand. This is a situation I strongly believe could have been avoided through greater transparency regarding the position reclassification.

The Emergency Economic Stabilization Act of 2008 and the CFTC OIG Strategic Mission

In October 2008 Congress passed the Emergency Economic Stabilization Act of 2008 and established the Troubled Asset Relief Program, which may impact the strategic mission and long term objectives of my Office.

While we have not received any allegations regarding the misuse of TARP funds or other improper conduct relating to TARP that involve matters or entities under CFTC jurisdiction, we have reached out to the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) and have made our Office available to assist wherever appropriate. We look forward to working cooperatively with SIGTARP in the future as the need arises.

The Bernard Madoff Ponzi Scheme

In the wake of the December 2008 revelation of the multi-billion dollar Ponzi scheme perpetrated by Bernard Madoff, I am concerned that similar allegations concerning entities falling under the CFTC's jurisdiction are investigated to the fullest extent possible, and are not ignored.

As far as Ponzi investigations are concerned, we are not aware of any allegations that have been ignored. The Commission filed 13 complaints last year in suspected Ponzi scheme cases. After the arrest of Mr. Madoff in December 2008, the Commission received an influx of similar allegations and filed 12 additional Ponzi cases between January and March 18 of this year.

Currently we have no allegations that the CFTC Division of Enforcement has ignored or refused to investigate allegations. We note with approval that in 2008 CFTC announced investigations into both the energy markets and the silver market. My Office had previously received allegations of illegal trading in both markets, as well as requests for investigative action.

My Office routinely reviews each investigative opening memo and each proposed complaint issued by the Division of Enforcement, and while we do not supervise Enforcement filings, we also do not hesitate to bring potential issues to the attention of relevant Agency officials. In addition, my Office has conducted several investigations of alleged wrongdoing by CFTC employees in connection with investigations and enforcement activities, including an investigation into improper post-employment conduct by a CFTC enforcement attorney.

The Agency's obligation to investigate credible allegations is one we take seriously, and we will continue to follow this issue.

HR 885

My final topic is HR 885. HR 885 will elevate the Inspector General at five financial market regulators to Presidential appointments. There is no doubt that a Presidential appointment may make the Inspector General more visible.

IG independence, however, is established under the IG Act and other statutes, and applies equally to the Agency- and President-appointed Inspector Generals. It is more important to ensure that the best qualified individuals are selected to serve.

HR 885 as written will terminate pay parity for the CFTC Inspector General relative to other CFTC employees and officers. I understand that the other Inspector Generals named in HR 885 will be similarly affected and in some instances the pay cut will be significant. HR 885 therefore offers the prospect of rendering the Inspector Generals at the prescribed five financial Agencies lesser status than other high ranking officials since their pay will be significantly less than the latter.

It is clear that Congress authorized the CFTC to achieve pay parity with the other financial market regulators in order to attract and retain the best and brightest. One of my goals has been to perform a review of the pay parity program at CFTC not only to determine its effect on employee retention, but also to determine whether new hires are appreciably more experienced or better qualified. During the past years the Agency's budget situation has resulted in hiring freezes and has not permitted a meaningful review. However, the Agency's recent budget increases will result in new hires and we are interested in reviewing the pay parity program in order to determine whether pay parity is achieving the intended results regarding both retention and better quality hires.

Thank you for the opportunity to appear before you today. I would be happy to answer any questions you may have.

Ms. WATSON. Thank you so much. And now Ms. Burrows.

STATEMENT OF VANESSA K. BURROWS

Ms. BURROWS. Thank you, Madam Chairwoman. Chairwoman Watson and members of the subcommittee, thank you for inviting me here today to comment on proposed changes effecting Offices of Inspectors General in House of Representatives 885. In particular, my testimony will focus on differences between the IGs located in Federal establishments and IGs located in the Designated Federal Entities. DFE IGs are typically found in the smaller agencies. Establishment and designated Federal entity differ in terms of their removal, appointment, transfer, budgets, applicable hiring laws, avenues for seeking legal counsel, and pay.

The most notable difference between establishment IGs and Designated Federal Entity IGs is the individual who appoints and who may remove or transfer the IG. Establishment IGs are appointed by the President, as you know, with the advice and consent of the Senate. They may be removed or transferred only by the President except in case of impeachment. Designated Federal Entity IGs are appointed and may be removed or transferred by the agency head except in the case of impeachment. My written statement discusses the potential advantages and disadvantages of converting these five IGs into Presidentially appointed, Senate confirmed positions.

Another difference between the establishment IGs and the Designated Federal Entity IGs is that by statute, establishment IGs receive a separate appropriations account or a line item in the establishment's appropriations. The Inspector General Reform Act of 2008 has increased and created additional safeguards in terms of the budgets of both establishment and Designated Federal Entity IGs. The IG Reform Act requires the IG to report an initial budget estimate to the head of the agency. The agency head must then include this information as well as comments of the Inspector General when transmitting the request to the President. The President in turn must then include in his budget submission the IG's initial budget estimate, the President's requested amounts, and the comments of the affected IG if the IG determines that the President's budget would substantially inhibit the IG from performing his or her duties.

The two types of IGs also differ in terms of how they may select their own employees. DFE IGs, the Designated Federal Entity IGs, are exempt from the sections of the IG Act, and have always been since their creation in 1988, from the sections that mandate the selection, appointment, and employment of officers and employees in the establishment IG Offices according to civil service employment laws. And that is because, as Congress indicated in a House Report back in 1988, some of these entities do not have to follow those laws and are subject to different laws and regulations.

Establishment and DFE IGs also differ in their ability to hire counsel or seek legal advice. These changes were created in the IG Reform Act of 2008, which addressed the use of legal counsel by the IG and specified that an establishment IG must seek legal advice from an attorney who they hire under civil service laws and who reports directly to that IG or to another IG.

The Reform Act also provided three ways for a Designated Federal Entity IG to obtain counsel. First, the Designated Federal Entity IG could obtain counsel from an attorney appointed by that IG in accordance with the specific laws and regulations governing appointments in the agency within the Designated Federal Entity. This counsel would report directly to the appointing IG.

Second, the Designated Federal Entity IGs, on a reimbursable basis, could obtain services from a counsel who was appointed by and who reports to another Inspector General. Third, the Designated Federal Entity IG may obtain the legal services of an appropriate person on the newly created Council of Inspectors General on Integrity and Efficiency.

The IG Reform Act of 2008 also continued preexisting differences between establishment and Designated Federal Entity IGs. For example, the Reform Act increased the pay of the establishment IGs to the rate of Level III of the Executive Schedule plus 3 percent. And currently Level III of the Executive Schedule is \$126,900. However, it included a provision which would allow the IGs who currently received higher pay to continue at that level. The IG Reform Act also increased the pay of Designated Federal Entity IGs but did not link them to the Executive Schedule. Some Designated Federal Entity IGs may make more than their establishment IG counterparts. The IG Reform Act also provided that Designated Federal Entity IGs should be classified for pay purposes at a level at or above the majority of the senior level executives of the Designated Federal Entity IG such as a General Counsel or Chief Financial Officer but that their pay could not be less than the average total compensation including bonuses of those senior level executives. The Reform Act also provided that the Designated Federal Entity IGs pay could not increase by more than 25 percent of the Designated Federal Entity IG's total pay for the previous three fiscal years.

Madam Chairwoman, that concludes my prepared statement. I would be happy to answer question that you might have.

[The prepared statement of Ms. Burrows follows.]



**Statement of
Vanessa Burrows, Legislative Attorney
Congressional Research Service**

Before

**The Committee on Oversight and Government Reform
Subcommittee on Government Management, Organization, and Procurement
House of Representatives**

March 25, 2009

on

**“The Roles and Responsibilities of Inspectors General within Financial Regulatory
Agencies”**

Madam Chairwoman and Members of the Subcommittee:

Thank you for inviting me to comment on proposed changes affecting offices of inspectors general (OIGs), particularly those offered in H.R. 885, the Improved Financial Commodity Markets Oversight and Accountability Act, introduced by Representative John Larson. I have also been asked to address the duties and functions of Inspectors General (IGs), the numbers of each type of IG, the differences between IGs appointed by the President and those appointed by the agency head, considerations for whether certain IGs should be appointed by the President as opposed to the agency head, and issues that may remain after the enactment of the Inspector General Reform Act of 2008 (Reform Act).¹ In October 2008, Congress enacted the Reform Act, which created additional protections and authorities for IGs with regard to removal or transfer of an IG, budgets, law enforcement authority, pay, subpoena power, and websites.

Overview

There are more than 60 OIGs in executive and legislative branch agencies, as well as special inspectors general (SIGs), who are responsible for audits and investigations related to particular programs or expenditures. IGs draw their authorities and duties,

¹ P.L. 110-409.

either in whole or in part, from the Inspector General Act of 1978, as amended (IG Act).² For example, while several legislative branch IGs have been created in separate statutes, their establishing acts reference several of the provisions of the IG Act. Similarly, Congress has established SIGs such as the SIG for Iraq Reconstruction (SIGIR), the SIG for Afghanistan Reconstruction (SIGAR), and the SIG for the Troubled Asset Relief Program (SIGTARP), and has granted these IGs many of the authorities and responsibilities listed in the IG Act.

The IG Act addresses the authorities and duties of two types of IGs: (1) federal establishment IGs, who are appointed by the President with the advice and consent of the Senate and may be removed only by the President; and (2) designated federal entity (DFE) IGs, who are appointed and may be removed by the agency head.³ The latter are typically found in the smaller agencies. IGs have been granted a substantial amount of independence, authority, and resources in their statutes to combat fraud, waste, and abuse. IGs operate under only the “general supervision” of the agency head, who is prohibited (with a few exceptions) from preventing or prohibiting an IG from initiating or carrying out an audit or investigation.⁴

The statutory purposes of the OIGs include: conducting and supervising audits and investigations within an agency; providing policy recommendations for activities to promote the economy, efficiency, and effectiveness of agency programs and operations; and conducting, supervising, or coordinating activities designed to prevent and detect fraud and abuse in agency programs and operations.⁵ IGs must also keep the agency head and Congress “fully and currently informed” about problems with the administration of agency programs and operations through specified reports and otherwise (which includes testifying at hearings and meeting with Members and staff).⁶ The reports include semi-annual reports as well as immediate reports regarding “particularly serious or flagrant problems.”⁷ The connections between IGs and Congress may enhance legislative oversight capabilities and provide IGs with potential support for their findings and recommendations for corrective action.

