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November 1, 2022

Vanessa A. Countryman
Secretary
US Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Via email: rule-comments@sec.gov

Re: Proposed Rule, Supplemental Comments, Securities and Exchange Commission; The Enhancement and Standardization of Climate-Related Disclosures for Investors; 87 Fed. Reg. 21334; File Number S7-10-22 (May 12, 2022)

Dear Ms. Countryman:

The U.S. Chamber of Commerce writes to supplement its comments[1] on the Commission's proposed rules regarding climate-related disclosures (the "Proposed Rules").[2] As we previously explained, the Chamber supports policy solutions that serve the goal of reducing greenhouse gas ("GHG") emissions as much and as quickly as reasonably possible based on what the pace of innovation allows and the feasibility of implementing technical solutions at scale. The Chamber, likewise, supports policies that provide for the disclosure of material information, including climate-related information, as necessary to protect investors. At the same time, policies must always be informed by the best science and a careful analysis of the available alternatives, outcomes, and cost-benefit tradeoffs to ensure that optimal policies are implemented. We are concerned that the Proposed Rules fail to strike the right balance. The Proposed Rules are vast and unprecedented in their scope, complexity, rigidity, and prescriptive particularity. Moreover, as is explained not only in the Chamber's initial comments, but

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[1] Comments of the U.S. Chamber of Commerce, File No. S7-10-22 (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131892-302347.pdf ("Chamber Comments").

[2] *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, 87 Fed. Reg. 21,334 (Apr. 11, 2022). The Commission reopened the comment period until November 1, 2022. *See Resubmission of Comments and Reopening of Comment Periods*, 87 Fed. Reg. 63,016 (Oct. 18, 2022). In addition, "consistent with the Commission's Informal and Other Procedures," the Commission considers comments submitted "before adoption of a final rule." *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8*, 85 Fed. Reg. 70,240, 70,268 n.312 (Nov. 4, 2020).

also in this letter, the Proposed Rules would saddle the U.S. economy with *billions* of dollars in added costs—often for little discernible benefit.

The Chamber's June 16, 2022 comments offered constructive feedback to help the SEC improve the Proposed Rules to better serve the interests of investors and the U.S. capital markets without impeding the progress the business community has already made in providing climate-related disclosures to investors and in developing strategies and technologies to reduce climate risk and its potential adverse impacts on society. This letter supplements the Chamber's initial comments in three respects. *First*, the Chamber submits this supplemental letter to note the unusually widespread concerns expressed about the Proposed Rules to date. Seemingly every segment of the market that will be subject to the Proposed Rules—from the public companies who will be forced to make extensive disclosures,[3] to the auditors who will need to review them[4]—warns that significant aspects of the Commission's proposal are massively costly and unworkable. Even more noteworthy, however, is the degree to which the investors that the Commission intends to serve—large institutional investors cited throughout the Proposing Release[5]—have vocalized opposition to the rules as proposed and have asserted that the Commission has gone too far.[6] While these investors support aspects of the Proposed Rules and the Commission's broader policy objectives, it is extraordinary for a proposal's intended beneficiaries to express concerns about so many aspects of the proposal. This broad range of concerns—from investors and public companies alike—is a powerful indication that the rules as proposed rest on an incomplete understanding of investor needs and market capabilities and are not justified on cost-benefit grounds.

Second, the Chamber submits this supplemental letter to highlight significant flaws in the Commission's cost-benefit analysis; the cost estimates are too low, and the anticipated benefits are too high. The Chamber already explained that the Commission grossly underestimated the costs of the Proposed Rules,[7] and the record bears this out.

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[3] *See, e.g.*, Chamber Comments; Comments of the Society for Corporate Governance (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132044-302525.pdf ("Society for Corporate Governance Comments"); Comments of the American Petroleum Institute (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131819-302262.pdf ("API Comments"); Comments of the National Association of Manufacturers (June 6, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20130306-296969.pdf ("NAM Comments"); Comments of the Business Roundtable (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132191-302705.pdf.

[4] *See, e.g.*, Comments of the Center for Audit Quality 9-13 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131819-302262.pdf ("Center for Audit Quality Comments").

[5] *See, e.g.*, Proposing Release, 87 Fed. Reg. at 21,338 n.38.

[6] *See, e.g.*, Comments from State Street Global Advisors 2-3 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131965-302424.pdf ("State Street Comments") ("We are … concerned that multiple aspects of the Commission's proposal do not reflect the nascent state of climate data, methodologies and reporting capabilities. … The detailed and prescriptive nature of the Commission's proposal at this juncture, coupled with increased costs and potential liability that companies will assume when providing such disclosures, would more than likely constrain, rather than encourage, effective climate disclosures by U.S. registrants now and in the future.").

[7] *See* Chamber Comments 15-17, 71, 80-82.

According to the Commission, all companies other than smaller reporting companies would (excluding assurance costs) incur initial compliance costs of $640,000 and annual ongoing compliance costs of $530,000.[8] That is not even close to the likely reality. As one large reporting company details in the record, its initial implementation costs would likely exceed $100 million, and its ongoing annual costs would likely range from $10 to $25 million[9]—orders of magnitude more than the Commission estimated. Other companies documented similarly large cost estimates.[10] The Commission's numbers are grievously understated. Indeed, some of the very sources the Commission cited in the Proposing Release to support the agency's estimates[11] have since disavowed the Commission's analysis, explaining that the actual compliance costs would exceed the Commission's estimates many times over.[12] In light of this evidence, the Chamber emphasizes the findings of three former SEC chief economists who have reviewed the Commission's work: the cost-benefit calculus must go back to the drawing board.[13]

In reevaluating the cost-benefit tradeoffs, the Commission must also confront other issues raised in the record. The Commission, for example, not only underestimated certain costs; it failed to consider other costs altogether. The Commission made no "attempt to understand the effect[s]" of the proposal on the broader economy[14]—a massive oversight in this case: using the Commission's own cost estimates, one commenter reports that standard economic models predict the "enduring economic impact" of the Proposed Rules to be "approximately $25 *billion*" in forgone GDP and *200,000* fewer jobs *per year*—which "translates to the U.S. economy missing *a month of job creation annually*."[15] The Commission must include such costs in the analysis. At the same time, the Commission must properly account for and assess the purported benefits. Empirical evidence demonstrates that many investors do not find GHG disclosures to be material,[16] undermining a significant plank (and source of alleged benefits) of the Proposed Rules.

