United States General Accounting Office

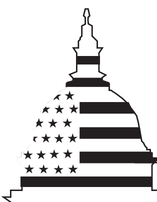
GAO

Report to the Ranking Minority Member, Committee on Energy and Commerce, House of Representatives

July 2001

SEC AND CFTC

Most Fines Collected, but Improvements Needed in the Use of Treasury's Collection Service



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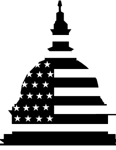
Abbreviations

CFTC	Commodity Futures Trading Commission
DCIA	Debt Collection Improvement Act of 1996
FMS	Financial Management Service
NASD	National Association of Securities Dealers
NFA	National Futures Association
SEC	Securities and Exchange Commission
SRO	self-regulatory organization
TOP	Treasury Offset Program



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Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

July 16, 2001

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

Dear Mr. Dingell:

Levying fines is an important mechanism that regulators use to sanction those who violate securities and futures industry rules. However, for fines to be an effective means of ensuring adherence with the rules, regulators must collect them. This report provides the results of our review of the fine collection activities of the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), and nine exchanges and industry associations that act as self-regulatory organizations (SRO) in the securities and futures industries.[1]

We reported on the fine collection activity of SEC, CFTC, and nine securities and futures SROs in November 1998 and presented their collection rates for 1992 through 1996.[2] As you requested, we have collected updated information on these regulators' fine collections and practices and assessed the changes they have made in response to the recommendations in our previous report. As agreed with your staff, this report (1) compares how the securities and futures regulators' current collection rates have changed since our prior report and assesses the changes they made in their fine imposition practices, (2) discusses the steps taken by SEC and CFTC to oversee the SROs' fine imposition activities, including the actions they have recently taken to improve this oversight, and (3) assesses the effectiveness of actions taken by SEC and CFTC to refer unpaid fines to the Department of the Treasury's Financial Management Service (FMS).

[1] SEC and CFTC enforce the federal securities and commodity futures laws, respectively. Responsibility has been delegated to the SROs to enforce these rules as well as their own rules and standards for SRO members. SROs include the national securities and futures exchanges and registered securities and futures associations. Other SROs include registered clearing agencies and the Municipal Securities Rulemaking Board, but we did not review these entities as part of this report.

[2] *Money Penalties: Securities and Futures Regulators Collect Many Fines But Need to Better Use Industrywide Data* (GAO/GGD-99-8, Nov. 2, 1998).

Results in Brief

SEC, CFTC, and the nine securities and futures SROs collected most of the fines they imposed in disciplinary cases closed from January 1997 through December 2000. During this period, SEC and CFTC collected about 91 and 86 percent, respectively, of the total fines levied on cases closed.[3] These collection percentages were comparable to those for the period 1992 through 1996. Of the SROs we reviewed, the National Association of Securities Dealers (NASD)[4] and the National Futures Association (NFA) had the lowest collection rates for the 1992 through 1996 period. However, both of these organizations' fine collection rates improved after they made changes to their fine imposition practices. Previously, when barring violators from their industries, NASD and NFA had levied fines that, in many cases, were due upon reentry into the industry. The imposition of such fines was viewed as a potential barrier to those individuals' reentry. Because few violators ever sought reentry, these fines were rarely collected. Since 1999, both NASD and NFA have generally stopped levying fines when barring violators, and their fine collection rates have greatly improved. It is uncertain whether barred violators would be more likely to seek readmission into the securities or futures industries if they no longer have fines to pay before reentering. Officials at both organizations told us that they would continue to apply stringent criteria when reviewing applications for reentry, including those cases in which violators were barred but not fined, and SEC and CFTC staff will also review applications for readmission into their respective industries.

As part of their oversight of the securities and futures industries, SEC and CFTC review individual fines imposed by SROs. SEC and CFTC have also taken various steps to improve their oversight of SRO fine imposition in general. In response to recommendations in our November 1998 report, SEC has begun to collect data that would allow it to analyze securities sanctions throughout the industry. Similarly, CFTC has begun documenting results of its reviews of industrywide futures sanctions. Also, as we recommended, these organizations have reviewed the extent to which their respective SROs maintain automated fine collection records.

[3]This report presents information on fines levied on closed cases for which all appeals are complete and the fines are, therefore, due. We did not include disgorgement amounts, which represent repayment of illegally earned profits.

[4]In 1999, NASD Regulation, Inc., was established as a separate independent subsidiary of the National Association of Securities Dealers, Inc. A major reason for the restructuring was to separate the regulation of the broker/dealer professionals from the operation of the Nasdaq Stock Market. (For purposes of continuity, we will refer to NASD Regulation, Inc., in this report as NASD).

In addition to their own collection efforts, SEC and CFTC are required by law to refer their unpaid fines to Treasury's FMS, which performs collection activities on behalf of federal agencies. However, FMS has collected only $5,000 of the over $3.5 million of fines that SEC has referred since 1996. Officials attributed this low collection rate primarily to the large average fine amount and the lack of identifiable violator assets. However, weaknesses in SEC processes have also hampered FMS' ability to collect fines. In some cases, FMS or its agents have negotiated compromises that would allow violators to pay reduced amounts to settle their fines, and delays in SEC approvals of these compromise offers resulted in monies going uncollected. In three cases in which violators offered to pay almost $250,000, SEC took between 42 and 327 days to approve these compromise offers, and when FMS subsequently attempted to obtain the funds, the violators were no longer able or willing to pay. SEC staff stated that they have recently instituted improvements in their review processes and are working with FMS on reducing SEC review times for future compromise offers. In addition, SEC lacks specific regulations to address another mechanism FMS uses to collect amounts owed to SEC. As a result, until such regulations are adopted, SEC fines have been withdrawn from a Treasury program that can identify any federal government payments due to the violator, such as tax refunds, and apply them against the delinquent fines owed to SEC.

Because CFTC submitted its first fines to FMS at the end of September 2000, information on the results of FMS collection efforts on CFTC's behalf were not available. However, a recently completed internal audit[5] found that CFTC had not been submitting fines to FMS within the required time frames and did not ensure that all required information was obtained for cases to be sent to FMS. We found that CFTC had not yet established formal procedures to ensure timely fines submissions to FMS.

This report includes recommendations to SEC and CFTC that they assess the impact of the fine imposition changes at NASD and NFA and that they also improve their procedures for submitting fines to FMS for collection. We requested comments on a draft of this report from the heads, or other designees, of SEC, CFTC, FMS, NASD, and NFA. Overall, these organizations generally agreed with our findings and recommendations. Their comments are discussed near the end of this letter. SEC, CFTC, and

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[5]Report A-01-01, *Audit of Civil Monetary Penalty Collections*, CFTC Inspector General, dated April 27, 2001.

FMS also provided written comments, which appear in appendixes II through IV.

Background

SEC and CFTC are responsible for administering and enforcing federal securities and commodity futures laws and regulations, respectively. They are also responsible for supervising daily market activity for the trading of securities and futures, as well as ensuring fair and orderly markets. A great deal of market regulation is carried out through SEC's and CFTC's oversight of national exchanges and SROs. Securities and futures statutes authorize the establishment of SROs subject to SEC and CFTC oversight, which regulate and operate markets in which securities and futures are traded.

SEC and CFTC are responsible for overseeing and regulating the operations and activities of their respective SROs. Two SROs--NASD for the securities industry and NFA for the futures industry--are associations that regulate registered securities and futures firms as well as oversee individuals employed in the securities and futures industries. SEC has enforcement programs and processes for taking actions against violators of federal securities laws, and CFTC has similar programs and processes for taking actions against violators of futures laws. SROs have disciplinary programs through which they can discipline their members for violations of securities and commodity futures laws, agency rules, and their own rules. Once a violation is detected or suspected, agency or SRO staff can investigate the facts of each case. Depending on the circumstances, a case may be adjudicated in a federal court or decided by an administrative body within the agencies or SROs. After a hearing, if the adjudicators determine that a violation occurred, they may levy sanctions against the violators. Also, the agencies or SROs may reach a settlement with the alleged violator before an adjudicatory proceeding takes place, in which both parties agree on the sanctions to be imposed. Violators of agency or SRO rules may be subject to a variety of sanctions, including fines, and more than one sanction may apply.[6]

Under the Debt Collection Improvement Act of 1996 (DCIA), federal agencies are required to submit unpaid debts, including fines, after a specified period of time, to Treasury's FMS for collection. The DCIA was

[6]Other sanctions could include censure, industry bars, suspensions, and revocation of registration.

passed to maximize collections of delinquent debts owed to the government and minimize the cost of debt collection by consolidating related functions, among other things. Specifically, the DCIA requires federal agencies to refer their receivables that are over 180 days delinquent to FMS. FMS staff attempt to collect referred debts during an initial 30-day period and then transfer any unpaid debts to private collection agencies that make further collection attempts for specified periods, during which time they send any collections to FMS to return to the federal agencies that submitted the debts.