To carry out these and other duties, IGs have access to agency information and subpoena power for records and documents, as well as independent law enforcement authority. IGs must report suspected violations of federal criminal law immediately to the Attorney General.⁸ Agencies may also have a separate office that is responsible for

² 5 U.S.C. Appendix.

³ DFE IGs were created in the Inspector General Act Amendments of 1988, P.L. 100-504. Section 3 of the IG Reform Act of 2008 establishes a requirement that the President or the agency head must notify Congress in writing at least 30 days before removing or transferring an IG. P.L. 110-409. This testimony does not address potential constitutional concerns with this provision. Additionally, either an establishment or DFE IG may be impeached.

⁴ 5 U.S.C. Appx. § 3(a).

⁵ Although IGs oversee agency programs and operations, they do not have program operating responsibilities. See 5 U.S.C. Appx. §§ 8G(b), 9(a)(2); H.R. Rept. No. 100-1020, at 28 (Sept. 30, 1988) (Conf. Rept.).

⁶ 5 U.S.C. Appx. §§ 2, 4(a)(5).

⁷ 5 U.S.C. Appx. § 5(d).

⁸ 5 U.S.C. Appx. § 4(d).

conducting criminal investigations under the statutes that the agency is responsible for administering and enforcing, which may make recommendations for further investigation and prosecution to the U.S. Department of Justice.

Types of IGs

Including the newest IG for the Federal Housing Finance Agency, there are presently 30 establishment IGs that have been appointed by the President. They are located in the following departments and agencies: (1) Agriculture, (2) Commerce, (3) Defense, (4) Education, (5) Energy, (6) Health and Human Services, (7) Housing and Urban Development, (8) Interior, (9) Justice, (10) Labor, (11) State, (12) Transportation, (13) Homeland Security, (14) Treasury, (15) Veterans Affairs, (16) Environmental Protection Agency, (17) General Services Administration, (18) National Aeronautics and Space Administration, (19) Nuclear Regulatory Commission, (20) Office of Personnel Management, (21) Railroad Retirement Board, (22) Federal Deposit Insurance Corporation, (23) Small Business Administration, (24) Corporation for National and Community Service, (25) Agency for International Development, (26) Social Security Administration, (27) Federal Housing Finance Agency, (28) Tennessee Valley Authority, (29) Export-Import Bank, and (30) Treasury Inspector General for Tax Administration.⁹ The IG Act also provides that IGs may be established in commissions created under 40 U.S.C. § 15301, which are the Southeast Crescent Regional Commission, the Southwest Border Regional Commission, and the Northern Border Regional Commission.

Not including the IG for the Federal Housing Finance Board, as that agency has become part of the Federal Housing Finance Agency, there are currently 29 DFE IGs, appointed by the agency head and located in the following agencies: (1) Amtrak, (2) Appalachian Regional Commission, (3) Board of Governors of the Federal Reserve System, (4) Commodity Futures Trading Commission, (5) Consumer Product Safety Commission, (6) Corporation for Public Broadcasting, (7) Denali Commission, (8) Equal Employment Opportunity Commission, (9) Farm Credit Administration, (10) Federal Communications Commission, (11) Federal Election Commission, (12) Election Assistance Commission, (13) Federal Maritime Commission, (14) Federal Labor Relations Authority, (15) Federal Trade Commission, (16) Legal Services Corporation, (17) National Archives and Records Administration, (18) National Credit Union Administration, (19) National Endowment for the Arts, (20) National Endowment for the Humanities, (21) National Labor Relations Board, (22) National Science Foundation, (23) Peace Corps, (24) Pension Benefit Guaranty Corporation, (25) Securities and Exchange Commission, (26) Smithsonian Institution, (27) United States International

⁹ Section 12(2) of Title 5 Appendix, United States Code, lists 32 IGs, including the IGs in numbers 1-29 in the above text. However, the IGs for the Federal Emergency Management Agency, the Community Development Financial Institutions Fund, and the Resolution Trust Corporation are no longer in existence. The functions of those agencies were either transferred or abolished. Also, 5 U.S.C. Appx. § 2 specifically lists the Office of Treasury IG for Tax Administration; the Treasury is defined as an establishment under 5 U.S.C. Appx. § 12(2).

Trade Commission, (28) Postal Regulatory Commission, and (29) United States Postal Service.¹⁰

There are several additional types of IGs that draw their authorities in part from the IG Act. The five legislative branch IGs are located in the following entities: (1) Government Accountability Office, (2) Architect of the Capitol, (3) Government Printing Office, (4) Library of Congress, and (5) Capitol Police. There are three Special IGs: (1) SIGIR, (2) SIGAR, and (3) SIGTARP. Finally, there is an IG for the Central Intelligence Agency (CIA) and an IG for the Office of the Director of National Intelligence (DNI).

Differences Between Establishment and DFE IGs

The IG Act Amendments of 1988 expanded the number of presidentially appointed establishment IGs and also created DFE IGs. Initially, the DFEs in which the 1988 amendments created IGs were entities that were “(1) regulatory agencies of the Federal Government or (2) were established by the Federal Government and receive[d] over \$100 million annually in Federal funds.”¹¹ The House Report on an earlier version of the 1988 amendments stated that although most of the DFEs at the time had “audit units and some also have investigative units . . . the extension of the 1978 act is necessary, because many of these entities have failed to comply with longstanding requirements regarding independence” of such units.¹²

The most notable difference between establishment IGs and DFE IGs is the individual who appoints and who may remove or transfer the IG — for establishment IGs, this individual is the President and for DFE IGs, this person is the agency head. Another key difference between establishment and DFE IGs is that establishment IGs receive a separate appropriations account or a line item in the establishment’s appropriations.¹³ In contrast, each DFE IG’s budget is part of the parent entity’s budget process, which may be due to the relatively small funding amounts that some DFE IGs receive. A 1992 guidance memorandum from the Office of Management and Budget (OMB) stated that “because of the reporting relationship established by the IG Act, entity heads must make entity budget formulation and budget execution decisions affecting the

¹⁰ Section 8G(a)(2) of Title 5 Appendix, United States Code, lists several DFE IGs that are no longer in existence, have had their functions transferred, or are now presidentially-appointed IGs. For example, the FDIC IG is still listed in 5 U.S.C. § 8G(a)(2) as a DFE IG, however, he was made a presidentially-appointed IG. The Federal Housing Finance Board (FHFB) was merged into the Federal Housing Finance Agency (FHFA); the FHFA IG was added as an establishment IG on July 30, 2008, in P.L. 110-289, and is currently led by an acting IG, who was the IG for the FHFB. The Panama Canal Commission ended with the transfer of the canal to Panama (22 U.S.C. § 3611). In P.L. 103-236, the Board for International Broadcasting was abolished and its functions were transferred to the U.S. Information Agency, of which the newly created Broadcasting Board of Governors (BBG) was a part. The functions of the BBG were transferred to the Department of State in § 1332 of P.L. 105-277. Currently, the Department of State IG is also the IG for the BBG. See 22 U.S.C. § 6203; Department of State, Office of Inspector General, <http://oig.state.gov/>. However, a January 2009 *Federal Register* notice listed the BBG IG as a separate DFE. 74 Fed. Reg. 3656 (Jan. 21, 2009).

¹¹ H.R. Rept. No. 100-771, Inspector General Act Amendments of 1988, at 2 (July 13, 1988).

¹² *Id.* at 13.

¹³ 31 U.S.C. § 1105(a)(25).

IG.”¹⁴ OMB stated that it was “expected that entity heads will apply agency budget reductions, redistributions, sequestrations, or pay raise absorptions to the Office of the IG with due consideration to the effect that such application would have on the Office’s ability to carry out its statutory responsibilities.”¹⁵ OMB’s guidance added that the IG was to “have an ongoing dialogue with the OMB budget examiner” regarding the IG’s “operational plans, activities, and accomplishments.”¹⁶ The Reform Act created additional safeguards for IG budgets. Section 8 of the Reform Act addressed the reporting of the IG’s initial budget estimate to the head of the establishment or DFE. The budget estimate includes the budget request, a request for funds for training, and amounts necessary to support the newly created Council of the Inspectors General on Integrity and Efficiency (CIGIE). The establishment or DFE head must then include this information, as well as comments of the IG, when transmitting the request to the President. The President, in turn, must then include in his budget submission: the IG’s budget estimate; the President’s requested amounts for the IG, IG training, and support of the CIGIE; and comments of the affected IG, if the IG determines that the President’s budget would “substantially inhibit” the IG from performing his or her duties.

Other less-apparent differences also exist between establishment IGs and DFE IGs, such as how the two types of IGs may be selected and how they may select their own employees. The House Report on a version of the 1988 IG Act amendments stated that “the committee recognizes that not all Federal entities operate under the Civil Service personnel system,” and therefore Congress did not extend such provisions regarding employee hiring to DFE IGs.¹⁷ The DFE IGs are exempt from the sections of the IG Act (§§ 6(a)(7) and (a)(8)) that mandate the selection, appointment, and employment of officers and employees in establishment IG offices according to civil service employment laws. DFEs have been exempt from these requirements for establishment OIGs since DFEs were created. DFE IGs must be appointed by the head of the agency “in accordance with the applicable laws and regulations governing appointments within” the agency.¹⁸ The DFE IGs, in turn, must hire employees for their offices “subject to the applicable laws and regulation that govern such selections, appointments, and employment, and the obtaining of such services, within the [DFE].”¹⁹

The Reform Act created new protections and authorities for IGs. The Reform Act addressed the use of legal counsel by the IGs and delineated different relationships between establishment and DFE IGs and their attorneys. The Act specified that an establishment IG must receive legal advice from an attorney who is hired under civil service laws and reports directly to the IG or to another IG. The Reform Act also provided three ways for a DFE to obtain counsel. First, a DFE IG could obtain counsel from an attorney appointed by the IG (according to the DFE-specific laws and regulations governing appointments within the DFE) who reports directly to the IG. Second, DFE

¹⁴ Memorandum from Frank Hodsoll, Office of Management and Budget, *Inspectors General in Designated Federal Entities: Key Statutory Provisions and Implementing Guidance* (Nov. 13, 1992), at 6.