Third, and finally, the Chamber submits this supplemental letter to note recent developments that cast further doubt on the Commission's legal authority to finalize

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[8] *See* Proposing Release, 87 Fed. Reg. at 21,439.

[9] *See* Comments of ConocoPhillips 2 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131839-302285.pdf ("ConocoPhillips Comments").

[10] *See, e.g.*, Society for Corporate Governance Comments 40.

[11] *See, e.g.*, Proposing Release, 87 Fed. Reg. at 21,440-41 & n.925 (citing Letter from Williams Companies, Inc. (June 12, 2021)).

[12] *See* Comments from The Williams Companies, Inc. 14-15 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132208-302726.pdf ("Williams Companies Comments").

[13] *See* Chamber Comments, Annex A, Report of James A. Overdahl, Ph.D. ¶ 58 (June 16, 2022) ("Overdahl Report"); Comments of S.P. Kothari & Craig Lewis 7 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132332-302895.pdf ("Kothari & Lewis Comments").

[14] Kothari & Lewis Comments 7.

[15] Comments of Matthew Winden, Ph.D. 7 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132304-302836.pdf ("Winden Report") (emphases added).

[16] *See* Comments of Daniel Taylor (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131668-302058.pdf ("Taylor Comments").

the rules as proposed. Perhaps most significantly, the Supreme Court's decision in *West Virginia v. EPA*[17] emphasized a "common sense" principle of statutory interpretation that readily applies here: the major questions doctrine. That doctrine instructs that Congress does not delegate to agencies highly consequential powers—including the power to resolve the types of "major questions" addressed in the Proposed Rules—in "modest words, vague terms, or subtle devices."[18] Rather, when Congress "wishes to assign to an agency decisions of vast economic and political significance," Congress "speak[s] clearly"[19]—but, as the Chamber has previously explained,[20] here, Congress did not. While the Commission may have some latitude in requiring the disclosure of certain types of material, financial information, Congress never delegated to the Commission the comprehensive statutory power to reorder the market as the Commission claims. Nor did Congress delegate to the Commission the authority to regulate air emissions that contribute to climate change, which the Environmental Protection Agency (EPA) regulates pursuant to the Clean Air Act. Moreover, as the record indicates, the Proposed Rules would compel speech on controversial issues fraught with uncertainty and reasonable grounds for debate—a clear violation of the First Amendment.

For these and a multitude of other reasons documented in the record, the Commission should abandon the overly prescriptive, unduly burdensome approach of the Proposed Rules and should instead work with stakeholders to craft a more practical, durable approach to climate disclosures that builds on the work that the Commission and American businesses have already been doing. The Chamber, in its initial comments, laid forth a constructive path forward, and we urge the Commission to take it.

The flaws in the Commission's proposal are not just errors of substance, but of process. Simply put, the Commission is moving too quickly. As the Chamber previously warned, the speed at which the Commission has been seeking to push through a huge volume of proposals has risked depriving even the Commission's own staff of the time needed to develop thoughtful, properly tailored rule proposals.[21] The Chamber's warnings have borne out. The Commission recently reported that its own systems have been unable even to *capture* all of the public comments the Commission has received,[22] let alone facilitate a thorough review of those comments. The Commission's Inspector General has identified other difficulties still. In a report attached as Exhibit A, the Inspector General highlighted concerns from managers in numerous SEC divisions that the Commission's "more aggressive [rulemaking] agenda" has "limit[ed] the time available for staff research and analysis."[23] The staff has not "received as much feedback during the

[17] 142 S. Ct. 2587 (2022).
[18] *Id.* at 2609 (cleaned up).
[19] *Id.* at 2605 (quoting *Util. Air Regulatory Grp. v. EPA*, 573 U.S. 302, 324 (2014)).
[20] *See* Chamber Comments 25.
[21] *See* Chamber Comments 83.
[22] *See* Resubmission of Comments, 87 Fed. Reg. 63,016, 63,016 (Oct. 18, 2022).
[23] The Inspector General's Statement on the SEC's Management and Performance Challenges 3 (Oct. 13, 2022), https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf.

rulemaking process, either as a result of shortened timelines during the drafting process or because of shortened public comment periods."[24] The staff is also shorthanded, and thus has been "relying on detailees, in some cases with little or no experience in rulemaking."[25] The Commission should proceed at a more manageable pace that ensures stakeholders are able to provide the input the Commission needs, and which gives the Commission the time it requires to do its important job properly.

I. THE PROPOSAL IS SUBJECT TO UNUSUALLY WIDESPREAD CRITICISM.

Perhaps the best evidence that the Commission failed to strike the right balance in the proposal is the degree to which virtually every segment of the market agrees that the Proposed Rules present a number of significant concerns. From investors the Commission cited in support of its proposal, to corporate governance professionals who will implement it, to auditors who will opine on the required disclosures, a broad range of key commenters agree that the Proposed Rules go too far.

A. Investors the Commission cited in support of the proposal agree that aspects of the Proposed Rules are overly costly.

In support of the Proposed Rules, the Commission repeatedly cited a demand for climate-related disclosure from select institutional investors.[26] Many of those same investors, however, after having weighed the Proposed Rules, agree that aspects of the Commission's rules are unreasonably costly.

Proposed Article 14 of Regulation S-X is a prime example of the Commission's overreach. Among other things, Article 14 would require companies to calculate the impacts of severe weather events, transition activities, and other climate-related risks *on every line item on their financial statements*, and then disclose, on a line-by-line basis, any impacts that aggregated to 1% or more of a line item.[27] This would be a massively costly undertaking,[28] but offers no discernible benefit to investors. State Street, for example, explained that the line-by-line reporting contemplated by the proposal would be a huge "operational burden" for companies, yet would produce information that is "far too granular to inform investment decisions."[29] Numerous other investors agree. T. Rowe Price stated that Article 14 would not "result in meaningful or

[24] *Id.*

[25] *Id.*

[26] *See, e.g.*, Proposing Release, 87 Fed. Reg. at 21,338 n.38 (citing letters from BlackRock, Ceres, Council of Institutional Investors, Investment Adviser Association, Investment Company Institute, State Street Global Advisors).

[27] *Id.* at 21,366.

[28] *See, e.g.*, Chamber Comments 53-54; Society for Corporate Governance Comments 65-67; ConocoPhillips Comments 2; NAM Comments 29-31.