Scope and Methodology

Our work focused on fine collections achieved by the respective enforcement and disciplinary programs of SEC, CFTC, and the securities and futures SROs. As in our previous review, we did not include fines for minor violations, such as floor conduct or decorum violations—generally referred to as “traffic ticket” violations—that normally do not undergo disciplinary proceedings but are handled through summary proceedings. We also did not include monies owed for disgorgements, which are imposed to return illegally made profits, or for restitution, which is imposed to restore funds illegally taken from investors.

To determine the collection rates and changes made in agency or SRO rules or processes regarding fines since our November 1998 report, we interviewed officials from both SEC and CFTC, as well as the same SROs and industry associations, regarding the fines they levied and collected.[7] We also obtained collection data on fines levied for closed cases and for which all appeals had been completed for 1997 through 2000. The securities SROs included the American Stock Exchange, the Chicago Stock Exchange, the Chicago Board Options Exchange, the New York Stock Exchange, and NASD. The futures SROs included the Chicago Mercantile Exchange, the Chicago Board of Trade, the New York Mercantile Exchange, and NFA. Because our 1998 report found no problems with the accuracy or reliability of data provided, we did not test the data sets or verify assertions that fines were paid. We also obtained specific data and information regarding changes to agency and SRO rules or processes.

[7]As we had in our previous report, we excluded regional securities exchanges that delegated their broker-dealer examination authority to the American Stock Exchange, Chicago Board Options Exchange, NASD, or New York Stock Exchange because they administered few disciplinary actions. We also excluded certain futures exchanges for the same reason.

To determine how SEC and CFTC oversee the fine imposition and collection efforts of SROs, we interviewed SEC and CFTC officials and reviewed inspections and examinations of SRO activities that these agencies had conducted. To learn what actions they had taken to improve their oversight of the SRO programs, we interviewed SEC and CFTC officials concerning the actions taken to implement the recommendations in our 1998 report and reviewed documentation related to these actions.

To determine how successful FMS had been in collecting fines owed to SEC and CFTC, we interviewed FMS officials regarding the procedures used to collect the delinquent debts of federal agencies, including SEC and CFTC. We also reviewed documentation describing the process as well as factors bearing on FMS' ability to collect on SEC's behalf. We obtained statistics on the fines submitted to FMS by SEC and CFTC as well as FMS' overall collection statistics for all federal agencies. A collection agency association official also provided insights and data on the degree to which the passage of time impacts collectibility. We did not evaluate the effectiveness of FMS' overall collection efforts on behalf of government agencies because such efforts were the subject of an August 2000 GAO report.[8]

We conducted this work in Washington, D.C., and Chicago, IL, from August 2000 to June 2001 in accordance with generally accepted government auditing standards.

Regulators' Collection Rates Have Generally Improved, but Impact of Changes In Fine Imposition Practices at NASD and NFA Is Unknown

As we found in our November 1998 report, both SEC and CFTC continue to collect most of the dollar amount of the fines they levy. Both NASD and NFA made changes in their fine imposition practices that improved their overall collection rates. However, these changes could result in barred violators being more willing to seek readmission into these industries. The other seven SROs we reviewed also continued to collect most of their fines.

[8] *Debt Collection: Treasury Faces Challenges in Implementing Its Cross-Servicing Initiative* (GAO/AIMD-00-234, Aug. 4, 2000).

SEC and CFTC Collection Rates Have Improved Since Our Previous Report

SEC and CFTC continue to collect the majority of the fines they levy, and both agencies also made other improvements in their collection procedures. As shown in table 1, these agencies' collection rates for the period 1997 through 2000 were higher than the 1992 through1996 rates presented in our November 1998 report. Specifically, SEC's average collection rate was 8 percentage points higher than its 1992 through 1996 rate, while CFTC's was 5 percentage points higher than the previous period.

Table 1: SEC and CFTC Fine Collection Rates for Fines Levied on Closed Cases for 1997-2000 and 1992-1996

(Dollars in thousands)

	Total of fines on closed cases for 1997-2000			Total of fines on closed cases for 1992-1996
Agency	**Amount levied**	**Amount collected**	**Percentage collected**	**Percentage collected**
SEC	$119,284	$108,650	91%	83%
CFTC	177,830	152,757	86	81

Sources: SEC and CFTC.

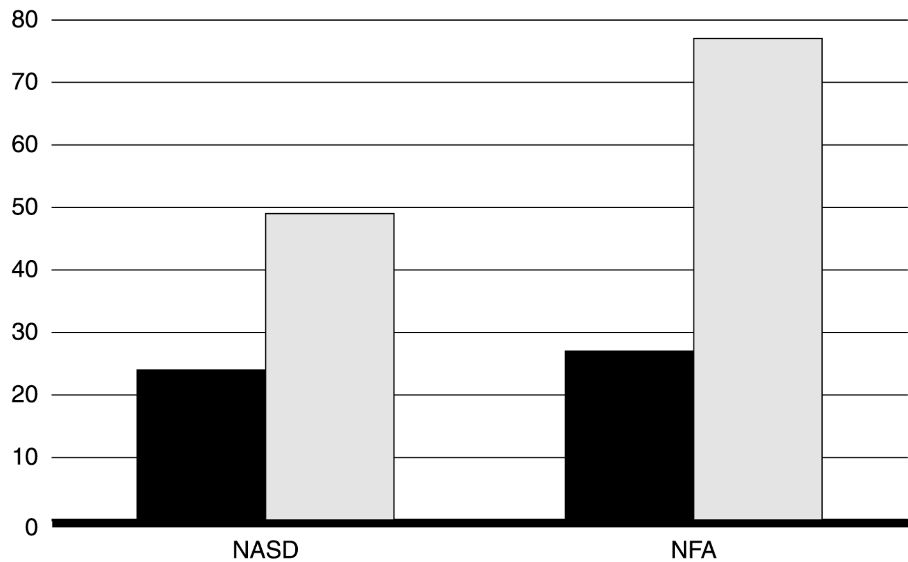
Both agencies have also taken various actions to improve their fine collection processes. In October 1999, SEC established a staff position to serve as a focal point for collecting fines. This person was to be responsible for additional collection efforts after staff in SEC's Division of Enforcement had exhausted their collection attempts. The official serving as the focal point stated that to aid the Enforcement Division attorneys in their collection efforts he had developed a collection protocol that provides step-by-step tasks for collection efforts, as well as a list of information sources that can help locate violators and their assets. This official also obtained software programs to aid in the collection process.

CFTC officials also said that they had made changes to improve their collection process. Previously, CFTC did not generally levy fines when settling with violators who reported assets deemed insufficient to pay the full amount of their fines. However, according to CFTC officials, agency policy since June 2000 has been to fine violators with insufficient assets and to require that they establish a payment plan that extends for up to 10 years. The payment amounts under these plans are based on the violators' incomes.

Changes in NASD and NFA Fine Imposition Practices Resulted in Improved Collection Rates

Fine collection rates improved at both NASD and NFA primarily because of changes they made to their fine imposition practices. NASD's practices changed in October 1999, with collection rates markedly improving thereafter. As shown in Figure 1, the percentages of fines collected by NASD and NFA in the period 1997 through 2000 was more than double the percentages for the period 1992 through 1996. In addition, NASD has taken other actions to improve its fine collection activities, including affirming violators' fine obligations under court orders obtained by SEC and contracting with a private collection agency to assume collection responsibilities for NASD fines. NASD and NFA changed their fine imposition practices to eliminate routinely assessing fines in cases in which violators were being barred from their industries. Officials at both associations stated that they intend to continue to fine barred violators in cases involving particularly egregious violations. Whether these changes will result in more violators seeking readmission is unknown, but officials at both associations stated that they would continue to apply stringent criteria to any reentry applications.