¹⁵ *Id.* at 7.

¹⁶ *Id.*

¹⁷ H.R. Rept. No. 100-771, Inspector General Act Amendments of 1988, at 16 (July 13, 1988).

¹⁸ 5 U.S.C. Appx. § 8G(c).

¹⁹ 5 U.S.C. Appx. § 8G(g)(2).

IGs, on a reimbursable basis, could obtain services from a counsel who is appointed by and who reports to another IG. Third, the DFE IG may obtain the legal services of an appropriate person on the CIGIE.²⁰

The Reform Act also continued preexisting differences between the two types of IGs addressed in the IG Act. For example, the Reform Act increased the pay of establishment IGs, the CIA IG, and the Special IGs for Iraq Reconstruction and Afghanistan Reconstruction to the rate of level III of the Executive Schedule, plus 3%.²¹ The Reform Act also increased the pay of DFE IGs, but did not link them to the Executive Schedule. The Act provided that DFE IGs should be classified for pay purposes at a level at or above a majority of the senior level executives of the DFE (such as a General Counsel or Chief Acquisition Officer), but that the pay could not be less than the average total compensation, including bonuses, of those senior level executives.²² The Reform Act also provided that a DFE IG's pay could not increase by more than 25% of the DFE IG's average total pay for the previous three fiscal years.²³

Prior to the Reform Act, additional disparities existed between establishment and DFE IGs. That Act required DFE IGs, like their establishment IG counterparts, to be appointed based only on the individual's skills in auditing or other relevant areas.²⁴ In the conference report for the Inspector General Act Amendments of 1988, the conferees indicated that they "intend that the head of the designated Federal entity appoint the Inspector General without regard to political affiliation and solely on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigations."²⁵ However, this sentiment was not added to the law until the Reform Act was enacted. Additionally, the Reform Act provided that the CIGIE must submit recommendations for nominees to establishment, DFE, CIA, and DNI IG positions.²⁶

The Reform Act also granted law enforcement authority to DFE IGs, which was previously only available to establishment IGs, including the authority to carry firearms, make arrests without warrants, and seek and execute arrest warrants.²⁷ Additionally, the Reform Act addressed a protection that DFE IGs enjoyed that was not previously available for establishment IGs — the Reform Act added a provision regarding transfers of establishment IGs to their removal clause; the removal clause for DFE IGs previously mentioned transfers of DFE IGs, but did not provide the notification requirement added by the Reform Act. As mentioned previously, the Reform Act provided that the President

²⁰ P.L. 110-409, § 6; 5 U.S.C. Appx. § 8G(g)(4).

²¹ 5 U.S.C. § 5314. Currently, level III of the Executive Schedule is \$126,900.

²² P.L. 110-409, § 4(b).

²³ Additionally, federal employees appointed to serve as IGs could not have their pay reduced as a result of being appointed to the IG position, nor could IGs currently serving have their pay reduced as a result of the law's enactment.

²⁴ P.L. 110-409, § 2.

²⁵ H.R. Rept. No. 100-1020, at 27 (Sept. 30, 1988) (Conf. Rept.).

²⁶ P.L. 110-409, § 7(c)(1)(F).

²⁷ P.L. 110-409, § 11.

and the agency head must notify Congress of the reasons for a removal or transfer of an IG in writing at least 30 days before removing or transferring the IG.²⁸

Proposed Changes

H.R. 885, the Improved Financial Commodity Markets Oversight and Accountability Act, would elevate five DFE IGs in entities that address financial issues — the IGs for the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission (CFTC), the National Credit Union Administration (NCUA), the Pension Benefit Guaranty Corporation (PBGC), and the Securities and Exchange Commission (SEC) — to the status of presidentially appointed, Senate confirmed IGs. The changes would take effect 30 days after the law was enacted. The IGs that currently serve as the head of the OIG offices in those DFEs would continue serving as the IG until the President makes an appointment under the IG Act procedures. However, IGs acting in that capacity would remain subject to current DFE limitations, such as those on authorities and pay. Nothing in H.R. 885 would prohibit the President from appointing the individuals currently serving as the DFE IGs to the new presidentially-appointed IG positions.

Presently, the duties and authorities of the five DFE IGs highlighted in H.R. 885 are substantially the same as those of other DFE IGs. The IG Act only outlines a few specific exceptions to its general provisions for certain IGs, such as the United States Postal Service IG.²⁹ It does not appear that the IG Act imposes any specific limitations or additional duties upon the IGs for the CFTC, NCUA, PBGC, or the SEC. However, the IG Act does provide that the Federal Reserve IG may be prevented by the Chairman of the Board of Governors of the Federal Reserve from initiating, carrying out, or completing an audit or investigation, or issuing a subpoena, for two specified reasons: if the IG's activities require access to sensitive information affecting “deliberations and decisions on policy matters . . . the disclosure of which could reasonably be expected to have a significant influence on the economy or market behavior”, and “other matters the disclosure of which would constitute a serious threat to national security or to the protection of any person or property authorized protection” by certain provisions in the United States Code.³⁰ When exercising this power, the Chairman must transmit an explanatory statement for such action to the IG, who must submit the statement within 30 days to several congressional committees.

²⁸ P.L. 110-409, § 3.

²⁹ The United States Postal Service IG may be removed for cause only, and there is a separate line item in the annual budget or appropriations for both the USPS IG and the National Science Foundation IG. P.L. 106-74; 113 Stat. 1091 (1999).

³⁰ 5 U.S.C. Appx. § 8G(g)(3); 8D.

Potential Considerations for Converting Certain DFE IGs to Presidentially-Appointed IGs

Elevating the five DFE IGs identified in H.R. 885 to presidentially appointed, Senate confirmed (PAS) positions would be within Congress's discretion, as provided for in the Constitution. Article II, section 2, clause 2 states that "the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments."³¹ Many PAS positions other than high-level policy positions have been created because some Members of Congress saw a need to establish such position as one requiring advice and consent. This section discusses several potential considerations, which could be construed as advantages or disadvantages of establishing these five DFE IGs as PAS positions.³² There are several approaches that Congress could pursue — (1) taking no action, (2) converting some DFE IGs (such as those in H.R. 885) into PAS positions, (3) converting all DFE IGs into PAS positions, or (4) converting some or all DFE IGs into PAS positions but including a sunset provision. If a sunset provision was added to a statute converting some or all of the DFE IGs, Congress could then evaluate the benefits and drawbacks of granting PAS status to some or all of these IGs. The PAS positions could automatically revert back to agency appointments after a period of time unless Congress made such changes permanent. CRS takes no position as to which of these options would be most desirable.

A conversion of some or all of these positions to PAS positions could have both positive and negative effects. Some of the advantages may be that the PAS process ensures that potential appointees are subject to more extensive ethical and political scrutiny, and IGs appointed under the PAS process may have greater credibility than their agency head-appointed counterparts. Congress, specifically the Senate, may indirectly exert greater influence over the selection process and prevent unqualified individuals from being appointed. The prestige of a presidential appointment may also attract additional candidates. Some of the disadvantages of the PAS process may be the potential embarrassment or confusion of nominees. The politicization of the process could deter well-qualified candidates (although politicization may be less likely with IGs, due to their statutory qualifications regarding appointment without regard to political affiliation). Potential nominees may be required to submit a large quantity of paperwork as the President, and later the Senate, consider the individual's merits. As a result, the establishment of additional PAS positions may increase the workload of Senate committees and consume time and resources that could be used for other pending issues.

If an appointee is confirmed by the Senate, that IG may be seen as more credible and accountable to Congress than an appointee that does not require Senate confirmation. During the confirmation hearing, the Senate may obtain verbal commitments from the IG

³¹ It should be noted that the President could be vested with authority to appoint IGs alone. For example, SIGAR is a presidentially appointed, but not Senate confirmed, IG. 5 U.S.C. App. § 8G note.

³² This section summarizes some concerns outlined in CRS Report RL32212, *The Appropriate Number of Advice and Consent Positions: An Analysis of the Issue and Proposals for Change*, by Henry B. Hogue (Mar. 14, 2005).

appointee to respond to future requests for testimony. Such specific commitments with regard to future testimony may not be necessary, as the IG Act provides that they have a duty to keep Congress “fully and currently informed.”³³ However, such commitments may ease the process for requesting IG testimony in the future. The Senate may also seek additional commitments during the confirmation process and explain its vision for the position or for the agency. At the same time, the PAS process may increase congressional involvement in the organization and activities of these five DFE IGs. Confirmation hearings for these IGs could be used as a vehicle to conduct oversight of the DFEs and their programs and operations. Additionally, the IG appointee may have developed relationships with Senators and congressional staff throughout the appointment process. However, the practical effect of these considerations may be limited as the IG Act ultimately indicates that DFE and establishment IGs are accountable to Congress, due, in part, to their reporting requirements.

Alternatively, it could be argued that maintaining the status quo for these IGs provides the President with greater flexibility in terms of managing staff, in that a typical conversion of a non-PAS position into a PAS position might make such IGs more amenable to indirect congressional control. Such amenability could undermine presidential control as compared to the status quo. The President would stand to lose, as IGs appointed by the agency heads alone may be more responsive and accountable to the President and more likely to implement his priorities, if any, for the IG office. Allegiance from DFE IGs under the current system arguably may assist the President’s ability to address problems quickly. However, unlike other positions being considered for conversion to the level of a presidential appointment, IGs are perhaps unique because they are already accountable to Congress in terms of their statutory responsibilities, and they also have specified qualifications required for appointment. Under the status quo, DFE IGs are not necessarily required to make commitments to Congress, unless congressional requests for particular audits or investigations were placed in statute.

Due to the nature of the agencies being considered in H.R. 885, the President would only appear to retain more control over the appointment of the five DFE IGs under the status quo if he also gained more control over the agency boards. The Federal Reserve, CFTC, NCUA, and the SEC are independent agencies.³⁴ These independent agencies are insulated from complete Executive Branch control as they are headed by multi-member boards. For example, the boards of the CFTC, SEC, and NCUA are comprised of members of both political parties, but may have no more than a simple majority from one political party. In addition, the board membership at these agencies is determined according to staggered terms, so that not all of the members may be replaced at once. The Federal Reserve Board of Governors and the SEC have for cause removal protection.³⁵ Therefore, arguably, the President may have more control over the five IGs if they are converted to PAS positions and the President is able to appoint those IGs himself. This would appear to be true even though the nominee would be approved through the advice and consent process.