[29] State Street Comments 5.

comparable climate disclosures."[30] The Investment Company Institute warned that the information would "not be useful to investors" and would risk "overloading" them with "inconsequential information that [would] complicate their analysis of [a] company's operations and financial condition."[31] BlackRock cautioned that the resulting disclosures would "dilute the materiality of [other] climate-related financial disclosures and potentially mislead investors into assuming that [the] data [were] more relevant or reliable than it actually [would be]."[32] This broad range of concerns—from the same investors the Commission intends to serve—is a strong indication that the Commission has not proposed a rule aligned with the type of information investors need, and that the factual predicate and asserted rationale for the Proposed Rules are legally inadequate.[33]

That misalignment is also evident in other significant aspects of the Proposed Rules. For instance, investors agree that, at least for now, disclosure of Scope 3 emissions data would be of limited use, and yet the Commission has proposed a Scope 3 disclosure requirement that would impose enormous burdens on public companies.[34] According to T. Rowe Price, for example, "the reality is that [Scope 3] methodologies continue to be under development and, in its current state, Scope 3 GHG data is of limited reliability."[35] There is simply "no uniform methodology or approach" to calculating Scope 3 emissions, and thus, T. Rowe Price explained, it would be "highly unlikely that Scope 3 GHG disclosures [would] provide comparable, useful, material, climate-related information" to investors.[36] For that reason, T. Rowe Price[37] and many other investors,[38] including a "large majority" of the Investment Company Institute's

[30] Comments of T. Rowe Price 8 (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131721-302138.pdf ("T. Rowe Price Comments").

[31] Comments of the Investment Company Institute 28 (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131852-302300.pdf ("ICI Comments"); *see also* Comments of Investment Adviser Association 23 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132612-303149.pdf ("IAA Comments") (explaining that the Commission "has not provided an adequate justification" for a 1% line-item materiality standard).

[32] BlackRock Comments 19.

[33] *See also, e.g.*, Comments of Scott Fitzpatrick, Missouri State Treasurer 2 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132271-302800.pdf (explaining that proposed Article 14 is not "likely to be financially material to a reasonable investor"); Comments of Council of Institutional Investors 20 (May 19, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20129121-294979.pdf (acknowledging that the "SEC has failed to justify a 1% threshold for" line-item reporting); Comments of State Financial Officers Foundation 2 (June 17, 2022), https://www.sec.gov/comments/s7-17-22/s71722-20132175-302672.pdf (stating that the "increased costs of compliance" will be "borne by issuers, with no clear benefits to the issuers or investors").

[34] *See, e.g.*, Chamber Comments 71; NAM Comments 21-23; ConocoPhillips Comments 10; Society for Corporate Governance Comments 45-46.

[35] T. Rowe Price Comments 4.

[36] *Id.*

[37] *Id.*

[38] *See, e.g.*, State Street Comments 4 ("[W]e urge the Commission to refrain from mandating Scope 3 emissions disclosures, and consult further with a range of constituencies regarding the path forward on Scope 3 GHG reporting."); IAA Comments 15 ("We believe it is premature at this point to require disclosure of Scope 3 GHG emissions due to data gaps and the absence of agreed-upon measurement methodologies.").

members, agree that the "Commission should *not* require companies to report Scope 3 emissions at this time."[39]

Investors similarly agree that the Commission should not require firms to file Scope 1 and 2 GHG emissions data in their annual reports. As BlackRock acknowledged, the collection and analysis of "quantitative climate-related data … often requires companies to collect and aggregate data from various internal and external sources."[40] This "cannot be completed on the same timeline as issuers' annual reports."[41] Accordingly, as BlackRock and others recommended, the Commission should, at the very least, give public companies "more time after the annual report deadline to prepare the information required" to be disclosed.[42, 43] Only then will the information even possibly be of the level of "quality and accuracy" that investors need.[44] Moreover, as investors have confirmed, there is no reason to require (as the Commission proposes) that the disclosures be filed with the Commission, rather than furnished. Furnishing the information strikes the right balance; it provides information to investors without unnecessarily subjecting companies to the stricter liability associated with "filed" disclosures.[45] Once again, the Commission's more burdensome approach goes too far and would impose enormous burdens for little benefit.

The Commission's proposal also includes requirements that may ultimately affirmatively harm investors' interests. For example, the Commission proposes to require detailed disclosures regarding a board of directors' oversight of climate-related risks, including the identity of any board member who has climate-related expertise.[46] The value of such detailed disclosures is questionable[47] and may operate "to the

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[39] ICI Comments 15 (emphasis added) ("A large majority of our members believe that the Commission should not require companies to report Scope 3 emissions at this time, because of significant data gaps and the absence of agreed-upon methodologies to measure Scope 3 emissions. These deficiencies seriously undermine the ability of most companies to report consistent, comparable, and verifiably reliable data.").

[40] BlackRock Comments 6.

[41] *Id.*

[42] *Id.*

[43] BlackRock notes that this timeline should allow the disclosure to be produced simultaneous to a corporate issuer's proxy statement, allowing investors time to absorb the information contained within before voting on annual meeting items. BlackRock Comments 6, 13.

[44] *Id.* at 6-7; *see also* T. Rowe Price Comments 6 ("To allow registrants the opportunity to provide accurate and reliable data, which will be more useful for investors, we recommend that Scope 1 and 2 GHG emissions be disclosed in a furnished form due within 120 days of the fiscal year end ….").

[45] *See, e.g.*, T. Rowe Price Comments 6 ("[W]e recommend that Scope 1 and 2 GHG emissions be disclosed in a furnished form …."); State Street Comments 5 ("The Commission should allow registrants to provide any additional climate disclosures in a furnished, rather than field, format on a *comply* or *explain* basis.").

[46] Proposing Release, 87 Fed. Reg. at 21,359.

[47] *See, e.g.*, BlackRock Comments 13 ("Prescribing such a granular level of required disclosures under these proposed items would likely require issuers to disclose a large volume of information that is, on the one hand, unlikely to be material for investors, and on the other hand, may be competitively sensitive for issuers."); IAA Comments 10 ("For example, the Proposal requires disclosure of whether any member of a registrant's board of directors has expertise in climate-related risks, with disclosure required in sufficient detail to fully describe the nature of the expertise. It is unclear to us what metrics would be used to determine what qualifies as expertise in climate-related risks or how it would be measured …. We also generally believe that the board's experience and expertise as a

detriment of the company's investors."[48] As the Investment Company Institute warned, the detailed disclosure requirements regarding board composition and expertise "may cause companies to create larger, and possibly less cohesive, boards."[49] Or as T. Rowe Price cautioned, the pressure to find board members with "[s]ingle-issue expertise" will come at the expense of the more "well-rounded candidates" investors prefer—the type of board members who are "able to contribute in multiple ways to a company's governance."[50] This range of concerns over the detrimental effects of the Commission's proposal is widely held in the investment community.[51]

As the above discussion indicates, the rules as proposed do not accurately reflect or advance the needs of the investors whom the rules are intended to benefit.