Figure 1: Percentage of Fines Collected by NASD and NFA for 1992-1996 and 1997-2000



Note: NASD's new fine imposition and collection policy became effective October 1999.

Source: GAO analysis of NASD and NFA data.

NASD's Fine Collection Rates Improved After It Changed Its Fine Imposition Practices

Compared with its rates for the 1992 through 1996 period, NASD has recently been more successful in collecting the fines it levied. As shown in table 2, NASD's collection rates for the period 1997 through 2000 are approximately double that for the 1992 through 1996 period represented in our previous report.

Table 2: NASD Fine Collection Rates for Fines Levied on Closed Cases, by Year

(Dollars in thousands)

	Fines on closed cases					
Closed cases	1997	1998	1999	2000	Total of fines collected 1997-2000	Total of fines collected 1992-1996
Amount of fines levied	$38,782	$27,933	$40,258	$14,293	$121,266	$113,858
Amount of fines collected	9,991	11,128	27,170	11,595	59,884	27,068
Percentage collected	25.5%	39.8%	67.4%	81.1%	49.4%	24%

Source: NASD.

NASD significantly improved fine collections after making a policy change recommended by staff and its National Adjudicatory Council. NASD established a task force in 1998 to review its policy on the imposition, suspension, and collection of monetary sanctions. This task force considered the purpose of monetary sanctions, particularly remedial fines when a violator is to be barred from the industry, and determined that fines need not be imposed in certain instances in which no widespread customer harm was done and serious wrongdoers had been removed from the industry. In its November 1998 report, the task force suggested that, in lieu of continuing to add fines routinely to sanctions barring individuals from the industry, NASD should add fines in only the most egregious cases. Officials told us that NASD had intended its previous policy of suspending fines until the violators sought reentry into the securities industry to serve as a barrier to keep barred or suspended violators from seeking reentry into the industry.

In 1999, NASD adopted the task force recommendations and implemented a new sanctioning policy that

- requires payment of restitution and disgorgement, as well as a fine, in sales practice cases in which (1) widespread, significant, and identifiable customer harm results or (2) the violator has retained substantial ill-gotten gains;
- orders restitution and disgorgement in cases in which quantifiable customer harm has been demonstrated or a violator has been unjustly enriched;
- does not impose a fine in certain categories of cases (i.e., exam cheating, conversion, and forgery) if an individual is barred; and

- requires satisfaction of any order of restitution or disgorgement when an individual reenters the securities industry in cases in which there has been no widespread customer harm and the violator has been barred or suspended.

NASD's policy continues to consider a violator's inability to pay when imposing monetary sanctions. According to an NASD official, this policy is consistent with applicable case law. NASD officials told us that when a fine is ordered in addition to an order of restitution and/or disgorgement, NASD's first priority is to return collected funds to customers under the restitution or disgorgement orders. Only after the restitution or disgorgement has been fully discharged do NASD officials apply collected money toward fine payment.

NASD Has Initiated Other Changes to Improve Its Fine Collection Capabilities

In addition to changing its sanctioning policy, NASD has also taken two other steps to improve its collection efforts. NASD recently initiated a program to obtain SEC assistance in obtaining court orders that direct violators owing NASD fines to pay these amounts. In late 1998, NASD contacted SEC to inquire whether SEC could use particular authority under the Securities Exchange Act of 1934 (the Exchange Act) to help NASD pursue collection of its fines. SEC agreed to do so. Section 21(e)(1) of the Exchange Act authorizes SEC to seek court orders that require violators to comply with certain orders issued under the act, which include those orders involving monetary sanctions imposed by SROs, and affirmed by the SEC. Under the agreement reached between SEC and NASD, SEC requires that the cases meet certain criteria before it will seek these court orders. Specifically, SEC will seek such orders for cases that

- have been affirmed by SEC on appeal,
- require the violator to pay any amount of restitution or a fine of $50,000 or more, and
- are less than 5 years old so that they are within the statute of limitations, and the appeal process has been exhausted.

NASD officials said that one reason for seeking this agreement with SEC was so to obtain federal court orders that would make it easier to pursue collection of fines owed by violators. Between April 1999 and December 31, 2000, NASD submitted over 60 cases to SEC. As of April 30, 2001, SEC had accepted 34 of these cases and had obtained court orders on 11 of the cases, representing fines of over $648,000. By that date, NASD had collected over $22,000 on 3 of the 11 cases, and had forwarded 8 to a private collection agency. In addition, NASD reported receiving about $67,000 on four cases before SEC obtained final court orders. The

remaining 26 cases of the over 60 submitted to SEC, which did not meet SEC's criteria, were returned to NASD. NASD officials said that they intend to submit the cases to a private collection agency.

Another improvement NASD made was to contract with a national collection agency to handle all aspects of its collections. In spring 2001, NASD staff finalized a contract with a private organization to pursue outstanding money obligations from NASD-related disciplinary proceedings. NASD officials believe that using an outside agency that specializes in collecting debts and is equipped to litigate collection matters is a more efficient and cost-effective use of its resources.

Similar Change in Fine Assessment Practices Improves NFA Fine Collection Rate

Although it did not make a formal change to its fine imposition policy, NFA has changed its fine imposition practices since December 1998. Like NASD, NFA no longer generally levies fines on violators who are barred from the futures industry. As a result, its fine collection rates, as shown in table 3, have also improved since the 1992 through 1996 period shown in our previous report.

Table 3: NFA Fine Collection Rates for Fines Levied on Closed Cases, by Year

(Dollars in thousands)

Closed Cases	Fines on Closed Cases 1997	1998	1999	2000	Total of fines collected 1997-2000	Total of fines collected 1992-1996
Amount of fines levied	$427	$ 968	$761	$1,269	$3,425	$3,221
Amount of fines collected or being paid on time under installment plans	402	450	716	1,081[a]	2,649	881
Percentage collected	94.1%	46.5%	94.0%	85.2%	77.3%	27.0%

[a]This amount includes actual cash collections as of December 31, 2000, of only $337,000. The remaining $743,000 shown as collected reflects the fines being paid in installments on which no payments are delinquent. NFA officials expected to collect these remaining amounts in full by December 2001.

Source: NFA.

As shown in table 3, some violators are paying off their NFA fines in installments. Of the 17 fines due in 2000, 9 were paid in full and 8 are being paid on 1-year payment plans, with balances due by December 31, 2001. NFA officials explained that they use an accrual accounting system, which, under generally accepted accounting principles, allows entities to report amounts as fully earned in the year recorded, regardless of whether they were actually received or remain due as receivables. Therefore, NFA reports fines as fully paid both when they have received full payment and when installment payments are current as of the reporting date.

NFA's improved collection rate stems from the change in its fine assessment practices. Previously, NFA levied fines as an additional sanction against violators that it also barred from the futures industry. NFA officials stated that in adding fines to bars, their intent had been to ensure that the violators would remain out of the industry. They said that such fines were also intended to deter other industry participants from violating the rules. They cited our November 1998 report, which pointed out that such fines were seldom, if ever, collected, as influencing their decision to discontinue the practice in all but the most egregious cases. They reasoned that a bar alone would both protect the industry and punish the violators by removing them from the industry and denying them their livelihood. The NFA officials stated that they intend to continue adding fines to bars in egregious cases as a message to industry participants that NFA will not tolerate such violations.

Impact of NASD and NFA Fine Imposition Changes Are Unclear

Because both NASD and NFA have only recently changed their fine assessment practices, the impact of these changes on whether barred individuals seek readmission into the securities or futures industries is unknown. Officials at both SROs stated that the fines levied in addition to bars could effectively serve as barriers to keep these individuals from returning to their respective industries, although they acknowledged that they were unlikely to collect these fines.