³³ 5 U.S.C. Appx. §§ 2, 4(a)(5).

³⁴ The PBGC is a federal corporation.

³⁵ 12 U.S.C. § 242; *SEC v. Blinder, Robinson & Co.*, 855 F.2d 677, 681 (10th Cir. 1988).

Furthermore, DFE agency heads, who are politically aligned with the President, would likely prefer to maintain their influence on the selection process of the DFE's IG. Such appointment power may enable the DFE head to exercise greater control over the agency, posing questions of intrusion on the IG's independence. A DFE head's appointment power may help curry favor with the IG, as the DFE head is responsible for hiring and firing the IG. If the DFE IGs were converted to PAS positions, the agency head may still have some level of influence as the President may consult with the agency head when making an appointment to the IG position.

Presidential appointees may also encounter procedural or political complications during the Senate confirmation process, such as a hold placed on a nomination. The confirmation process arguably provides the Senate with greater leverage during its negotiations with the Executive Branch over matters that may or may not be related to the appointment. Holds may be placed on nominations for various reasons. Whether as a result of a hold or other factors, the appointment process may be lengthy, thus potentially leading to longer vacancies.

The Government Accountability Office (GAO) has issued several reports dealing with IG structural and organizational changes. The reports considered the conversion of DFE IGs from agency head appointments and removals to presidential appointments and removals, which would affect the status and control of the current DFE IG offices. GAO concluded that such an arrangement would strengthen the independence, efficiency, and effectiveness of the DFE IG offices. In its 2002 report, GAO found no consensus among DFE and establishment IGs regarding the perceived impact of conversion.³⁶ The report noted that the presidentially-appointed IGs "generally indicated that DFE IG independence, quality, and use of resources could be strengthened by conversion," while the DFE IGs "indicated that there would be either no impact or that these elements could be weakened."³⁷ GAO called for dialogue among Congress, the IG community, and the affected agencies regarding specific conversions of DFE IGs.³⁸ In 2003, the Comptroller General similarly testified regarding GAO's determination that "if properly implemented, conversion . . . and consolidation of IG offices could increase the overall independence, economy, efficiency, and effectiveness of IGs."³⁹

Potential Concerns within the IG Community after the Enactment of the Inspector General Reform Act of 2008

This section attempts to identify other potential IG-related issues that may be of concern to Congress. As a practical matter, this section does not address issues that may arise in IG offices with the implementation of the Reform Act, as there is little information available regarding how agencies and OIGs have responded to the Reform

³⁶ GAO, *Inspectors General: Office Consolidation and Related Issues*, GAO-02-575 (2002).

³⁷ *Id.* at 3.

³⁸ *Id.* at 4.

³⁹ Statement of David M. Walker, Comptroller General, GAO, *Inspectors General: Enhancing Federal Accountability*, GAO-04-117T (2003), at 1.

Act's provisions. In terms of other issues, first, there is the question as to whether IGs should be subject to the Paperwork Reduction Act, which may pose practical limitations on the types of investigations that IGs may conduct, as well as potentially compromise an IG's independence.⁴⁰ Second, there is the ongoing examination of whether the SIGTARP possesses the necessary authorities to conduct adequate oversight of the expenditures made via the Troubled Assets Relief Program.⁴¹ Similarly, the newly created Recovery Accountability and Transparency Board may also require additional authorities or legislative fixes as it begins to examine potential fraud, waste, and abuse of funds allocated in the American Recovery and Reinvestment Act of 2009 (Recovery Act).⁴² Third, there is the question of how the IGs who were granted additional oversight duties in the Recovery Act will use additional appropriations and conduct audits and investigations with regard to the expenditures by their respective agencies of the monies received in the Recovery Act. Fourth, issues of agency heads impinging on the independence of DFE IGs may arise, and vary in terms of the level of interference and the type of intrusion. For example, the agency head may interfere with the DFE IG's conduct of investigations and audits or the DFE IG's expenditures. The agency head may also attempt to remove the IG or impose performance evaluations or other appraisals of the IG. Finally, IGs themselves may have or appear to have conflicts of interest that could impair objectivity, and may violate the spirit of the IG Act or quality standards guidance documents on investigations, inspections, and federal OIGs.

Madame Chairwoman, that concludes my prepared statement. I would be happy to answer any questions that you or other Members of the Subcommittee might have, and I look forward to working with all Members and staff of the Subcommittee on this issue in the future.

⁴⁰ For example, if an IG wants to collect information from ten or more nonfederal persons, the IG must obtain agency clearance and OMB clearance. The Paperwork Reduction Act and its key requirements are discussed on pages 17-19 of CRS Report R40099, *The Special Inspector General for the Troubled Asset Relief Program (SIGTARP)*, by Vanessa K. Burrows.

⁴¹ *See id.*

⁴² P.L. 111-5.

Ms. WATSON. Thank you, Ms. Burrows. And now Mr. Ervin.

STATEMENT OF CLARK KENT ERVIN

Mr. ERVIN. Thank you, Madam Chair. Thank you very much for calling this very important hearing. I commend you for your leadership on this issue.

We are learning the hard way because of the economic crisis that we are in, the midst of the greatest economic crisis since the Great Depression, yet again the importance of vigorous oversight and aggressive regulation. And it is absolutely critical to oversight that we have independent Inspectors General. As you see from my prepared remarks, I have made four recommendations that in my judgment would make Inspectors General more independent and therefore give them greater incentive to be aggressive in exercising the oversight responsibilities that they have been given.

The first one goes, of course, to the very heart of the legislation that we are considering and that is that I strongly believe as you do that all of the Inspectors General in the Federal system, and especially the Inspectors General of these critical financial regulatory agencies—the Federal Reserve Board, the Securities and Exchange Commission, the CFTC—be Presidentially appointed. It simply stands to reason, as Mr. Kepplinger said. It is a matter of logic that an IG is more likely to stand up to an agency head if there is a disagreement between the agency head and the Inspector General as to a particular audit or investigation if ultimately the Inspector General cannot be removed by that agency head.

I do not know Mr. Kotz, Mr. DeSarno, and Mr. Lavik. They are all, I am sure, fine gentlemen. I take them at their word when they say that they themselves have been independent in the discharge of their responsibilities. I take them at their word when they say that their respective agency heads, boards, as the case may be, have never interfered with their work. But that is beside the point. The point is, I am concerned about their successors and whether their successors will likewise have the impeccable character and reputation and ability to stand up to pressure that they have. We shouldn't make it harder for Inspectors General to stand up to agency heads. We should make it easier. And it simply is a matter of logic as I said. I think it is noteworthy for example, that in Mr. Kotz's statement, he began essentially by saying, the testimony I am about to give is my own testimony, that of the Office of Inspector General and not the SEC. There would be no reason to say that if he were an appointee of the President. No one would think that any remarks that he would make in a forum like this would be those of the SEC.

The second recommendation that I would have is that Inspectors General like the FBI Director, as Mr. Kepplinger noted, and I would note another example he could not think of one during his testimony, but another example of course is the Federal Reserve chairman, and the Federal Reserve chairman, which of course is exactly relevant here, likewise have a fixed term, not term limits, but a fixed term. And the reason for that, of course, is that these two officials are intended to be independent from Presidential administrations. Though they are appointed by a President, this fixed term is intended to insulate them to the maximum extent possible.

It matters less to me exactly what the term is. It is more important that there be a term. It would be most helpful if the term were to be long enough to span Presidential terms. In the case of the FBI Director, it is 7 years. I would note also, of course, the Comptroller General has a 15 year term and that is intended to insulate the Comptroller General from pressure from the administration and also from the Congress.

Third, of course, Inspectors General are human beings and therefore they are fallible like everybody else. So on occasion an Inspector General should be removed from office. But Inspectors General should be removed only for abusing their office, not simply for doing their jobs. An aggressive IG will occasionally, as I say, rub his or her agency head and the incumbent administration the wrong way. But that is not cause for removal. At present, a President need only notify Congress in writing 30 days before he removes an IG that he is doing so and why, with any reason given being reason enough. I think that Presidents should have the ability to remove an IG only for a cause that is spelled out in a statute. That is another recommendation I would make.

And then fourth, no one to date has mentioned this, but there are provisions in certain Inspectors General statutes, Inspectors General who are appointed by the President that even there limits the ability of the Inspector General to carry out certain audits and investigations. In particular, there is a provision in the statute for the Treasury IG that allows the Treasury Secretary to prevent an Inspector General from accessing sensitive information concerning deliberations and decisions on policy matters, the disclosure of which could reasonably be expected to have significant influence on the economy or market behavior. As I say in my statement, it is easy to imagine a situation in which a Treasury Secretary could prevent an IG from looking at policies with regard to things like, years ago, subprime mortgage lending and the variety of exotic financial instruments that lie at the heart of the present crisis.

So I think that we should look at all of the statutes that pertain specifically to a given Inspector General and remove those provisions that allow the agency head, even in those circumstances where at present an Inspector General is appointed by the President, that allows the agency head to prevent an Inspector General from looking at a particular matter either on the grounds of affecting market conditions or on national security grounds. There are like provisions in certain statutes of national security Inspectors General.

Finally, the greater the amount of money, the greater the complexity of programs an Inspector General has to oversee, the greater should be the resources given to the Office of Inspector General. So I hope very much that efforts will be made to significantly increase the budgets of all of the financial regulatory Inspectors General during this critical time. Thank you, Madam Chair.

[The prepared statement of Mr. Ervin follows:]

**TESTIMONY OF CLARK KENT ERVIN, FORMER INSPECTOR GENERAL
OF THE DEPARTMENTS OF STATE AND HOMELAND SECURITY, BEFORE
THE HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT
REFORM'S SUBCOMMITTEE ON GOVERNMENT, MANAGEMENT,
ORGANIZATION, AND PROCUREMENT – MARCH 25, 2009**

Thank you, Madame Chairman, Mr. Issa, and members for inviting me to testify today on “The Roles and Responsibilities of Inspectors General within Financial Regulatory Agencies.” I want to stress at the outset that I am not an expert in financial matters, and so I cannot comment in detail on the various economic recovery programs underway and on the drawing board to address the present crisis. By virtue of my service as Inspector General of two important government agencies – the Departments of State and Homeland Security - I do, however, have considerable expertise with respect to the subject of how to make Inspectors General as independent of politics as possible. I know from my experience that independent IGs are a prerequisite for effective government.