B. People who would implement the Proposed Rules agree that they are unworkable.

The Commission's rules as proposed are not only unwarranted, but unworkable. At every level of implementation, commenters explained that the Proposed Rules cannot reasonably be implemented and that significant aspects of the proposal are not feasible.

The public companies who would be directly subject to the Proposed Rules will not be able to operationalize key parts of the Commission's proposal. Regulation S-X, for example, would require public companies to calculate the impacts of severe weather events, transition activities, and other climate-related risks on every line item on their financial statements.[52] As the National Association of Manufacturers explained, "[f]rom a practical standpoint, the processes and procedures necessary to conduct the financial statement analysis that would be required under the proposed rule simply do not exist."[53] The detailed analysis required by Regulation S-X "would effectively require detailed tagging of financial impacts at the invoice level."[54] "Companies would be required to count every single financial impact that could plausibly be attributable to climate risks, weather events, or transition activities, somehow determine the degree of climate causation associated with each, and then aggregate these impacts to determine

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collective whole may be more important than having individual members with specific expertise and it is not clear how this experience would be treated.").

[48] ICI Comments 25.

[49] *Id.*

[50] T. Rowe Price Comments 7.

[51] *See, e.g.*, State Street Comments 6 ("Investors do not expect companies to focus climate risk expertise within a designated director, as it could impact their ability to identify and appoint directors with other experience."); BlackRock Comments 13 ("We believe that robust board oversight with respect to climate requires a whole-of-the-board approach, and the identification of 'specialist' directors is not conducive to a holistic undertaking by the board.").

[52] *See* Proposing Release, 87 Fed. Reg. at 21,366.

[53] NAM Comments 29.

[54] *Id.*

if they meet the proposed 1% threshold—for each line item in the consolidated financial statements."[55] As a multitude of commenters explained, "[c]ompanies' existing systems do not currently track data at such a granular level."[56]

The deadlines the Commission is proposing are similarly unworkable. For example, the Proposed Rules would require public companies to disclose Scope 1, 2, and 3 emissions data in their annual reports on Form 10-K.[57] Again, that is not doable. Companies must file annual reports on Form 10-K within ninety days of the end of their fiscal year[58] (and often sooner[59]). That is not enough time to produce GHG disclosures. According to the Society for Corporate Governance—an association of more than 3,600 corporate and assistant secretaries, in-house counsel, outside counsel, and other governance professionals—Scope 1 and 2 GHG emissions would generally take about six months to produce.[60] Scope 3 GHG emissions would take even more time.[61] These estimates are well supported in the record. A recent review, for example, found that more than 80% of sustainability reports are not published until the second quarter of the following year or later.[62] That is likely why the deadlines for other GHG reporting schemes—for example, the Carbon Disclosure Project—are not until late July.[63] The Commission's 90-day-or-less proposal is simply unworkable.

Public companies are not alone in objecting to significant aspects of the Commission's proposal. Auditors agree that the Proposed Rules "will result in various practical implementation challenges."[64] As discussed, public companies do not

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[55] *Id.*

[56] *Id.* at 29-30; *see also* Society for Corporate Governance Comments 64 ("[W]e do not believe that registrants can operationalize the portions of the Proposed Rule that would amend Regulation S-X. To comply with these portions of the Proposed Rule, registrants would be forced to spend a significant period of time and inordinate amounts of money to develop and implement controls to estimate and model outputs built on several disparate judgments and assumptions."); ConocoPhillips Comments 7-8 ("There are several elements of this disclosure that will be particularly difficult, if not impossible, to implement …. We, along with many other companies, do not segregate and track in our systems the costs and benefits of climate-related risks or events, the costs of mitigating such risks, or the estimates and assumptions underlying such metrics. Compliance with the proposed rules, and particularly at the level of granularity required for financial statement line items under the proposed rules, will require registrants to implement an entirely separate and additional set of books or ledgers of activity-based costing, which will be costly and time-consuming. For instance, systems and processes for tagging and tracking costs across our entire supply chain would need to be redesigned. There will also be reporting lags for discrete events that cannot be tagged until they have concluded."); Comments of Exxon Mobil Corporation 5 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132323-302882.pdf ("ExxonMobil Comments") (explaining that the "Proposal's amendments to Reg. S-X to include line-item disclosures in a note to the financial statements would, in our view, pose significant challenges in real-world application for many registrants").

[57] Proposing Release, 87 Fed. Reg. at 21,448.

[58] *See* 17 C.F.R. § 249.310(b)(3).

[59] *See id.* § 249.310(b)(1)-(2).

[60] Society for Corporate Governance Comments 52.

[61] *Id.*

[62] NAM Comments 8.

[63] Society for Corporate Governance Comments 52; NAM Comments 8.

[64] Comments of Center for Audit Quality 2 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131819-302262.pdf ("CAQ Comments").

currently have systems in place to tag and aggregate the information needed to disclose the impacts of severe weather events and other natural conditions on each line item of a company's financial statements. Moreover, and as Ernst & Young explained, once costs and other expenditures are recorded in an IT system, they are often "pooled by the system in various intermediate accounts and departments" before ultimately being "allocated to the appropriate financial statement line items."[65] This would make it "difficult to know precisely which line item includes the climate-related expenditures or portions of the climate-related expenditures."[66] As a result, an independent auditor would not have sufficient information to "be able to perform sufficient procedures to audit" a company's disclosures and related internal controls.[67] These and related concerns are shared broadly by the audit community[68] and are a further indication that the Commission's proposal is misaligned with the current preferences and capabilities of the market.

II. THE RECORD REFUTES THE COMMISSION'S COST-BENEFIT ANALYSIS, WHICH CONTAINS FUNDAMENTAL FLAWS.

By the Commission's own estimate, the Proposed Rules are among the most costly in its history, yet the Commission's cost-benefit analysis is fundamentally flawed.

A. The Commission underestimated the proposal's costs.

Although the Commission has a "unique obligation" to "apprise itself—and hence the public and the Congress—of the economic consequences of proposed regulation,"[69] the record demonstrates that the Commission has failed to adequately consider the costs of its proposal. Indeed, the record refutes the Commission's cost-benefit analysis.