With such fines no longer generally being levied, the impact on the willingness of violators to seek reentry is not yet known. According to NASD and NFA officials, few individuals that they have barred for violating their rules have ever applied for readmission. NASD officials told us that, as of June 12, 2001, applications for reentry by individuals who had been barred by NASD since they changed their fine imposition policy had not increased. These officials said that they did not believe that their policy change would cause such applications to increase because it is very difficult to obtain approval for reentry after being permanently barred. They also said that other SROs that do not impose fines on barred individuals have not seen many applications for reentry. The criteria that NASD considers for reentry by barred individuals include

- the nature and gravity of the disqualifying event,
- the length of time that has elapsed since the disqualifying event,
- whether any intervening misconduct has occurred,
- whether the disqualified person has other disciplinary history,
- any other mitigating or aggravating circumstances that may exist,
- the precise nature of the securities-related activities proposed in the application, and
- the disciplinary history and industry experience of both the member firm and the person proposed by the firm to serve as the responsible supervisor of the disqualified person.[9]

An official in NFA's General Counsel's Office told us that the Commodity Exchange Act, which governs the futures industry, does not specifically contain provisions that would allow a barred individual to seek reentry, nor does it specifically preclude such reapplication. An individual seeking reentry would have to present evidence of mitigating facts or

[9]Article III § 3 and § 4 of the NASD bylaws describe disqualifying events for members, for which they can be barred, expelled, suspended, or subject to certain other sanctions. (See http://www.nasdr.com/sd_process.htm.)

circumstances relating to the conduct that led to the individual's being barred as well as evidence of rehabilitation since the conduct occurred.[10] The NFA official also could not recall anyone being allowed to reenter and stated that such applications would be held to strict standards. Both NASD and NFA officials also pointed out that under their new practices, individuals who had committed violations that resulted in considerable customer losses would still have to pay disgorgement and restitution monies before they could reenter either industry.

Both SEC and CFTC officials have a role in reviewing applications for persons seeking readmission into the securities and futures industries. SEC officials told us that Rule 19h-1 under the Securities Exchange Act requires SROs to submit applications of persons subject to statutory disqualification for readmission into SEC. These applications are then reviewed by staff in the Chief Counsel's Office within SEC's Division of Market Regulation. SEC has the authority to deny the applications of such persons. A CFTC official told us that CFTC's staff have participated in a Registration Working Group with staff from NFA and the other SROs since 1996. This group meets quarterly to discuss various issues of mutual interest, including the review of applications of persons seeking entry or readmission into the futures industry. The CFTC official stated that persons whose registration or SRO membership has been revoked rarely return or seek readmission into the futures industry. He said that any applications for readmission into the futures industry would be scrutinized carefully.

Other Securities and Futures SROs Continue to Report High Collection Rates

The other securities and futures SROs that we reviewed also continued to collect the majority of the fines they levied. As shown in table 4, three of the four other securities SROs reported higher collection rates than those detailed in our 1998 report. The fourth SRO, the Chicago Stock Exchange, reported a lower collection rate, which according to a Chicago Stock Exchange official, was due to the fact that certain fines levied late in 2000 had not yet been received.

[10]Rule 501, of the *NFA Rulebook* describes NFA's authority to deny, condition, suspend, restrict, and revoke registration.

Table 4: Reviewed Securities SROs' Fine Collection Rates for Fines Levied on Closed Cases for 1997-2000 and 1992-1996

(Dollars in thousands)

	Total of fines on closed cases for 1997-2000			Total of fines on closed cases for 1992-1996
SRO	Amount levied	Amount collected	Percentage collected	Percentage collected
American Stock Exchange	$1,385	$1,247	90.0%	75.0%
Chicago Stock Exchange	566	495	87.4	100
Chicago Board Options Exchange	2,768	2,700	97.5	95
New York Stock Exchange	14,301	14,244	99.6	98

Sources: American Stock Exchange, Chicago Stock Exchange, Chicago Board Options Exchange, and New York Stock Exchange.

The recent collection rates for the three other futures SROs we reviewed were generally about the same as their rates for the 1992 through 1996 period, although the Chicago Board of Trade's 95-percent rate for 1997 through 2000 was significantly higher than its rate for the previous period, which was 54 percent. However, Chicago Board of Trade officials formerly had explained that the lower rate for the previous period had been because several large-dollar fines had been written off.

Table 5: Reviewed Futures SROs' Fine Collection Rates for Fines Levied for 1997-2000 and 1992-1996

(Dollars in thousands)

	Total of fines on closed cases for 1997-2000			Total of fines on closed cases for 1992-1996
SRO	Amount levied	Amount collected	Percentage collected	Percentage collected
Chicago Mercantile Exchange	$4,286	$3,160	73.7%	85%
Chicago Board of Trade	2,618	2,493	95.2	54
New York Mercantile Exchange	1,984	1,722	87.0	N/A[a]

[a]Dollar amounts collected in 1992-1996 were not available when we prepared our 1998 report.

Sources: Chicago Mercantile Exchange, Chicago Board of Trade, and New York Mercantile Exchange.

SEC and CFTC Continue to Review Individual SRO Fines but Have Also Taken Steps to Improve Their Industrywide Oversight

In conducting their oversight of securities and futures SROs disciplinary programs, SEC and CFTC review individual fines imposed by SROs to assess the reasonableness of the sanctions applied. Their reviews have generally found that the fines the SROs levied were appropriate. In response to recommendations in our November 1998 report, they also have taken steps to improve their ability to review SRO fines on an industrywide basis.

SEC and CFTC Reviews of Individual SRO Fines Found Most Fines Appropriate

In overseeing the disciplinary programs of SROs, SEC and CFTC conduct on-site inspections during which their examiners review the supporting documentation for selected fines and other sanctions SROs have levied. In general, their findings indicated that SROs levy fines appropriate to the nature of the violations identified.

According to SEC officials, in general, the securities SROs adequately administer their formal disciplinary programs and levy appropriate sanctions. In a small fraction of the cases, SEC examiners found that some

SROs had levied inadequate sanctions. We reviewed 10 SEC reports that were completed between January 1, 1997, and December 31, 2000,[11] for the 5 securities SROs that were included in our report. Although examiners generally found that most sanctions were appropriate given the violation and case circumstances, in five reports, SEC examiners noted instances in which they believed different sanctions should have been applied. For instance, one SRO inspection report cited as inadequate a fine that was about the same amount as the ill-gotten profit resulting from the violation. The report stated that a fine should be set significantly higher than the amount of ill-gotten gains resulting from violative activity in order to serve as a deterrent to such future activity. In another SRO inspection report, SEC examiners cited the imposition of disparate fines of $1,000 and $10,000 in two separate, but similar, cases involving failure to disclose criminal information. Noting that fines should be consistent in cases in which violations and circumstances are similar, SEC recommended that the SROs' attorneys consider past sanctions imposed for similar violations when determining sanctions for current cases.

CFTC officials also said that their reviews show that, overall, futures SROs levy sanctions that are appropriate for the violations. Between January 1997 and December 2000, CFTC examiners completed five reviews of the four futures SRO disciplinary programs.[12] Like SEC, CFTC examiners also occasionally found instances in which inadequate sanctions had been levied by futures SROs. In a report documenting the review of 1 SRO, CFTC examiners noted 1 instance, of 42 cases reviewed, in which they believed the fine should have been imposed for a higher dollar amount. In

[11]During this period, SEC inspected NASD's Hearing Officer and Disciplinary Program and the enforcement departments at the Chicago Stock Exchange, the Chicago Board Options Exchange, the Pacific Exchange, and the Philadelphia Stock Exchange once each. NASD's District Offices in New Jersey, New York, and Washington, D. C. were also inspected once during this period. They also inspected the Enforcement Department at the New York Stock Exchange twice, as well as NASD District Offices in San Francisco, Denver, Seattle, Atlanta, New York, Chicago, Philadelphia, Los Angeles, New Orleans, Cleveland, Kansas City, Dallas, and Boston. They inspected the American Stock Exchange three times during this period.