Our nation is in the midst of an economic crisis that is graver than any since the Great Depression. One of the lessons that we are learning as we go along, yet again, is the importance of oversight. Had our financial regulatory bodies been more proactive and aggressive, this crisis could well have been averted altogether; certainly, its effects could have been minimized.

If the job of regulators in this context is to oversee the markets and industry, it is the relevant Inspectors General’s job to oversee the regulators. The more independent the IGs, the more aggressive they can be in ensuring that regulators are as independent and aggressive as they should be. In my limited time here for opening remarks, I would like to make, in summary fashion, the following recommendations to enhance the independence of Inspectors General. I would be happy to expand upon any or all of them during the question and answer period.

First, it stands to reason that an IG is more likely to stand up to an agency head who balks at an aggressive Inspector General if the agency head lacks the power to fire the Inspector General. The IGs of most large and vitally important agencies are appointed by the President (and confirmed by the Senate), and only the President has the power to fire them. The IGs of the crucially important Federal Reserve Board, Securities and Exchange Commission, and Commodities Futures Trading Commission, however, are appointed by, and, therefore, can be fired by, their respective agency heads. These IGs, too, should be appointed by the President, confirmed by the Senate, and be subject to removal only by the President.

Second, like the Fed Chairman and the FBI Director, both of whom are supposed to be independent from presidential administrations even though they are appointed by a President, there should be a fixed term for Inspectors General. It matters less what the

exact term is than that there be a term, though it would most helpful if the term were to be to be long enough to, in all likelihood, span presidential terms.

Third, of course, Inspectors General are human beings, and, therefore, they, like everyone else, are fallible. On occasion, then, an Inspector General *should* be removed from office. But, Inspectors General should be removed only for abusing their office, not for simply doing their jobs. An aggressive IG will, at least occasionally, rub his/her agency head and the incumbent Administration the wrong way. That is *not* cause for removal. At present, a President need only notify Congress in writing 30 days before he removes an IG that he is doing so and why, with any reason given being reason enough.

Fourth, provisions like the one in the statute for the Treasury IG that allow the Treasury Secretary to prevent an Inspector General from pursuing an investigation or audit, including the issuance of subpoenas, which, among other things, would “require access to sensitive information concerning... deliberations and decisions on policy matters, including documented information used as a basis for making policy decisions, the disclosure of which could reasonably be expected to have a significant influence on the economy or market behavior,” and/or which could “significantly impair the national interests of the United States,” should be jettisoned so as to remove a temptation to use the provision as an excuse to prevent the IG from pursuing an investigation or audit that could merely prove to be politically harmful to the Administration or contrary to its ideology. One can easily see how such a provision could have been used by a Treasury Secretary to prevent an IG from looking at policies with regard to sub-prime mortgage lending and the variety of exotic financial instruments that lie at the heart of the present crisis.

And, finally, the greater the amount of money and the complexity of programs and operations an Inspector General has to oversee, the greater should be the resources given to his/her office to conduct such oversight. Since we are talking about huge sums of taxpayer money in the various bailout and recovery programs underway and yet to be begun, programs of mind numbing complexity, it is imperative that the relevant IGs be given resources that are commensurate with the huge responsibility that they have been asked to undertake with regard to the present crisis.

Thank you very much, again, for inviting me to testify today. I look forward to your questions.

Ms. WATSON. And thank you. We can now proceed to Ms. Brian.

STATEMENT OF DANIELLE BRIAN

Ms. BRIAN. Thank you very much, Madam Chairwoman, for inviting me to discuss one of my favorite topics, the Federal Inspector General system.

Over the past year and a half, POGO has been investigating both the independence and accountability of that system. Last week, we released our second report on IGs. Our first report, which was released last year, focused specifically on weaknesses that we believe hampered some of the IGs' independence and recommended some necessary changes to the law. The IG Reform Act of 2008, with the terrific leadership from Congressman Cooper and Senator McCaskill, included most of the improvements we believe were needed to enhance IG independence.

Since that time, POGO has been examining the other side of that essential equation for Inspectors General which is accountability. And we have provided copies of our report to you today. Holding IGs accountable is a job that needs also to be embraced more thoughtfully by the Congress and accomplished more effectively by their peers through the IG Council's Integrity Committee. But the IG system is not broken. However, POGO urges the IG community to review its priorities.

The most troubling finding we found in our most recent report is that IGs all too often treat those complainants or whistleblowers who come to them with problems in their agencies as mere afterthoughts. I need to point out this is not a specific concern regarding the IGs who I share the table with. But to answer your wonderful question, Madam Chairwoman, of the earlier panel, I would strongly suggest that at this point Federal employees do not have adequate whistleblower protections. And that is no fault of the House. The House has been regularly stalwart in insisting that Federal employees have better whistleblower protections. Our problem has been that the Senate has not accepted the strong recommendations from the House on that matter so they remain very underprotected, we believe.

But as our country reels from the economic crisis, we are relying more on the IGs not only to detect and deter the misuse of public funds, but to help restore confidence in our Government's operations. I believe House of Representatives 885 has been offered in that spirit in order to provide IGs of the financial regulatory agencies the independence that they require. But I would respectfully suggest that the tools given IGs in last year's legislation largely accomplish that goal.

And I did want to react to some of the earlier testimony and offer a couple of cautionary notes. One thing is that IGs whose behavior has caused concerns about their independence have far more often actually been Presidential appointees. Two that were specifically noted before were that of NASA and Commerce. Those were Presidentially appointed IGs. I was also very concerned about the discussion of the use of numbers of audits or investigations as a measure of effectiveness of DFE IGs as opposed to Presidentially appointed IGs. That is a big part of the point of the report that we have offered to you. We don't believe it is a good way to measure

the quality of work of an IG to measure the number of investigations or audits they complete. I have learned that you can double the number of audits by cutting in half the subject matter of the audits, and then suddenly you have double the number of audits. That is not a useful measure for measuring the quality of an IG. It also didn't recognize that over half the DFE IG Offices only have a total of six people. So it is important to keep in perspective how many of those DFE Offices are just absolutely tiny.

I must admit that when I began focusing on the IG system over a year ago, I shared the perception that underlies House of Representatives 885, that DFE IGs are somehow less independent because they are appointed by their agency heads rather than the President. I have come to appreciate that in some cases there is some logic to the DFE structure especially for those agencies that are headed by a multi-person commission or board generally filled with bipartisan appointments rather than having a single agency head.

So it may in fact be the case that some DFE IGs, many of those are those that are being discussed in this legislation, are actually more independent because, as one IG put it to me, I would have to PO five people to be removed as a DFE but as a Presidential appointee only one person would have to want me gone.

My second reason for believing that House of Representatives 885, while very well intentioned, may be counterproductive is that which was discussed before with regards to the comparability pay structure because of these uniquely unusual pay structures for the financial regulatory agencies. And that would actually reverse the fix that had been accomplished through last year's legislation.

Finally, while the legislation provides for the current IGs to remain in place until a Presidential appointee is confirmed, this change would then undercut the current IGs' authority by making them acting at a time we would want these IGs to be confident they can be bold and protected even when they are the messengers of bad news.

Congress should be applauded for turning to the Inspectors General and worrying about whether they are able to be the aggressive watchdogs we need. But if the goal of this legislation is to strengthen the important work of these IGs, I would suggest respectfully that we may be focusing on the wrong issue and that making them Presidential appointments may merely be a distraction. I would suggest there are a few other changes that you might consider to enhance their roles. For example, most of these IGs are currently restricted from accessing information directly from the regulated entities. These IGs should have the capacity to subpoena both documents and testimony from the entities regulated by their agencies. A second valuable step forward, as mentioned earlier, would be to apply the provision in the SIGTARP legislation which requires the head of an agency to certify to Congress whether they are implementing IG recommendations and to explain why if they are not. A third improvement would be to give IGs control over their approved budgets which means not just that their budgets are more transparent, which was a very important improvement of last year, but DFEs still have trouble making hiring and promotion

decisions within those budgets. And that is a change that I think would be very important to accomplish.

And finally, the OIGs we are talking about today have not benefited from the extra funds provided to their agencies that have received stimulus funds. Increasing the resources available to these IGs commensurate with the new expectations of their Offices would be another real way of helping them do their work.

So I applaud the Congress and I applaud you Madam Chairwoman and the subcommittee for turning your attention to this very important issue. And I look forward to working with the subcommittee as it endeavors to make sure the IGs are all they can be.

[The prepared statement of Ms. Brian follows:]

Exposing Corruption Exploring Solutions
Project On Government Oversight

**Testimony of Danielle Brian, Executive Director
 Project On Government Oversight (POGO)
 before the
 House Oversight and Government Reform Committee's
 Government Management, Organization, and Procurement Subcommittee
 on
 "The Roles and Responsibilities of Inspectors General
 within Financial Regulatory Agencies"**

March 25, 2009

Thank you very much Chairwoman Watson and Ranking Member Bilbray for inviting me to discuss one of my favorite topics, the federal Inspector General system. Over the past year and a half, POGO has been investigating both the independence and accountability of that system. Last week, we released our second report, *Inspectors General: Accountability is a Balancing Act*. Our first report, *Inspectors General: Many Lack Essential Tools for Independence*, published in February 2008, identified weaknesses that hampered some IGs' independence, and recommended some changes in the law necessary to ensure IGs were given the independence they require. The IG Reform Act of 2008 as passed included most of the improvements we believed necessary to enhance IG independence. For example, greater transparency of IG budget requests was an important step taken to enhance IG independence. In addition, the law now makes a peer-elected IG as Chair of the IG Council, rather than the Deputy Director of OMB as had formerly been the case.

Since that time POGO has been examining the other side of the essential equation for Inspectors General: Accountability. It is important to remember that because Inspectors General are accorded extraordinary independence in order to do their jobs, they must also be held to the highest levels of accountability. Our recent report focuses on determining how to hold these independent watchdogs accountable both for their conduct and for the quality of their work. Watching the watchdogs is an essential factor in keeping this vital system in balance, and holding IGs accountable is a job that needs to be embraced more thoughtfully by Congress and accomplished more effectively by their peers through the IG Council's Integrity Committee.