The Commission's cost estimates are far too low. The Commission estimated that, excluding assurance costs, companies other than smaller reporting companies would incur initial compliance costs of $640,000 and annual ongoing compliance costs of $530,000.[70] The record does not support those estimates. To the contrary, record evidence indicates that the "cost of implementation and compliance for issuers [would] be orders of magnitude greater than the estimates in the Proposal."[71] Companies would

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[65] Comments of Ernst & Young LLP, Appendix 3 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131957-302416.pdf ("Ernst & Young Comments").

[66] *Id.*

[67] *Id.*

[68] *See, e.g.*, CAQ Comments 12; Comments of KPMG LLP 4 (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131616-301992.pdf; Comments of Deloitte & Touche LLP 4 (May 31, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20129946-296218.pdf.

[69] *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

[70] *See* Proposing Release, 87 Fed. Reg. at 21,439.

[71] ExxonMobil Comments 12; *see also* Society for Corporate Governance Comments 41 ("[A]ll of the members who participated in the comment letter process and that specifically weighed in on this issue indicated that

need to "rework [their] accounting and financial reporting systems and processes to allow tagging and aggregate reporting of climate-related effects, by [financial statement] line-item."[72] For a large corporation, this would cost a "multiple of the combined costs required to implement two recent FASB Standards—*Leases* and *Revenue from Contracts with Customers*"—both of which "were multi-year projects that cost tens of millions of dollars."[73] Thus, systems changes alone could "easily reach into the hundreds of millions of dollars."[74] In addition, companies would need to increase staffing and training on climate-related issues,[75] and also amend contracts with third-parties to require the sharing of climate-related data—a process that could impact thousands of contracts and require "tens of thousands of hours" of employee time.[76] All in all, the implementation costs for some large companies would likely exceed $100 million.[77]

Ongoing compliance costs also would be substantial. Far from the Commission's $530,000 estimate,[78] some large companies would spend at least $4 to $5 million per year on ongoing compliance costs,[79] with many spending a lot more—up to $25 million per year.[80] To comply with the Proposed Rules, companies would need to spend millions of dollars on added headcount,[81] yet the Commission's estimate for annual internal costs of $150,000[82] "is likely insufficient to cover the cost of adding a *single* qualified full-time employee."[83] External costs would rise as well—and far above the Commission's estimates.[84] The Commission estimates assurance and added audit

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their company believes that the Proposing Release grossly or significantly underestimates the implementation and ongoing compliance costs. By way of example, some comments we received include: The company thinks that the SEC's estimated costs 'are off by an order of magnitude.' 'The cost of complying with the SEC rule is expected to be several times of order of magnitude greater than preparing voluntary disclosures.' The company believes that the Proposing Release 'grossly underestimates the implementation and compliance costs.'").

[72] ExxonMobil Comments 12; *see also* ConocoPhillips Comments 14; NAM Comments 29; API Comments 24-25; Williams Companies Comments 14. Companies in the energy sector are among the companies most experienced with making climate-related disclosures; their cost estimates are therefore particularly credible.

[73] ExxonMobil Comments 12.

[74] *Id.*

[75] *Id.*; ConocoPhillips Comments 14.

[76] ConocoPhillips Comments 14.

[77] *See id.* ("[W]e expect implementation costs for our company to be in the $100-500 million range ….."); ExxonMobil Comments 12 ("The cost of significant structural changes to existing enterprise resource planning systems for large corporations can easily reach into the hundreds of millions of dollars.")

[78] Proposing Release, 87 Fed. Reg. at 21,439.

[79] *See* Society for Corporate Governance Comments 40.

[80] *See* ConocoPhillips Comments 14.

[81] *See* Society for Corporate Governance Comments 89.

[82] Proposing Release, 87 Fed. Reg. at 21,439.

[83] Williams Companies Comments 15 (emphasis added).

[84] The Commission's estimates are outdated and fail to account for inflation. For example, the Commission estimates "that the average cost of retaining outside professionals [would be] $400 per hour." Proposing Release, 87 Fed. Reg. at 21,458. The Commission has used that estimate "for about 16 years." Comm'r Mark T. Uyeda, Statement on the Final Rule Related to Listing Standards for Recovery of Erroneously Awarded Compensation (Oct. 26, 2022), https://www.sec.gov/news/statement/uyeda-statement-clawbacks-102622. It is far too low. In a different rulemaking, the Commission recently "revised that number to $600 per hour—a 50% increase, to reflect an inflation adjustment."

costs for large companies at around $110,000[85] and $15,000,[86] respectively, per year, but commenters agree that those numbers are too low. Ernst & Young expressed concern that the Commission's estimate may not "appropriately reflect the time and expertise required to meet … auditor's obligations."[87] Some public companies have estimated these costs at $1 to $2 million per year,[88] nearly ten to twenty times the Commission's estimate.

The record does not support the Commission's estimate. In support of its estimate, the Commission cited a June 2021 letter from the Williams Companies, which stated that a management level director spends about 25% of his time on sustainability reports and ESG issues and that the firm pays a third-party consultant more than $250,000 per year to assist with sustainability reports and ESG issues.[89] As Williams has since explained, those costs are not indicative of what the firm would pay to comply under the Proposed Rules. The compliance costs for the rules as proposed would be much higher. For example, Williams would "be unable to leverage its prior efforts to disclose both Scope 1 and 2 GHG emissions because the SEC is [proposing to] requir[e] emissions disclosures on a different timeline, using different methodologies, and requiring different levels of attestation."[90] The cost to the company of voluntarily reporting Scope 3 GHG emissions would add more than $1 million alone, not including the costs of the "accounting personnel [needed] to incorporate Scope 3 emissions reporting into [the] Form 10-K or any commercial efforts needed to amend contracts or attempt to gather and verify Scope 3 emissions data across [the company's] value chain."[91] As Williams concluded, the Commission's cost estimates are "woefully low."[92]

In an attempt to bolster the Commission's estimates, activist groups cite a survey by ERM,[93] which claims that the "SEC's estimated annual costs after the first year of compliance are generally comparable to corporate issuers' current average spend."[94]

Id.; *see Listing Standards for Recovery of Erroneously Awarded Compensation*, Securities Act Release No. 11,126, Exchange Act Release No. 96,159, Investment Company Act Release No. 34,732 (October 26, 2022). The Commission should make similar adjustments here before it even begins to reevaluate the other deficiencies in its cost estimates.