[12]CFTC prepared 13 exam reports during this period. These included two reviews each for the Chicago Board of Trade, the Kansas City Board of Trade, and the New York Cotton Exchange, as well as single reviews of the Chicago Mercantile Exchange; the Coffee, Sugar & Cocoa Exchange, Inc.; the Commodities Exchange; the Minneapolis Grain Exchange; the New York Futures Exchange; and the New York Mercantile Exchange. In addition, one CFTC report represented a joint review of the Chicago Board of Trade, the Chicago Mercantile Exchange, the Coffee, Sugar & Cocoa Exchange, Inc.; the New York Mercantile Exchange/COMEX, and the New York Commodity Exchange.

another case, they cited that a fine should have been imposed but was not. The report recommended that the SRO set more appropriate sanctions for similar future violations.

SEC and CFTC Have Taken Steps to Improve Their Oversight of SRO Sanctions Industrywide

In response to recommendations in our November 1998 report, SEC and CFTC have taken various steps to improve their oversight of the SRO disciplinary programs. These improvements relate to data collected and reviewed for the purpose of assessing SRO fines on an industrywide basis. In addition, SEC and CFTC have taken steps to ensure that SROs maintain automated sanctions information where appropriate.

SEC Now Captures Data for Reviewing Disciplinary Actions Across SROs

In response to our recommendation that SEC analyze industrywide information on disciplinary program sanctions, particularly fines, SEC has begun to employ a new database to capture information on disciplinary actions. In 1998, we reported that SEC's oversight approach involved reviewing sample cases at each SRO and comparing the sanctions imposed with those imposed at other securities SROs. We recommended that SEC maintain and analyze industrywide information to provide it an additional means with which to ensure that comparable fines are assessed for similar violations throughout the SROs. According to SEC officials, SEC's Office of Compliance Inspections and Examinations had previously maintained limited sanctions information, such as the dates SROs filed the sanctions, and violators' names. However, these data did not include sufficient information about the violations for industrywide analyses.

In October 2000, the examination staff implemented a new database to serve as a repository for information reported to SEC on disciplinary actions taken by securities SROs. In addition to violators' names and SRO filing dates, the new database captures information such as rules violated, violation type (such as sales practices and recordkeeping), and sanctions applied (such as suspension, fine, and censure). SEC officials stated that because the new system allows them to generate reports that focus on any of the data fields, they may be able to identify trends or disparities in sanctions across SROs. As of May 31, 2001, the new database contained information from 1,111 filings.

CFTC Now Documents Its Reviews of Disciplinary Actions Imposed by Futures SROs

In our previous report, we noted that CFTC performed industrywide analyses of sanctions imposed by the futures SROs but did not document the results of these analyses. We recommended that CFTC appropriately document the results of these analyses. CFTC officials told us that since

January 2000, they have prepared reports that document their quarterly reviews of sanctions across SROs. Our review of all four quarterly reports for 2000 found that they discussed the number of disciplinary cases at each SRO, the rules violated, the sanctions imposed, and the consistency of sanctions across SROs. In addition to the quarterly reports, CFTC's Division of Trading and Markets also reports annually to the Commission on civil monetary penalty collection activities for the fiscal year. This report compares the year's collections with those of previous fiscal years, discusses collection activities, and analyzes outstanding debts.

SROs Reviewed Have Automated Systems

Our 1998 report also noted that some SROs did not maintain automated records of their fine collection activities and recommended that SEC and CFTC encourage their SROs to maintain automated records of their fine collection activities that are appropriate for the number of fines they impose. SEC and CFTC officials told us that SROs included in this review use accounting-based software to monitor their collection activities.

SEC and CFTC Process Weaknesses Hamper FMS Efforts to Collect Their Fines

As required by the DCIA, SEC and CFTC refer delinquent fines to Treasury's FMS, which conducts collections on behalf of federal agencies (see app. I for information on FMS' general activities and procedures). However, FMS has had little success in collecting fines on SEC's behalf, which FMS officials attributed to several factors, including the large-dollar amount of SEC referrals, the age of the cases when referred, and the lack of violator assets. However, according to FMS officials, weaknesses in SEC processes have also hampered FMS' ability to collect fines, including SEC delays in approving offers made by violators to settle their fines for lesser amounts. Also, SEC has yet to complete procedures necessary for its fines to be submitted to a Treasury program that allows for the collection of fine amounts from other government payments that might be due to the violators. Because CFTC began referring its cases to FMS only 3 months before the end of 2000, FMS officials stated that they had not had sufficient time to have collected anything for CFTC. However, an internal audit of CFTC referrals to FMS (1) found that not all CFTC fines were being submitted in a timely manner, and (2) also noted a weakness in CFTC's procedures for submitting fines to FMS.

FMS Collections for SEC Fine Referrals Are Low Compared With Collections for Other Federal Agency Fine Referrals

Although SEC was one of the first agencies to sign an agreement with FMS stating that it would refer its delinquent cases for collection, FMS collections on SEC's behalf have been much lower than its collections for other federal agencies. SEC began referring cases to FMS shortly after executing the September 17, 1996 letter of agreement with FMS. By the end of 2000, SEC had referred 25 cases representing fines and penalties totaling over $3.5 million. FMS had collected about $5,000, or 0.14 percent of the total fines SEC referred for collection. In contrast, of the 18,557 fines totaling more than $110 million in fines referred to FMS by all federal agencies by year-end 2000, FMS had collected 10.4 percent of these debts.

FMS officials cited several factors to explain why their collection rate for SEC fines is so much lower than for other federal agency debts. The officials stated that SEC fines generally represent larger dollar amounts than debts referred by other agencies. According to FMS data, the average SEC fine referred to FMS for collection was over $141,000, which is almost eight times as large as the $18,400 average referral from other agencies. The officials stated that, historically, larger debts are less collectible than smaller debts. An FMS official also stated that because SEC makes significant collection efforts before referring amounts to FMS, SEC referrals are, on average, 15 months delinquent when FMS receives them. According to the FMS official, the age of the SEC's debts further reduces their collectibility compared with the smaller, more recent debts referred by other agencies.

FMS officials stated that the low collection rate is the fault of neither the agency nor FMS but is due to the nature of the cases themselves. Both SEC and FMS officials told us that, in some cases, by the time a debt has been referred to FMS, the debtors are either in jail or their assets have already been stripped and there is no way to collect. According to FMS records on the status of debts, in 6 of the 25 SEC cases, totaling almost $600,000, debtors had no assets or were no longer in business. However, in 11 of the 25 cases, totaling almost $2.7 million, collection agents have been unable to locate and initiate contact with the debtors to attempt to collect the fines. The remaining eight cases represented a variety of dispositions, including those returned to SEC as uncollectible. SEC officials also pointed out that SEC fines represent rulings against violators who have already proved unwilling to pay, despite being ordered to do so by a judge. In contrast, other debts referred to FMS involve such government debts as delinquent loans. According to an SEC official who oversees collection efforts, FMS' lack of success in collecting SEC fines underscores the thoroughness of SEC's own collection efforts.

Lack of Timely Action on Compromise Offers May Have Hampered Collections

In addition to the characteristics that make SEC fines difficult to collect, SEC's slow responses to compromise offers have also exacerbated FMS' low collection rate on these fines. In some cases, an agency and a debtor may reach an agreement, called a compromise offer, in which the agency agrees to discharge a debt by accepting less than the full fine amount. Private collection agencies under contract to FMS usually negotiate compromise offers[13] with individual debtors. A compromise offer can also result if the collection agency negotiates an agreement under which the debtor would pay his or her total debt or some lesser amount in installments,[14] rather than in one lump sum. Once an offer to pay a lesser amount or installment payments over an extended time period has been negotiated, a collection agency then sends the compromise offer to FMS. Although some FMS collection agreements with federal agencies stipulate that FMS can unilaterally accept compromise offers above certain dollar amounts or percentages of the originally owed amount, SEC's agreement requires FMS to send all compromise offers to the agency for approval. Because SEC was one of the original agencies with which FMS agreed to perform collection services, the agreement between the two agencies did not provide broad authority for FMS to accept compromise offers on SEC's behalf.