The IG system is not a broken one. However, POGO's report calls on IGs to constantly review how they present their findings and whether their reports can be made more meaningful; how they focus their scarce resources on the external or internal activities of their agency; and whether they engage in periodic reassessment to be sure they are capturing the most significant

issues facing their agencies. The report also addresses another critical factor of a successful OIG: Impact and the importance of IGs' letting Congress and the world know about their important work. POGO urged the IG community, particularly at a time when transparency and accountability have taken on greater urgency, to review its priorities.

Our most troubling finding was that many IGs – the very offices charged by Congress with receiving complaints about agency problems – all too often treat those complainants or whistleblowers as mere afterthoughts. I need to point out that this is not a specific concern regarding the IGs here today. However, we strongly urge all OIGs to treat the information from genuine whistleblowers with the significance it merits, and treat the complainants with the dignity and protection they deserve.

Now, more than ever, we need to ensure our IG system is robust. As our country reels from the economic crisis, we are relying more on the IGs of the financial regulatory agencies, the many IGs overseeing the funds spent through the American Recovery and Reinvestment Act, and the Special Inspector General for the TARP. The work of these Inspectors General is essential, not only in detecting and deterring the misuse of public funds, but indeed in restoring confidence in our government's operations.

I believe that H.R. 885 has been offered in that spirit, in order to provide the IGs of the financial regulatory agencies the independence they require. I would respectfully suggest, however, that the tools given IGs last year in the Inspector General Reform Act of 2008 largely accomplished that goal, and making the CFTC, Federal Reserve, NCUA, PBGC, and SEC IGs Presidential appointments will not provide the rest of the needed tools.

I must admit that when I began focusing on the Inspectors General system, I shared the perception that underlies H.R. 885 – that DFE IGs are somehow less independent because they are appointed by their agency heads, rather than by the President. I have come to appreciate, however, that there is some logic to the DFE structure, especially for those agencies that are headed by a multi-person commission rather than an individual agency head. It may in fact be the case that some DFE IGs have more independence because, as one IG put it to me, "I'll have to p. o. five people to be removed as a DFE, but as a Presidential appointee, only one person has to want me gone."

My second reason for believing that H.R. 885, while well-intentioned, may actually be counterproductive is because of the comparability pay structure that many of the financial regulatory agencies have in order to better compete with the private sector. If these IGs were to become Presidential appointments, many of them would actually be paid significantly less than senior officers at the agency, and even some of their own subordinates – a problem that was also addressed by the IG Reform Act of 2008.

Finally, while the legislation provides for the current IGs to remain in place until a Presidential appointee is confirmed, this change would undercut the IGs' authority by making them "acting," at a time when we want these IGs to be confident that they can be bold and protected even when they are the messengers of bad news.

In the end, Congress should be applauded for turning to the Inspectors General and worrying whether IGs are able to be the aggressive watchdogs we need. But if the goal of this legislation is to strengthen the important work of these financial regulatory agency IGs, we're focusing on the wrong issue – making them Presidential appointments may be merely a distraction. I would suggest that rather than converting these IG positions to political appointments, there are other changes that could enhance their roles.

For example, most of these Inspectors General are currently limited to auditing and investigating the work of their agencies and commissions, but are restricted from accessing information directly from the regulated entities. This is an area where expanded authority may very well allow these IGs to better be able to evaluate and improve the work of their agency. These IGs should have the capacity to subpoena both documents and testimony from the entities regulated by their agencies. A second valuable step forward would be to apply the provision from the SIGHTAR legislation requiring the head of an agency to certify to Congress whether they are implementing IG recommendations, and to explain why if they are not. This change would have the valuable impact both of elevating that decision to the head of an agency, rather than being made lower in the agency management structure, as well as of making sure Congress is notified of the agency's follow-up – or lack thereof – other than where it is buried in the IG's Semi-Annual Report. A third change would be to provide the IGs with control over their approved budgets, including making hiring and promotion decisions without micromanaging from their agency. Fourth, the OIGs we are talking about today have not benefited from the extra funds provided to the other agencies that have received stimulus funds from the Recovery Act. Increasing the resources available to these IGs, commensurate with the new expectations of their offices, would be another real way of helping them do their work.

Perhaps the most important thing the Congress can do with regard to these Inspectors General is instead to continue paying attention to them. Provide them the opportunity to make recommendations for improvements in their agencies. Hold them accountable for aggressively overseeing the operations of their agencies, which includes making sure the IGs are paying attention to the whistleblowers that are coming to them. That will be the best way the Congress can help this vital oversight tool – the Inspectors General system – do its part in helping to restore the financial regulatory system and ultimately recovering the economy.

Ms. WATSON. I want to thank all of the panelists. I really appreciate your patience and coming up with something we can dig into. Ms. Brian, I was quite interested in your final remarks. You are an independent, private agency, right?

Ms. BRIAN. Non-profit, yes, Madam.

Ms. WATSON. Non-profit?

Ms. BRIAN. Yes, Madam.

Ms. WATSON. And I think you stated that information could not be shared with your, I guess, investigators and so on. Would you clarify that for me?

Ms. BRIAN. Well, I wasn't talking about my own. I was talking, speaking to the IGs' access. Currently their capacity is to gather information, and it actually changes slightly agency by agency so you might ask my colleagues about their particular agencies, but a number of those in question have the capacity to look at what their agency has collected but can't reach out to the bank or the financial institution and subpoena documents. And they can't subpoena any testimony from anybody, currently. That is the kind of capacity we think could be really very valuable.

Ms. WATSON. Let me go back to Mr. Kotz. Do you find it very difficult to go into those lending agencies and get information? What are the hurdles and challenges that you face?

Mr. KOTZ. Yes. I mean, I do agree with those remarks that if we had the ability to subpoena individual testimony of lending agencies, of investment banks, of institutions that are regulated by the SEC, that would be very helpful in our operations. Right now, we can subpoena documents but not testimony. We can subpoena testimony of SEC individuals but not testimony of other folks. So we wanted to take the testimony of the General Counsel of a large bank and we were able to do it, but he would not submit to being under oath because we don't have the power to subpoena the testimony in that manner. So I would suggest that is a very good suggestion to improve our ability to do our job.

Ms. WATSON. Well, you know, I am stunned by the response that you cannot get all the information you need to do a credible job. And so with subpoenaing power, you think that would be possible?

Mr. KOTZ. Yes, I think that would be very helpful.

Ms. WATSON. Mr. DeSarno, would you like to speak to that concern?

Mr. DESARNO. Well, I would echo the comments from David Kotz. At NCUA we have never had a problem in getting information because if we need information, either records or documents from the credit unions that NCUA supervises, we would go through the NCUA examination staff to get those documents. And of course, the agency had the authority to get those documents for us from the regulated credit unions. And we have been successful in every instance we have ever had so we have never had to use any subpoena authority. But David is correct. While we could, if we had to, subpoena records and documents from the credit unions, I don't believe we have the authority to actually force testimony from the employees of those credit unions.

Ms. WATSON. Is there anyone else on the panel that would like to address that concern?

Mr. LAVIK. I would just say that I have always found it very strange, the bifurcated manner that you can subpoena documents but not witness testimony. I think it goes back to someone I met in a conference, a Congressman from Texas. He explained to me that he just didn't trust us enough. He is no longer there. He is a very good fellow, by the way, let me hasten to add.

Ms. WATSON. Is it like taking the fifth?

Mr. LAVIK. Yes, sort of.

Ms. WATSON. I do not understand how an individual who has other people's money in their hands, Madoff, was able to get away with it this long. What happened? Where did the system break down? I understand he did his own accounting and all of his own paperwork. You know, we talk about it here as cooking the books. How in the world, I know there is a Ponzi scheme, but with the SEC, how in the world could he get away with it that long? I have people in my district that lost hundreds of millions of dollars through him. How in the world could he get away with that? Does anybody dare to give their idea of how he was able to carry on in this way?

Mr. KOTZ. I can only say that we will have that answer. We are working on a report of how the SEC let it happen and we will have an answer to all of those questions. And it will be a report that, as appropriate, will be very critical of SEC, you know, as an independent IG can do. So we will get to the bottom of it from the SEC perspective. That I can assure you.

Ms. WATSON. Well, thank you so much. When do you expect you will be able to get to the bottom?

Mr. KOTZ. We think we will have a report by the end of the summer. It will be a comprehensive report of all the different complaints that came into the SEC going back many years, all the different examinations and investigations that the SEC conducted and how it went wrong.

Ms. WATSON. Well, I am going to request of my staff that when that report is made public or given to Congress that we hold another hearing and let you go through it and have people to comment on it.

Mr. KOTZ. Thank you, absolutely.

Ms. WATSON. Now, I would like to continue to address areas of concern. I would like to talk about the legal authorities of the IG and whether the IGs at our financial regulatory agencies have adequate laws. Of course, we have already talked about the subpoenaing power. But is there anything else that you think would be necessary legally to get to the bottom line, get to the truth? Would anybody like to tackle that one?

Well, let me give you an example. The Federal Reserve IG is required to examine all failed FDIC insured institutions that have resulted in a material loss to the Deposit Insurance Fund. Now, I would like to know whether any of the IGs here today have had similar statutory requirements that would permit them to examine financial institutions that have failed or that require Government assistance to remain solvent? Wouldn't such requirements for the IG from the SEC or the CFTC make sense if we should witness another Lehman Brothers or collapse of a hedge fund that is signifi-

cantly leveraged in commodities or futures? What is it that you would need? Anyone can respond.

Mr. DESARNO. Well, let me respond for the National Credit Union Administration. Like the FDIC and the Treasury, we have legislation in the Federal Credit Union Act that requires us to do a material loss review of any failed institution, in this case a credit union, that causes a loss of greater than \$10 million to the Shared Insurance Fund. We have already completed two of those reviews. Right now we are doing two more and we have about three or four more in the queue waiting to do those.

So we have the authority we need to do those material loss reviews. We are doing the work. It is stretching our resources as far as we can possibly go. And the only thing I would request is I would wish that the Congress and the agency and the agencies that have the authority would provide the Inspectors General with whatever resources they need in order to get that work done.

In my case, I did request additional staff. We are hiring an additional staff person. In fact, she will be coming on board on Monday and that will help alleviate some of our problems. We also requested additional funding, contract dollars. We did get the contract dollars in our budget so we can use the additional staff and contract dollars to augment some of our material loss review work. But we do have the authority that we need right now to look into those failed institutions.