[85] Proposing Release, 87 Fed. Reg. at 21,442.

[86] *Id.* at 21,455.

[87] Ernst & Young Comments, Appendix 4.

[88] *See* Society for Corporate Governance Comments 89.

[89] *See* Proposing Release, 87 Fed. Reg. at 21,440-41 & n.925.

[90] Williams Companies Comments 14; *see also* Society for Corporate Governance Comments 23 (explaining that the Proposed Rules would require more and different disclosures than companies are currently voluntarily providing).

[91] Williams Companies Comments 14.

[92] *Id.* at 15.

[93] *See* Comments of Ceres 48 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132097-302580.pdf; Comments of Persefoni AI Inc. 2 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132512-302998.pdf.

[94] Costs and Benefits of Climate-Related Disclosure Activities by Corporate Issuers and Institutional Investors 8, https://www.sustainability.com/globalassets/sustainability.com/thinking/pdfs/2022/costs-and-benefits-

Yet, the ERM survey does not support the Commission's estimates and is flawed. As an initial matter, public companies' "current average spend" is not indicative of what their average spend would be under the Proposed Rules. As numerous commenters have explained, from virtually every vantage point—from public companies,[95] to auditors,[96] to investors[97]—the rules as proposed require more and different disclosures than companies are currently making. Thus, if the Proposed Rules were adopted as constructed, public companies would spend substantially more than they spend today.[98] ERM's estimate of a "*current* average spend" of $533,000[99] is further evidence that the Commission's estimate of *future* compliance costs of $530,000 is far too low.[100] That is especially true given a fundamental flaw in ERM's analysis. Buried in a footnote, ERM reveals that it calculated average costs by including responses of "zero."[101] That serves only to artificially depress ERM's calculations, as is confirmed by review of the "zero" responses. For example, one respondent "marked zero for 'internal climate-related investment analysis' noting that '[t]his does not reflect hours of FTE time'"[102]—but employee hours *should* be included; the "zero" response is misleading and biases the results. Thus, by its own admission, ERM's estimates are flawed.

The record also reveals other costs that the Commission failed to consider. As explained by the Office of Advocacy of the U.S. Small Business Administration,[103] the Commission's own Small Business Capital Formation Advisory Committee,[104] and the

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of-climate-related-disclosure-activities-by-corporate-issuers-and-institutional-investors-17-may-22.pdf ("ERM Survey").

[95] *See, e.g.*, Society for Corporate Governance Comments 23-43; Williams Companies Comments 14-15; Chamber Comments 61-63.

[96] *See, e.g.*, CAQ Comments 2 ("[W]e think it's important to acknowledge that many companies are voluntarily reporting under different organizational boundaries than proposed. As a result, companies could encounter reporting challenges and burdens as they move toward reporting under a different boundary.").

[97] *See, e.g.*, BlackRock Comments 4 ("[W]e are concerned that certain elements of the proposal, which go beyond or differ from the recommendations of the TCFD, will decrease the effectiveness of the Commission's overarching goal of providing reliable, comparable, and consistent climate-related information to investors."); State Street Comments 5 ("We do not agree with the Commission's proposal to require registrants to include quantitative information about climate-related financial risks and climate-related financial metrics in their financial statements. The introduction of any percentage threshold for such disclosure—particularly calibrated at 1%, on a line-by-line basis—would be a huge operational burden given registrants have to monitor and perform the calculation on a quarterly basis. Such a low threshold would be a significant departure from the well-established U.S. GAAP accounting definition of materiality, and also has no premise in TCFD.").

[98] *See, e.g.*, Williams Companies Comments 14-15.

[99] ERM Survey 5.

[100] Proposing Release, 87 Fed. Reg. at 21,439.

[101] ERM Survey 18 n.20.

[102] *Id.* at 11.

[103] *See* Comments of the Office of Advocacy, U.S. Small Business Administration (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131758-302192.pdf ("Small Business Administration Advocate Comments").

[104] *See* Comments of the SEC Small Business Capital Formation Advisory Committee 1 (July 13, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20134360-304077.pdf (urging the Commission to provide "a more detailed cost-benefit analysis, including the impact that the proposed rules would have on smaller public and private companies").

Ranking Member of the House Committee on Small Business,[105] the Commission failed to adequately consider the toll that the Proposed Rules would take on the United States' small businesses. In the Proposing Release, the Commission stated that the "nature of any benefits or costs associated with the [Proposed Rules] would be similar for large and small entities"[106]—but that is untrue. Small businesses would need to "allocate larger shares of their technological, financial, and staff resources" to come into compliance with the Proposed Rules than larger firms;[107] and many small businesses have less developed climate-disclosure programs than their larger peers. "Representatives from the biotechnology, plastics, and equipment manufacturing industries," for example, have reported to the Office of Advocacy "that small businesses in their industries have not traditionally tracked GHG emissions or other climate-related metrics," and would thus need to build out reporting programs from scratch.[108] This will be a massive undertaking that the Commission must factor into its cost-benefit analysis.

The Commission also must consider the effects the Proposed Rules would have "across the economy," "beyond the costs" imposed directly on public companies.[109] As former SEC chief economists S.P Kothari and Craig Lewis explained, the Commission "does not attempt to understand" those indirect costs and costs on non-public companies.[110] This was a multi-billion-dollar oversight. To plug the hole in the Commission's analysis, and to determine the Proposed Rules' impact on U.S. economic activity more broadly, Professor Matthew Winden employed the Regional Economic Models, Inc.'s ("REMI") model of the U.S. economy.[111] REMI is an "economic and demographic model in wide use throughout federal agencies, individual states, academic institutions, and consulting firms" to "model the impact policy changes [will]

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[105] *See* Comments of Blaine Luetkemeyer, Ranking Member, House Committee on Small Business et al. 2 (July 20, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20134840-305978.pdf ("As the U.S. economy struggles to recover, unleashing a devastating and an unrealistic climate disclosure regime that goes well beyond the publicly traded companies, impacting nearly every small business, is irresponsible. Small firms simply cannot afford the additional burdens of the proposed rule.").

[106] Proposing Release, 87 Fed. Reg. at 21,462.

[107] Small Business Administration Advocate Comments 5.

[108] *Id.*

[109] Kothari & Lewis Comments 7.