However, SEC has not always made timely responses to compromise offers presented by FMS, which may have worsened FMS' chances of collecting the amounts offered in those compromises. FMS officials told us that during the time the offers were awaiting SEC approval, some violators' assets diminished to the point that the debtors were no longer able to pay the agreed amount. As a result, money that could have been collected was not. According to FMS officials, SEC has kept compromise offers for long periods before responding. For instance, according to data provided by SEC and FMS, three cases that SEC approved in March 2001 had spent from 42 to 327 days awaiting SEC decisions. An FMS official said that, by the time the cases had been approved, the debtors no longer had the money to pay the amounts in the agreements. As of mid-June 2001, FMS had not received any payments on these compromise offers, which

[13]According to FMS officials, private collection agencies have 50-percent compromise authority, meaning that they can negotiate compromise offers for no less than 50 percent of the original debt amount owed. Because the collection agencies are paid on a commission basis, it is to their advantage to collect as much as possible to increase their commission.

[14]Generally, installment payments must be for at least $100 and can extend to no more than 24 months.

totaled almost $250,000. The FMS official responsible for overseeing these offers stated that the likelihood of nonpayment increases with the passage of time, because assets can be depleted during the time that SEC is considering its decision.

SEC officials acknowledged that there had been delays in responding to FMS. In the case that took 327 days to review, SEC officials explained that they attempted to contact the regional office staff who originally investigated the case to discuss the compromise offer, but these staff had left the agency. The officials said that because the compromise offer involved repayments over a 16-year period, obtaining the investigating staff's opinion was considered important to ensure that the fine remained meaningful. However, in some cases, the SEC staff said that not all of the information that SEC needed to review the compromise offers, such as the violators' financial statements, were included with FMS requests for action. In such cases, a few days were added to the time that SEC spent reviewing the offers because SEC staff had to request this information from FMS before they could conduct their reviews. An FMS official explained that because FMS had not required its private collection agencies to obtain violators' financial statements, FMS staff had to request these documents on SEC's behalf. However, beginning October 2001, all collection agencies with which FMS contracts will be required to obtain such statements in addition to the currently required credit bureau reports.

FMS and SEC officials told us they have been working together to reduce the delays in approving compromise offers. At a meeting in April 2001, FMS officials informed SEC staff that the DCIA gives FMS the authority to act on behalf of other agencies to approve compromise offers. They stated that a clause to that effect is now routinely part of its standard agreement with other federal agencies, although such a clause was not included in the SEC/FMS agreement. On April 20, 2001, FMS sent SEC's Division of Enforcement a letter proposing that, unless such action is otherwise prohibited by SEC's governing statute, the FMS/SEC agreement be amended to state that FMS is authorized to act on SEC's behalf to approve compromise offers if SEC has not responded after 30 days. SEC staff are considering the Commission's legal authority to delegate to an external agency the authority to compromise a judgment debt.

SEC staff said that they are currently making improvements to their procedures for processing compromise offers submitted by FMS. They stated that they have changed their process to include using a standardized format and new tracking system to ensure that compromise

agreements are on track for response within 30 days of receipt. According to the information they provided, the compromise offer that FMS most recently sent to SEC took the shortest amount of time--42 days—for SEC to review. However, even this faster response from SEC did not elicit payment from the violator.

SEC's Lack of Applicable Regulations Affects FMS' Ability to Use Government Payments to Pay SEC Fines

SEC's lack of specific regulations has affected another mechanism FMS uses to collect amounts owed to SEC. In addition to its other collection efforts, FMS also uses the Treasury Offset Program (TOP)[15] to attempt to obtain monies owed to federal agencies. This program is designed to (1) identify any federal government payments, such as tax refunds, due to an individual or entity with an outstanding government debt and (2) apply them toward repayment of the outstanding government debt. The collection agreement between FMS and SEC stated that FMS could use TOP to collect SEC debts after consulting with and obtaining the concurrence of SEC officials. FMS has collected some money on SEC-ordered disgorgements through TOP and had also routinely put SEC fines into the program. However, SEC officials said that they did not believe that their existing offset regulations provided sufficient authority to allow FMS to obtain collections on fines owed to SEC through TOP. In addition, they did not believe that they had ever formally concurred with FMS' submission of SEC fines into TOP. In April 2001, SEC officials asked FMS to withdraw all outstanding fines from the program until the SEC staff had completed steps to comply with the DCIA, including addressing additional requirements arising from November 2000 amendments. This legislation requires agencies to first adopt regulations that address collecting fines by administrative offset before using TOP for collection.[16] SEC officials told us at the end of June 2001 that they had rewritten their rules and expected them to be sent to the Commission soon for approval, but the officials could not estimate when the rules would be approved and in force.

CFTC Debts Have Been Recently Referred to FMS for Collection

FMS has also recently agreed to perform collection activities on CFTC's behalf, but concerns already exist regarding the timeliness of CFTC's submissions to FMS. CFTC signed a letter of agreement with FMS on August 27, 1999, authorizing FMS to provide debt collection services on its

[15]Under TOP, the database of delinquent federal debtors is matched against a database containing the names of those to whom payments are to be disbursed by Treasury. When matches are identified, the owed amounts are offset or withheld from the federal payment due to those owing the delinquent debts.

[16]31 U.S.C. 3716(b)(2000 supp.).

behalf for its delinquent debts. On September 29, 2000, CFTC referred its first 13 fine cases to FMS totaling $3.2 million, followed in November by 2 more cases totaling over $200,000. According to FMS officials, as of December 31, 2000, FMS had not yet made any collections on the 15 cases. The FMS officials also stated that they have not had the referrals for a sufficient period of time to make collections, and they do not have enough experience with CFTC referrals yet to comment on the cases.

However, FMS collections on CFTC fine cases may be reduced if the referrals are not timely. According to a report prepared by the CFTC Inspector General, CFTC staff does not refer cases to FMS as soon as they are eligible. This internal audit report, which examined the agency's civil monetary penalty collections, reviewed data collected through February 1, 2001. According to the report, the auditors found 12 eligible cases totaling over $17 million that had not yet been sent to FMS. Of these, 11 cases were eligible to have been sent with the first batch of cases in September 2000, and 1 case was eligible to have been sent with the second batch in November 2000. The report recommended that CFTC refer cases to FMS at least monthly. As previously stated in this report, the longer cases wait for collection, the lower the likelihood that they will be collected. Therefore, CFTC's delays in referring cases are likely to reduce FMS collections. CFTC officials stated that since February 2001, they have sent 15 more penalties to FMS including 11 of the 12 cases previously discussed. They expect to refer the 12th case to FMS soon. Also, rather than waiting for fines to be delinquent 180 days, CFTC officials said they have begun to refer cases to FMS as soon as the required debtor notification periods are complete.

Weaknesses in CFTC's procedures for submitting fines to FMS may reduce FMS collections. According to CFTC officials, although the agency's staff recently submitted additional fines to FMS, their written procedures have not been updated to address referrals to FMS. In addition, one fine submission to FMS was delayed because of inadequate communication between the CFTC's Division of Trading and Markets and its Division of Enforcement. According to the CFTC Inspector General report, this communication problem resulted in one fine of over $7 million not being referred for more than 2 years. CFTC staff stated that the agency is also taking steps to use other information sources for violator addresses. CFTC is currently awaiting Treasury instructions for obtaining addresses from Internal Revenue Service records. In commenting on this report, CFTC noted that the Commission is revising its internal instructions to ensure that cases are referred to FMS within 180 days of becoming delinquent,

and that the Division of Enforcement provides all of the necessary information to make such referrals.

Conclusions

On the basis of the data we obtained, collection rates at SEC, CFTC, and the nine securities and futures SROs were generally comparable to, or higher than, their rates from our previous review. In addition, NASD and NFA, which previously had the lowest collection rates, changed their fine imposition practices and, therefore, their collection rates greatly improved.

However, whether the actions NASD and NFA have taken will affect the number of formerly barred individuals seeking and gaining reentry into the securities or futures industries is unknown. Previously, these SROs would levy fines in addition to barring individuals from their respective industries for rule or law violations. These fines, though seldom collected, served as a potential barrier to individuals applying for readmission into their industries. The subsequent decisions by NASD and NFA to generally discontinue levying fines when barring individuals appear to have improved these SROs' fine collection rates. However, because certain barred violators no longer face the prospect of paying off a fine before reentering these industries, they may be more willing to seek readmission. NASD and NFA officials indicated that to prevent readmission of unsuitable individuals to either industry, they would continue to apply stringent criteria to any readmission applications. SEC and CFTC staff also review readmission applications when they are received from the SROs and could, as part of their periodic reviews of SRO operations, ensure that changes in NASD's and NFA's fine imposition practices do not result in any unintended consequences, such as inappropriate readmissions.