Ms. WATSON. Well, you just answered my next question, if you had reasonable resources.

Mr. DESARNO. Yes.

Ms. WATSON. And I understand you don't. Let me pose something else. Under current law, the heads of six Federal agencies including Treasury and the Federal Reserve are permitted to terminate or prevent an IG from carrying out an audit, investigation, examination, or other activities for specified reasons that include national security or criminal investigative matters.

While I would never want an inquiry of any kind to jepordize a criminal or a national security matter, I am concerned that this type of exemption in power for an agency head is excessive over what is supposed to be an independent office. I would like to hear from any of you or each of you whether the law ought to be altered in some way to ensure that these exemptions are not misused.

Now, let me give you an example. I suppose the Treasury Secretary or the Federal Reserve chairman could make a case that market instability or systemic risk may be a threat to national security—how many times have you heard that?—so perhaps an examination of firms on the verge of collapse is inappropriate. Now, would you consider this an inappropriate use of the law?

But we as Congress, we are cutoff from the information, shall I say, linkages out of the White House. We stood in the dark on many things. When the whole economic crisis came out publically in September and we had to move really quickly, I was stunned. How did the market collapse so quickly and nobody forecasted it? That blows my mind. You know, I know people in futures; isn't that what futurists are all about? What happened? Mr. Ervin.

Mr. ERVIN. Thank you, Madam Chair. I can't comment on the futures aspect of this, but you began by asking about our position on

these various provisions for certain IGs that allow the agency head to prevent the Inspector General from pursuing an investigation or audit on national security grounds. I touched on that in my prepared remarks. There is such a provision for the CIA Inspector General, for the Justice Department Inspector General, for the Department of Homeland Security Inspector General. So I was under that provision when I was the Inspector General there, and the Treasury Inspector General.

But as I mentioned in my statement, a Treasury Secretary would not have to make the argument that a particular investigation might impinge upon national security. There is a specific provision in the Treasury IG statute that allows the Treasury Secretary to stymie an investigation if, in the judgment of the Treasury Secretary, there would be adverse market effects from such an investigation without having to show any national security nexus.

And my position is that all such provisions should be excised from the applicable statutes because an agency head could use such provisions, as you were suggesting, merely to shield an administration from political embarrassment or because an investigation might in its conclusion be contrary to the ideology of a given administration. So I am very much opposed to those provisions.

I had in my very first, and I will conclude, I had in my very first meeting with then Secretary-Designate Ridge a discussion about this very provision in the Department of Homeland Security statute. I told him that if I were to be confirmed that I would work very hard, in the spirit of full disclosure, with Congress to try to get that provision excised. He assured me that he would never use the provision, and to his credit he never did. But the fact that it was in the statute was always a potential sort of Damocles over the head of the Inspector General. And I think this present economic crisis that we are experiencing underscores how important it is to excise such provisions.

Ms. WATSON. Ms. Brian.

Ms. BRIAN. I would just want to echo my friend Mr. Ervin's comments. I think it is a very problematic provision and I think it is something the Congress should be reviewing.

Ms. BURROWS. Madam Chairwoman, if I could also comment, I can't comment as CRS on whether it would be good or bad to remove this provision. But the way the provision works now is that, for the Federal Reserve for example, the chairman makes a statement to the IG that he is going to be exercising this power. Then the IG provides the explanatory statement to Congress within 30 days. One way or one approach might be that the statement can go directly to Congress from the chairman of the Federal Reserve or from the Secretary of the Treasury so that Congress receives direct notification. And you could place a time limit so it would occur within 3 days or 5 days or whatever so you would know immediately if such power was being exercised.

Ms. WATSON. Thank you. I would like to direct this to Mr. Kotz. In 2008, at a request of Senator Grassley's, your office completed two inquiries on the effectiveness of the SEC's Consolidated Supervised Entities and Broker-Dealer Risk Assessment Programs. These were done in response to the fall of Bear Stearns and Lehman Brothers. Your CSE report made 26 recommendations to the

SEC for areas needing improvement and several recommendations regarding the Risk Assessment Program. First, can you tell us how many of these recommendations are in the implementation stage by the SEC? Then let me just add the other couple of questions on the same issue.

Mr. KOTZ. OK, there is a process in our office. The agency comes to us and says, we would like to close these recommendations. Then we make a decision of whether we think that it is appropriate to close the recommendation and provide advice on that. So we recently received from the SEC numerous requests to close recommendations. Many, almost all were of the recommendations in the CSE report and many of the recommendations in the Broker-Dealer Risk Assessment report.

However, I will tell you that we are looking at them very carefully to see if we believe that sufficient work has been done to close them. So there is certainly an effort on the part of the agency to try to demonstrate that they have implemented those recommendations but we have not completed our process as to whether we believe that they actually have been. And we are very careful. We scrutinize very carefully what the agency has done before we actually agree that something should be closed.

Ms. WATSON. Now, did you take initiative on your own to inquire how did Bear Stearns and Lehman Brothers got to where they are?

Mr. KOTZ. Yes. Well, I mean, we conducted that audit report. We conducted the audit looking at Bear Stearns to try to figure out how it is that this process went forward while the SEC was engaged in regulation and yet, as you said, it seemed to be a surprise to everybody. It is one thing for it to be a surprise to, you know, investors out there. It is another thing for it to be a surprise for the regulators who are meeting with the folks from the entities, you know, on a common basis. And going back to your previous point, it was raised somewhat in our audit that if we issue this report it would have some effect on the markets because it was very critical of the SEC. And there was no provision in place like with those other agencies. Those are all the Presidentially appointed IG agencies. In those cases, there was a provision that allowed the agency head to stop it. In our case, it was suggested that perhaps this would have an adverse impact and we simply said well, thank you very much, but we are going to go ahead and issue the report anyway. So this was a case where we did feel it was important to get out the information about what happened with the SEC's regulation of Bear Stearns, and so we provided a comprehensive report. And now we are following up to make sure they actually did what they said they were going to do.

Ms. WATSON. You know, it is like trying to unscramble eggs. I don't know if it can ever be done. But anyway, did you find that there was enough there before it was revealed to really get started investigating? I think I heard you say you were taking a look at it. You know, all of a sudden, this thing blew up to the public and I am wondering what were the indicators along the way?

Mr. KOTZ. We found that, you know, the SEC was aware of vulnerabilities on the part of Bear Stearns and did not place enough pressure on Bear Stearns to reduce its leverage or risk. You know, I mean, it is a little bit difficult because hindsight is 20/20.

So at that point in time, after it happened, you look at the indicators and you say, oh, that was an indicator.

Nevertheless we did find that there were situations where the agency was aware of potential risk factors and yet did not pressure Bear Stearns enough with respect to those risk factors. We also found, for example, that there were certain standards that the SEC could have been tougher with requiring Bear Stearns to comply with. We found that the SEC authorized those firms to have internal audit staff perform critical audit work.

So they allowed internal audit staff to perform the audit work involving risk management rather than having an outside entity. Obviously if you have an outside entity, you are going to have better audit work. So there were specific areas that we found that we felt after looking at it, even with hindsight being 20/20, that said these are indicators—you missed these indicators—how come you didn't see this at the time? And then we made recommendations so the SEC now knows how to deal with things going forward.

Ms. WATSON. You deserve a drink of water.

Mr. KOTZ. Thank you.

Ms. WATSON. I am going to go to Mr. DeSarno now. What are, Mr. DeSarno, the greatest challenges that now face the NCUA in its oversight of the credit union industry? And are credit unions also experiencing higher default rates from market issues? Has the recession exposed an increasing number of NCUA insured institutions?

Mr. DESARNO. Well, let me say first of all that I have been at NCUA for about 11 years and this is the first time we have had to do any material loss reviews. So what that means is that we have never had losses to the Shared Insurance Fund of \$10 million or more. And we are having them now. But with that said, I think I can comfortably say that the credit union industry is much better off than the banking industry. It may sound self-serving but it is because they really didn't get involved in a lot of the riskier investments.

For the most part, credit unions did make mortgages and they did make mortgage loans, and they are having some higher default rates, but that is not causing them the problems of going out of business. The material loss reviews that we have done so far in two specific credit unions, the reason that those credit unions went down is because they got involved in very speculative real estate deals outside of their area of influence. These were credit unions in the middle of the country that decided they were going to get involved in the real estate market in Florida. And when the housing market went down, then they lost an awful lot of money. NCUA now is taking steps to prevent that from happening in the future.

Looking forward, what are the most critical challenges right now? I think the most critical challenge right now for NCUA is dealing with the corporate credit union structure. They are taking action right now. That, because the corporate credit unions were the ones that were involved in investing in mortgage backed securities and of course they got bit by the mortgage backed security problem that everyone else has run into. And so NCUA right now is in the process of trying to restructure the corporate credit

unions. And I think that will have a positive impact on the credit union industry as we go forward.

Ms. WATSON. OK, thank you. And Mr. Lavik.

Mr. LAVIK. The futures industry has had some instances of bankruptcy, failure, but certainly not to the same extent as commercial banks or, from what Bill says, credit unions. Partly I think it is because of the provision of margin. You have to put up margin to buy a futures contract and that is adjusted daily. So, for example, if your price of your futures goes down, you have to put up more margin.

So there have been some failures but, interestingly enough, the two that I am aware of were not recently. They go back, the one case about 5 years. The fellow who was in charge of it was a rather big, what they call a futures commission merchant. He is now spending some time in jail. And there was one about 2 or 3 years ago. But anyway, the point is I can't think of one right now of a large size that has been in the recent economic turmoil. We have been lucky.

Ms. WATSON. Yes, I always saw credit unions differently because it is the field of people who invest in their credit union and usually they are in—

Mr. DESARNO. It is a cooperative move.

Ms. WATSON. It is a cooperative move. And they don't take the same kind of risks. And I have always been stunned by the fact that we don't know what is inside those portfolios. And when you make the wrong decision, we suffer. And so, not being able to get to that kind of information leaves it strung out.

I want to know also, how has the newly combined Council on Inspectors General for Integrity and Efficiency improved the coordination and the efficacy of IGs? Anybody want to talk about improvement? Do you see it yet?