[110] *Id.*

[111] Winden Report 4.

have on the economy."[112] Using the Commission's own cost estimates,[113] Professor Winden found that the Proposed Rules would cost the U.S. economy $25 billion in forgone GDP and 200,000 fewer jobs *per year*.[114] To put those numbers in perspective, 200,000 fewer jobs per year would be the equivalent of the U.S. losing an entire month of job creation every year under normal growth.[115] The Commission must consider these major costs and consequences of the Proposed Rules.

Opportunity costs need to enter the equation as well. Money spent on implementing (and enforcing) a vast, mandatory reporting program has to come from somewhere. Companies and the Commission alike would need to reallocate their budgets and priorities—potentially taking funding and effort away from more valuable activities. As Professor Taylor explained, the "Commission's cost-benefit analysis should articulate what specific functions will be diminished as a result of the resources needed to implement the Proposal and should account for the effect of diminished resources in other (non-climate-related) areas on investors and markets."[116] The Commission has not performed this analysis, either with regard to the Commission or with regard to the private sector. For example, studies show that additional compliance spending on public reporting hampers innovation.[117] As companies spend more money on mandatory reporting, they spend less on research and development—a dynamic that could very well slow the type of innovation needed to address climate change.[118] The Commission must factor these opportunity costs into its analysis.

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[112] *Id.*; *see, e.g.*, *DOT Hours of Service of Drivers*, 68 Fed. Reg. 22,456, 22,484 (Apr. 28, 2003) (utilizing the REMI model to "give an approximate picture of the relative effects of the alternatives on economic growth and employment across the country"); *EPA Effluent Limitations Guidelines and Standards for the Construction and Development Point Source Category*, 73 Fed. Reg. 72,562, 72,591 (Nov. 28, 2008) (using the REMI model to "derive a more comprehensive estimate of the potential long-term effects on the national economy"); *Fixing Our Broken Immigration System: The Economic Benefits to Agriculture and Rural Communities*, 2013 WL 3874832, at *2 (White House July 29, 2013) ("According to an economic analysis by the Regional Economic Models, Inc. (REMI), an expanded H-2A visa program … would raise GDP by approximately $2 billion in 2014 and $9.79 billion in 2045."); *Petition of Champlain VT, LLC*, 2016 WL 146200, at *30 (Vt. Pub. Serv. Bd. Jan. 5, 2016) ("REMI offers one of the more sophisticated regional economic models for impact analysis. The model is well-documented, regularly updated, and has been widely used in Vermont and the nation, including use by the [Vermont] Department [of Public Service]."); George I. Treyz, *Regional Economic Modeling: A Systematic Approach to Economic Forecasting and Policy Analysis* (1993) (employing REMI models).

[113] *See* Winden Report 5.

[114] *Id.* at 7.

[115] *Id.*

[116] Taylor Comments 8.

[117] Martin Daks, *Mandated Financial Disclosures Leads to Fewer Innovative Companies*, Chicago Booth Review (June 6, 2022), https://www.chicagobooth.edu/review/mandated-financial-disclosure-leads-fewer-innovative-companies.

[118] The private sector is continually innovating. For example, at the recent White House Summit for Advanced Air Mobility, government officials noted that 20% of CO2 emissions are generated from wildfires and that, on the day of the summit, there were 53 active wildfires in the United States. Unmanned Aircraft Systems (UAS), being developed by the private sector, provide an important step forward in combatting wildfires. Unlike current aircraft and helicopters, whose fire-fighting operations are hampered by smoke, fog and darkness, advances in UAS

B. The Commission overstated the proposal's benefits.

The Commission erred on both sides of the ledger: just as its cost estimates were too low, its benefits estimates were too high. The Chamber has already shown that many investors do not believe that certain significant aspects of the proposal will produce valuable information.[119] The Commission's benefits analysis is flawed in other important respects as well.

The Commission did not adequately evaluate an important aspect of its proposal: a notable plank of the Proposed Rules is the requirement to disclose GHG emissions, which the Commission defended by asserting that "GHG emissions information is important to investment decisions."[120] However, as former SEC chief economist James Overdahl explained, the Commission failed to show that this assertion was actually true.[121] The Commission could, for example, "have employed well-known 'event study' techniques to assess the price or volume responses to climate-related disclosures, but the Commission did not conduct any such analysis, even though event studies are a standard method of assessing financial materiality."[122] Had the Commission conducted this analysis, it would have found that GHG emissions are generally *not* material to investors, and that a major plank of the Commission's proposal would offer little benefits.

Professor Daniel Taylor conducted the study the Commission did not.[123] Professor Taylor is an expert in corporate disclosure and routinely conducts statistical analysis of price and trading data to assess the materiality of disclosures.[124] In this case, Professor Taylor compiled a sample of all Form 8-Ks filed between January 2021 and March 2022 that disclosed GHG emissions.[125] Form 8-K disclosures are "highly visible disclosures," so if *any* GHG disclosures are material, it would be these.[126] Using standard event study techniques, Professor Taylor then analyzed whether there was a statistically significant change in stock price or trading volume in response to the GHG disclosures.[127] His study revealed that no such correlation existed—a powerful indication that "investors do not update their beliefs about value (upward or downward) in light of GHG emissions data."[128] Professor Taylor's study is direct empirical evidence that GHG emissions disclosures—the exact type of disclosures the Commission

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may allow for firefighting against wildfires to operate continuously in a 24-hour period. This innovation will help to mitigate CO_2 emissions and the impact of wildfires on the environment.

[119] *Supra* pp. 5-7.

[120] Proposing Release, 87 Fed. Reg. at 21,373.

[121] *See* Overdahl Report ¶ 34.

[122] *Id.* ¶ 37.

[123] *See* Taylor Comments. Professor Taylor's comments are hereby incorporated by reference.

[124] *Id.* at i.

[125] *Id.* at 4.

[126] *Id.* at 3.

[127] *Id.* at 6.

[128] *Id.*

proposes to require in its Proposed Rules—typically do "not contain material information" for investors.[129] Thus, the Commission's blanket assertion about investor benefits linked to GHG emissions for all public companies is false.

Professor Taylor's findings undermine the Commission's benefits analysis in other ways, as well. Professor Taylor finds "GHG emissions are extremely highly correlated over time (e.g., autocorrelation coefficient of 0.977)."[130] This means that, on average, one year's GHG emissions will be "almost the same" as the prior year's GHG emissions.[131] If that is the case, the Commission can claim little benefit to requiring every company to disclose GHG emissions every year. Such frequent and broad disclosures provide little marginal value.