Although the fines that SEC refers to FMS may be difficult to collect, various weaknesses also appear to have hampered FMS' efforts to collect fines on SEC's behalf. Delays in the approval of compromise offers appear to have resulted in lost opportunities to collect monies. Also, SEC has not yet adopted the regulations it needs to again submit its fines to TOP to benefit from the associated collection opportunities. Resolution of these issues would likely lead to an improvement in FMS' ability to collect fines on SEC's behalf.

Finally, although CFTC has only recently begun submitting fines to FMS for collection, already concerns about the timeliness of these submissions exist. The agency's Inspector General staff have recommended steps to ensure that CFTC fines are submitted more timely to FMS, but these steps

have yet to be implemented. Weaknesses in procedures for ensuring that CFTC submits all needed information to FMS to collect its unpaid fines also appear to have further delayed FMS' collection efforts. Because older fines are harder to collect, FMS prospects for collecting CFTC fines would improve if CFTC would more promptly refer its cases to FMS.

Recommendations

We recommend that the Acting Chairman, SEC,

- periodically assess the pattern of readmission applications to ensure that the changes in NASD's fine imposition practices do not result in any unintended consequences, such as inappropriate readmissions;
- continue working with FMS to ensure that compromise offers presented by FMS are approved in a timely manner; and
- take steps to ensure that regulations allowing SEC fines to be submitted to TOP are adopted.

We also recommend that the Acting Chairman, CFTC,

- periodically assess the pattern of readmission applications to ensure that the changes in NFA's fine imposition practices do not result in any unintended consequences, such as inappropriate readmissions; and
- take steps to ensure that delinquent fines are promptly referred to FMS, including creating formal procedures that address both sending debts to FMS within the required time frames and requiring all of the necessary information from the Division of Enforcement on these debts.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the heads, or other designees, of SEC, CFTC, FMS, NASD, and NFA, and we incorporated their technical comments into this report where appropriate. Overall, each of the organizations generally agreed with the findings and recommendations in our report. SEC, CFTC, and FMS provided us with written comments, which appear in appendixes II through IV. Their letters made the following points.

Regarding our recommendation that SEC provide more timely responses to FMS on compromise offers, the Director of SEC's Division of Enforcement stated that SEC staff are working with FMS to increase the timeliness of SEC responses to compromise offers presented by FMS. Regarding our recommendation that SEC improve its processes relating to TOP, the Director stated that SEC staff are diligently working toward promulgating regulations clarifying SEC's authority to take various steps

toward debt collection, including the use of this program. The Director also stated that the agency plans to use its new disciplinary action database to (1) identify trends and disparities in SRO sanctions, and (2) continue to assess the adequacy of SRO sanctions as well as any disparities in such sanctions during its oversight inspections of SRO disciplinary programs.

In commenting on our recommendation that CFTC review NFA readmissions to ensure that NFA's revised fine imposition practices do not result in the readmission of inappropriate individuals, CFTC's Acting Chairman stated that the agency does not anticipate a substantial increase in applications from barred individuals. The Acting Chairman further pointed out that any registration applications from individuals subject to an NFA bar would be carefully reviewed at the CFTC Registration Working Group's quarterly meetings. We responded by adding text to this report on the role that both SEC and CFTC have in reviewing applications for readmission into their respective industries. In addition, we revised our recommendation to clarify our intention that, in addition to reviewing individual applications for readmission, these agencies should also assess the pattern of applications to ensure that the changes in NASD's and NFA's fine imposition practices do not have unintended consequences. Regarding our recommendation that CFTC take steps to ensure that delinquent fines are promptly referred to FMS, the Acting Chairman stated that all but one case mentioned in our draft report had been sent to FMS, and that case should be referred to FMS by the end of August. The Acting Chairman also stated that CFTC is in the process of revising its internal instruction concerning penalty collections to ensure timely referral of delinquent cases with all of the necessary information, and that this process should be completed before the end of Fiscal Year 2001.

The Commissioner of the Department of the Treasury's FMS, pointing out that the collectibility of cases declines as debts age, suggested that we include information on the age of SEC cases referred for collection. We have included this information in this report. The FMS Commissioner also noted that because SEC has significant tools at its disposal to collect from solvent debtors before referring cases to FMS, the low collection rates on SEC fines are not unexpected. The Commissioner also stated that FMS is working in partnership with SEC to improve the agency's responsiveness to compromise and repayment agreement offers.

As agreed with you, unless you publicly release its contents earlier, we plan no further distribution of this letter until 30 days from its issuance date. At that time, we will send copies to the Secretary of the Treasury; the Acting Chairman, SEC; the Acting Chairman, CFTC, and other interested parties. We will also make copies available to others upon request.

If you have any further questions, please call me at (202) 512-8678 or Cody J. Goebel, Assistant Director, at (202) 512-7329. Additional GAO contacts and acknowledgments are listed in appendix V.

Sincerely yours,

Richard J. Hillman
Director, Financial Markets and
Community Investment

Appendix I: Department of the Treasury's Financial Management Service Debt Collection Process

The Department of the Treasury's Financial Management Service (FMS), originally established as the Bureau of Government Financial Operations in 1974, was renamed in 1984. The Debt Collection Improvement Act of 1996 requires federal agencies to refer their delinquent debts to FMS for collection, so that FMS can serve as the government's central debt collection agency, managing the government's non-tax delinquent debt portfolio.

Within FMS, Debt Management Services administers these efforts, called cross-servicing. The cross-servicing program collects debts more than 180 days delinquent that have been referred by federal agencies. According to FMS officials, 20 to 30 collectors perform the cross-servicing collection efforts at FMS' collection center in Birmingham, Alabama, and about 40 people at headquarters perform agency liaison or manage private collection agencies, for a total of about 70 to 100 people who work in some capacity on cross-servicing.

One tool that FMS uses to collect these debts is the Treasury Offset Program (TOP), in which FMS matches a database of delinquent debtors against payments to be disbursed by Treasury and then offsets or withholds federal payments to recipients who also owe delinquent debts. FMS (1) presently offsets Office of Personnel Management retirement payments, federal income tax refunds, vendor payments, and some federal salary payments and (2) is planning to add Social Security benefit payments and the remaining federal salary and non-Treasury-disbursed payments to the TOP system. FMS' cross-servicing collections for fiscal year 2000 were in excess of $41 million, almost doubling the $23 million collected in fiscal year 1999, which had more than doubled the $10 million collected in fiscal year 1998. Since the passage of the Debt Collection Improvement Act of 1996, cross-servicing collections have totaled $74.9 milion.

Federal agencies are required to send delinquent debts owed to them to FMS for collection once these debts are 180 days past due. FMS policy is to keep a case for 30 days, during which time it will send the debtor a demand letter asking for payment. If no payment is received 20 days after sending the demand letter, FMS will refer those cases that have a debtor's taxpayer ID number or electronic ID number to TOP for collection where it can remain active for up to 10 years. At the end of the 30-day period, FMS refers each unpaid case to 1 of the 11 private collection agencies it has on contract to collect debts on a commission basis. When referring cases to these collection agencies, FMS uses a distribution formula intended to distribute the debts among the agencies on the basis of their

performance history. A collection agency has 180 days to attempt to collect the debt, during which time it performs such actions as skip traces, asset searches, and information searches from credit bureaus. If a collection agency is unsuccessful in collecting the debt during the period it has the case, the case is referred to a second agency to pursue collection over a second 180-day period. These collection agencies work on a commission basis and get nothing if their efforts are unsuccessful at collecting a debt. FMS evaluates these agencies on their performance and may reward good performance with bonus payments or with additional referrals. For cases in which debtors can prove they are unable to pay their debts in full, a collection agency can also work with debtors to "compromise" debts, which means that they will accept less than full payment to discharge a debt. This compromise must be agreed to by the referring agency when amounts exceed certain agreed-upon thresholds.