Mr. LAVIK. The one thing I would say is that when we met separately there were usually 25 to 30 people in the room depending upon the particular time. Now there are almost 60. My impression generally is that, and I think there are some studies on this, the more people you have in a room can inhibit decisionmaking or consensus. Now, that has some pluses, but frankly, and I will defer to my Deputy back here, Ms. Judith Ringle, because she has actually gone to the meetings. They are crowded, she says. I have to say, as you can probably tell from my comments, I am not sure if it was a positive move to combine the two.

Ms. WATSON. Do they feel intimidated, do you think, that large group sitting among the experts?

Mr. LAVIK. You know, I don't know. I have always been an ECIE and I used to go to some of their meetings because I was an adjunct. I didn't feel intimidated. It is like—but that was smaller, that was 30 people—it is like anything. You find some really sharp PCIEs and you find some sharp maybe ECIEs and you find some who aren't that much.

Mr. DESARNO. Let me, I just want to, you know, add a comment to that as well. We have only had, I think we have had maybe three joint meetings now so far as the CIGIE. And I think it is helpful. Even though it is a bigger room and it is a much bigger setting, I think it is good that everybody meets at the same time

and we are all getting the same message at the same time. Because in the past, even though we, you know, we met individually as ECIE, it was a smaller group and a lot of times we weren't getting the same message as the PCIE, Presidentially appointed IGs. So I think now we are all getting the same message. We all have the same opportunities. So I think it will work out for the best.

Ms. WATSON. Thank you. Ms. Burrows, how are the DFE IGs currently evaluated when their agency heads have the appointment authority? Are there independent evaluations that are conducted or is it done by agency personnel? And is the process different from the Presidential appointment IGs?

Ms. BURROWS. Well, currently both the Presidentially appointed IGs and the Designated Federal Entity IGs have to be appointed without regard to political affiliation and solely based on their skills in auditing, management, and other types of skills. But I couldn't necessarily speak to how each agency decides how to appoint its IG. It might vary between the agencies. I don't think there is necessarily any criteria that they are looking for. But that might be a question that I could, you know, research and get back to you.

Ms. WATSON. Could you do that?

Ms. BURROWS. Sure, of course. I would be happy to.

Ms. WATSON. Put it in writing. We appreciate that.

Mr. LAVIK. Excuse me, Madam. One of the things that our agency, when I was initially appointed, the person did rate me. But I would say it is well over 10 years ago now that we came to an agreement that we are not rated and we don't take bonuses. This was even before the legislation that now forbids it. And that is certainly very helpful because there are subtle pressures one can make in ratings and so on as we are all aware. But at least, as I say, in my agency, I can't speak for that though I think there are many others that are not evaluated, rated by their chairmen, but certainly the CFTC, we haven't been. And that goes back, I would say, to 1998, several years.

Mr. DESARNO. Yes, the situation is very similar at NCUA. You know, we are on a merit pay system so I receive kind of like a pass/fail evaluation almost. But my average increase is just the average of what the other senior staff receive for that year. So it is not a written performance evaluation so I am not going to be downgraded or penalized if I issue a hard hitting report. I mean, that won't happen. And so my increase would just be the average of what the other senior staff members get.

Ms. BURROWS. If I could also add that in 2005 there was a controversy with the Legal Services Corp. that they had tried, the board of the Legal Services Corp. had tried to impose performance evaluations on their IG after their IG had issued some reports that were highly critical of how the agency was spending its resources. It is an agency that generally serves, provides legal services to the poor. And CRS had done an analysis to whether it was legally tenable to require performance evaluations of IGs. There is no specific part in the IG Act that would prohibit a performance evaluation but the general tenets of the IG Act in terms of independence and only general supervision by the agency head would seem to indicate that would not be a favorable avenue to pursue in terms of the agency head conducting a performance evaluation of its IG. But

that could be something that Congress could clarify, that this would be a prohibited act to conduct a performance evaluation of an IG.

Ms. BRIAN. Madam Chairwoman, in our review of the Inspectors General, our sense was the only time that was at all operative was prior to the legislation when some DFEs were actually receiving bonuses, many of which wouldn't accept them even though they were eligible.

Ms. WATSON. Please don't mention the B word, bonuses.

Ms. BRIAN. Right, well, I mean and as you can imagine, there is an essential problem with that. And so the law then prohibited such bonuses and sort of removed that concept from the IG system as far as I understand.

Mr. ERVIN. And if I can add to that, in my experience as a Presidentially appointed IG, I would say a couple of things. There is, for Presidentially appointed IGs, there really isn't an evaluation process per se. Certainly there is no evaluation by the agency head. Of course if there are complaints against an IG, those could be lodged with the PCIE, under the old system and that system continues to this day. A complaint can be lodged and then it is investigated. In terms of salary, compensation as Ms. Brian said, the issue arose since a Presidentially appointed IG controlled his or her budget, in theory an IG could give himself or herself a bonus. But that was never done. Obviously it was frowned upon. If I just might take this occasion, also to say a quick word since we are talking about bonuses and salaries?

Ms. WATSON. Please do because you were the next I was going to call on and I think you are addressing most of my question. So go ahead.

Mr. ERVIN. On this salary issue, because it is tangentially related, a number of people have raised the point that one of the effects of this legislation that we are here to talk about would be in effect to lower the compensation of the Inspectors General who are not Presidentially appointed if they were to be. And certainly that is a legitimate concern. I think that should be addressed separately.

Of course, I would not support an effect where as a consequence of this, their salaries would be diminished. But to me that is not an argument for not appointing, not making these Inspectors General Presidentially appointed. As I say, doing so clearly and only logically, it seems to me, would enhance their independence.

Ms. WATSON. Thank you so much. You covered some of the questions I was going to ask so we are going to go to our last witness now, Ms. Brian. Your recommendation in your most recent report on IGs states that Congress should consider adding more meaningful and reflective reporting requirements to statutorily required semi-annual reports. Please describe for us what some of these might be.

Ms. BRIAN. Well, what I found is when we looked at the numbers, and this goes back to my earlier questioning of using numbers to measure the effectiveness of an IG's work, is that is one of the measures that an IG is required to report in their SAR. And we found, sadly, there is a lot of work that goes into these semi-annual reports or SARs. I am sad to report how few people read those re-

ports because they are really boring. They are full of a lot of numbers.

Ms. WATSON. A lot of words, many pages.

Ms. BRIAN. And you know, I am just calling it as it is. So one example of that is that they are to report the numbers of cases referred for prosecution. And that is a measurement that has been used, I was with a former Deputy Director of OMB where he was testifying that was a real measure of the quality of the work of an IG. But when we got behind those numbers, we found that it really doesn't tell you very much. So, for example, if the numbers of referrals for prosecution from an IG shop is declining, it is assumed that means they are working less hard. It could be, however, that they are taking on much more important, putting their resources into much more important audits that aren't beefing the numbers up but are taking a lot more resources. Another thing to keep in mind is we found over the last 10 years, we talked to a lot of prosecutors, and it turns out that the IG shops are referring fewer bad cases. What we found was a pretty high declination rate. They refer a lot of cases for prosecution. The U.S. attorneys would look at them and say this is a dog; I am not going to do it. So there is a pretty high declination rate. Now what we are finding is that the declination rate is much lower because the IGs are referring fewer but stronger cases and they are actually consulting with U.S. attorneys, you know, early on in a more consultative way. So those are sort of the examples of why the numbers aren't very effective.

We thought the better way of approaching reports to Congress was to look at what the IG thought was the most important work. What were the things they really wanted the Congress to be aware of that was happening in their agencies? If that kind of reporting is done to really focus the SARs in those ways, then maybe you would be able to find out, you know, as an early warning in some of these crises that are approaching us and we are saying how did we find out about them after the fact.

Ms. WATSON. I appreciate that. We have seen a couple of cases in recent years where the IGs were found to have acted inappropriately or to have conflicts with the very agencies they are charged with overseeing. Are there adequate measures in place such as a peer review, which has been mentioned already, or external monitoring programs to keep check on these IG Offices?

Ms. BRIAN. Thank you for that question. We looked at the mechanism that is used to evaluate an IG's poor conduct, the Integrity Committee, and that continues to be the case through the laws now statutorily created. And we think that is a pretty good model where it is other IGs reviewing allegations of misconduct. However, there are some flaws in its execution. One is that we have found what has been happening is the Integrity Committee will have a finding or will go through an entire lengthy investigation but then won't have an actual finding at the end of the day. In one fairly famous case, the conclusion was that the IG should be disciplined up to and including removal from office. It was in the last administration. And the OMB received this information and then came back to the Integrity Committee and said, so are you saying he should be removed? And because they hadn't really made that conclusion,

they said, well, we didn't say that. And so nothing actually happened. So we think that is a change that needs to occur.

The other flaw we believe is that the Integrity Committee is currently now statutorily headed up by a member of the FBI. And the problem with that is that the FBI is, of course, looking for criminality. Rarely, I would hope, is it going to be the case that an IG is accused of criminality. It is going to be more a case of poor judgment or inappropriate behavior for an IG. We had another case where an IG actually acknowledged that he had provided to the President—this was a Presidentially appointed IG—provided to the President a very controversial report prior to its release for his counsel's opportunity to redact information. The Integrity Committee concluded essentially that he didn't violate the law, which is true.

However, I would believe most IGs would agree with me and I certainly believe that was really inappropriate behavior for an IG. So if that committee were headed up by an IG rather than a member of the FBI, I think the standards for conduct would be more appropriate.

Ms. WATSON. Well, I want to thank Mr. Kotz, Mr. DeSarno, Mr. Lavik, Ms. Burrows, Mr. Ervin, and Ms. Brian for your expert testimony. And believe me, we have taken a lot of this down. Our work is just beginning. And if there is one place that I think Congress has failed, and that is in its oversight duties. As the Secretary of Labor said in her acceptance speech, there is a new sheriff in town. So I want to thank my colleagues who were here and had to leave.

I want to thank each and every one of you for the time you have given us this afternoon and the wealth of information to start our wheels rolling. I think you are going to see a difference now with a new administration and more openness and all our concerns about how did we get ourselves into this mess. We have to answer to the people who sent us here to Washington. We expect to be able to do that. And we expect to be able to mitigate some of these problems, provide solutions, so that they who pay their taxes will have a better quality of life.

So without objection, this committee is adjourned with a sincere thanks to all of you.

[Whereupon, at 5:15 p.m., the subcommittee was adjourned.]