After two collection agencies have been unsuccessful in collecting a debt, the case is returned to FMS. FMS then can refer a case to the Department of Justice to pursue litigation against the debtor, or it can return the case to the referring agency as uncollectible. The referring agency can either write off the case, particularly if the debtor has no assets, or hold the case for later attempts at collection if it appears that the debtor may eventually gain some assets from which collection might be made. When a debt is written off or compromised, FMS will, upon agency request and if the forgiven amount exceeds $600, issue a Form 1099-C to the debtor, indicating that the forgiven amount may be taxable income to the debtor.

FMS charges 18 percent of any collections it makes while working the debt from its Birmingham Debt Management Operations Center in the first 30 days and on any judgment cases it sends to Justice for post-judgment enforcement. FMS' fee drops to 3 percent when a debt is referred to a private collection agency or to Justice on nonjudgment cases, but this is in addition to the collection agency's or Justice's fees of 25 and 3 percent, respectively. When TOP offset occurs, FMS charges 3 percent in addition to an across-the-board Offset Program fee of $11.75. The referring agency elects whether to (1) add this fee to the debt so that the debtor winds up paying the collection fee, or (2) deduct the fee from the original debt due the agency so that the agency pays the fee. In most cases, including both the Security and Exchange Commission and Commodity Futures Trading Commission, fees are added to the original debt amount so that the debtor pays.

Appendix II: Comments From the Securities and Exchange Commission

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

July 6, 2001

Mr. Richard J. Hillman
Director
Financial Markets and Community Investment
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Hillman:

Thank you for the opportunity to review and to comment upon your draft report entitled "Fine Collection: Regulators' Efforts Improved But Weaknesses Exist in Use of Treasury's Collection Service". The report reviews the fine collection activities of this Commission, the Commodity Futures Trading Commission, and nine exchanges and industry associations that act as self-regulatory organizations in the securities and futures industries. We agree with much of what is recommended and are in fact already addressing many of the concerns it raises. Our specific comments as to several of your findings follow.

In regard to our efforts to collect outstanding fines, as your report points out, in addition to our own collection efforts we are continuing to work with the Financial Management Service of the Department of Treasury. Following discussions with FMS staff, we have taken steps to ensure that they are provided with timely responses to various compromise offers submitted to us. In addition, we are working diligently toward promulgation in the very near future of regulations clarifying the SEC's authority to take various steps toward debt collection, including use of the Treasury Offset Program.

As noted in the GAO's report, we have developed a new database that includes information regarding SRO disciplinary actions. We plan to use the information in the database to attempt to identify trends and disparities in SRO sanctions. We also plan to continue to assess the adequacy of SRO sanctions and whether there are disparities in such sanctions during our oversight inspections of SRO disciplinary programs.

We appreciate the care and thoughtfulness with which this study was conducted. If we can be of further assistance, please call me at 202-942-4500.

Very truly yours,

Richard H. Walker
Director

Appendix III: Comments From the Commodity Futures Trading Commission

U.S. Commodity Futures Trading Commission
Three Lafayette Centre, 1155 21st street, NW, Washington DC 20581

James E. Newsome
Acting Chairman

(202) 418-5050
(202) 418-5533 Facsimile

Richard J. Hillman
Director, Financial Markets and
Community Investment
United States General Accounting Office
Washington, D.C. 20548

Re: GAO Report on Fines Collection, GAO-01-900

Dear Mr. Hillman:

Thank you for permitting the Commodity Futures Trading Commission (Commission) to comment upon the draft report entitled FINES COLLECTION: Regulators' Efforts Improved But Weaknesses Exist in Use of Treasury's Collection Service, GAO-01-900, which was forwarded to the Commission on June 20, 2001. We also appreciate the professionalism and courtesy of your staff in conducting the field work for this report so as to avoid disrupting our staff's penalty collection activities.

The report notes that the Commission's collection rate has improved (from 81 to 86 percent) since GAO's prior report on this topic. The Commission will continue to strive to improve the collection rate.

The report makes two recommendations. The first recommendation is for the Commission to monitor applications and approvals for readmission into the futures industry to ensure that NFA's revised fine assessment practices do not lead to readmission of inappropriate individuals. The report expresses concern that, because NFA has decided generally to discontinue assessing fines when barring individuals, these persons may be more likely to seek readmission to the industry. Because an NFA bar constitutes a statutory disqualification from registration under Section 8a(3)(J) of the Commodity Exchange Act, we would not anticipate a substantial increase in applications from barred individuals even if there were no fine associated with the bar. In any event, the Registration Working Group, which includes Commission and NFA staff members, discusses at all of its quarterly meetings applications considered by NFA from persons whose disciplinary history contains a statutory disqualification. Accordingly, a registration application from a person subject to an NFA bar will be subject to careful review by the Registration Working Group.

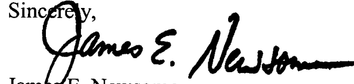
Richard J. Hillman
Page 2

The second recommendation is to take steps to ensure that delinquent fines are promptly referred to FMS, including creating formal procedures that address both sending debts to FMS within the required timeframes, and requiring all necessary information from the Commission's Division of Enforcement on these debts. The GAO draft report cites a report of the Commission's Inspector General that found eligible cases had not been sent timely to FMS as of February 2001. All but one of those have now been sent to FMS and the other case should be referred next month.

The Commission is revising its internal instruction concerning penalty collections to ensure that delinquent cases are referred to FMS within 180 days of becoming delinquent, as required by the Debt Collection Improvement Act of 1996, and that the Division of Enforcement provides all necessary information to make such referrals. We expect to complete that process before the end of the fiscal year.

Thank you again for your consideration of our comments. Please contact me if you have any further questions about this matter.

Sincerely,



James E. Newsome
Acting Chairman

Appendix IV: Comments From the Department of the Treasury's Financial Management Service

DEPARTMENT OF THE TREASURY
FINANCIAL MANAGEMENT SERVICE
WASHINGTON, D.C. 20227

COMMISSIONER

July 3, 2001

Mr. Richard J. Hillman, Director
Financial Markets and Community Investment
General Accounting Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Hillman:

Thank you for the opportunity to comment on the General Accounting Office (GAO) draft report (GAO-01-900) entitled, "Fines Collection: Regulators' Efforts Improved But Weaknesses Exist in Use of Treasury's Collection Service," regarding collection of fines and penalties by the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). I know that you have obtained data from Financial Management Service's (FMS) staff regarding our efforts to service these debts on behalf of the SEC and CFTC, and I am pleased to comment on the information and interpretations contained in your draft report. Overall, the report accurately reflects the information provided by FMS. I would, however, offer the following two comments:

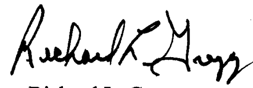
First, with regard to FMS' collection on behalf of SEC, it is important to note that the average age of the 25 cases reviewed by GAO was nearly 15 months at the time of referral to Treasury. As I am sure you are aware, the collectability of debts declines dramatically as the debts age. Given that these debts were on average more than a year old, as well as the fact that SEC has significant tools at its disposal to collect from solvent debtors, these return rates are not unexpected. I would suggest that information on the age of these cases be included in the report.

Second, the first full paragraph on page 21 implies that FMS has issued SEC an ultimatum stating that it will make compromise decisions on behalf of SEC if SEC does not respond to compromise offers in a more timely manner. In fact, FMS is working closely with SEC staff to assist them in obtaining a delegation of authority from the Commission to respond to compromise offers. In support of our SEC counterparts' request that the Commission grant them a delegation of authority, FMS agreed to issue a letter to SEC asserting our right to make compromise determinations if SEC does not respond to offers in a timely manner. FMS will continue to work in partnership with SEC to improve its responsiveness to compromise and repayment agreement offers.

Page 2 – Mr. Richard J. Hillman

Once again, we appreciate that GAO has sought input from the FMS regarding this Report, and hope that our responses will be helpful to you in finalizing the report. If you or your staff have any questions, please have them contact Dean Balamaci on (202) 874-6660.

Sincerely,



Richard L. Gregg

Appendix V: GAO Contacts and Staff Acknowledgments

GAO Contacts

Richard J. Hillman (202) 512-8678
Cody J. Goebel (202) 512-7329

Acknowledgments

In addition to those named above, Darleen Wall, Joan Conway, Sindy Udell, Emily Chalmers, and Steven Haughton made key contributions to this report.

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