Indeed, the record contains little evidence on how investors would actually use the disclosures that are proposed to be mandated. Investors confirm that much of the information would, in many respects, not be useful.[132] While some investors state, for example, that they would use the GHG emissions data as a proxy for climate-risk exposure,[133] nothing in the record indicates what additional value the required disclosures would provide beyond what is already readily available (or could be made available through reasonable, less-burdensome alternatives). As Dr. Overdahl explained—and as Professor Taylor confirmed[134]—much climate-related information can be "extracted from publicly-observable information such as industry sector, company size and the like, without a need for company-specific climate reporting."[135] To take just one example, a full "90% of the variation in [a company's] GHG emissions can be inferred from information that is already publicly available," including "industry membership; company size; sales growth; earnings growth; the value of plant, property, and equipment; capital expenditures; and profitability."[136] The record does not indicate what benefit, if any, the remaining 10% would add[137]—a question the Commission does not address.[138]

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[129] *Id.*

[130] *Id.* at 7.

[131] *Id.*

[132] *Supra* pp. 5-7.

[133] *See, e.g.*, Comments of California State Teachers' Retirement System 2 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132337-302902.pdf ("CalSTRS Comments").

[134] *See* Taylor Comments 7.

[135] Overdahl Report ¶ 38.

[136] Taylor Comments 7.

[137] It is important to recall that climate-related information "is just one piece of information among many other factors that inform an investment decision." Overdahl Report ¶ 34. So determining the final 10% of variation in a company's GHG emissions is just a small part of a company's overall valuation, with other factors, such as "cash flows, profitability, industry segment, company size, and the like" informing the analysis. *Id.*

[138] *See* Kothari & Lewis Report 7 ("[T]he Commission does not even attempt to assess the benefits of the Proposal qualitatively, much less quantitatively.")

C. Recent events have already overtaken the Commission's analysis.

Just a few months ago, the Commission proposed another climate-related rule: "Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices."[139] That proposal fundamentally changes the cost-benefit landscape. If adopted, the new proposal would require certain investment funds to make disclosures about their portfolio companies' GHG disclosures[140]—the same types of disclosures that the Commission proposes to require public companies to make here. These rules cannot be considered in a vacuum. The Commission should analyze the costs and benefits of both rules together and then re-open the comment files; only then can the public meaningfully comment on the Commission's interrelated rule proposals.

III. THE RECORD AND RECENT SUPREME COURT PRECEDENT CONFIRM THAT THE COMMISSION LACKS AUTHORITY TO FINALIZE THE RULES AS PROPOSED.

On top of everything else, the rules as proposed suffer from a fatal flaw: the Commission does not have the authority to finalize them. Numerous commenters, including respected legal scholars representing a wide range of perspectives, have detailed the legal flaws in the Proposed Rules.[141] Record evidence and recent Supreme Court precedent confirm those conclusions.

A. The major questions doctrine confirms the Commission's lack of statutory authority.

What the text and structure of the securities laws already establish,[142] the major questions doctrine confirms: the Commission is a financial regulator, not an environmental agency; it does not have the authority to direct environmental policy for American businesses or to resolve major questions relating to climate change.[143]

In *West Virginia v. EPA*, the Supreme Court emphasized a "common sense" principle of statutory interpretation known as the major questions doctrine: Congress does not delegate to agencies highly consequential powers—including the power to resolve "major questions"—in "modest words, vague terms, or subtle devices."[144] To the

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[139] 87 Fed. Reg. 36,654 (June 17, 2022). *See generally* Comments of the U.S. Chamber of Commerce, File No. S7-12-22 (Aug. 12, 2022), https://www.sec.gov/comments/s7-17-22/s71722-20137309-307871.pdf.

[140] *See* 87 Fed. Reg. 36,715-16.

[141] *See, e.g.*, Law and Finance Professors Comments (Apr. 25, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20126528-287180.pdf.

[142] *See* Chamber Comments 25-30.

[143] *See generally* Comments of Attorney General of West Virginia et al. (July 13, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20134128-303943.pdf; Comments of Amb. C. Boyden Gray (July 8, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20133906-303832.pdf.

[144] *West Virginia*, 142 S. Ct. at 2609 (cleaned up).

contrary, when Congress "wishes to assign to an agency decisions of vast economic and political significance," Congress "speak[s] clearly."[145]

The SEC should consider the major questions doctrine before moving forward on a rule. In arguing that the Securities Act and the Exchange Act empower the Commission to impose an incredibly burdensome reporting regime for the disclosure of non-financial climate-related information, regardless of materiality, the Commission claims to have "'discovered in [ ] long-extant statute[s] an unheralded power' representing a 'transformative expansion in its regulatory authority.'"[146] As the Chamber and others have explained, the Commission's authority has traditionally been understood to be limited to requiring the disclosure of information that is both financial in nature and necessary for investors to assess a security's value to avoid fraud or other undue risk.[147] The rules as proposed would turn this regulatory regime on its head. Instead of requiring the disclosure of core financial information, such as a profit and loss statement[148]—information that is "indispensable to any accurate judgment upon the value of a security"[149]—the Commission would require a firm to disclose, every year, among other things, the level of sulfur hexafluoride released, not just by the firm itself, but by the utility provider supplying energy for the firm's operations.[150] There are many reasons to be "skeptic[al]" of the Commission's claim to authority.[151]

The sheer magnitude of the economic consequences of the Proposed Rules provides reason for concern. As the Supreme Court has emphasized, Congress does not lightly confer on an agency an extravagant statutory power to regulate a "significant portion of the American economy"[152] or to require "billions of dollars in spending" by private entities.[153] However, that is the exact power the Commission has claimed in its rules as proposed. By its own estimate, the Commission estimates that the Proposed Rules would hit the economy with $6.38 billion in direct costs per year—and that is not including the 24 million "internal" hours people would spend that the Commission states that companies will need to devote to compliance on an annual basis,[154] nor the burden on non-public companies. There is reason to doubt that a power of this magnitude has gone unrecognized by the Commission since its inception. The better explanation is that the rules as proposed go beyond the SEC's statutory authority as a securities regulator, and that the rules venture into areas within the domain of other

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[145] *Id.* at 2605 (quoting *Util. Air Regulatory Grp. v. EPA*, 573 U.S. 302, 324 (2014)).

[146] *Id.* at 2610 (cleaned up) (quoting *Util. Air*, 573 U.S. at 324).

[147] *See* Chamber Comments 26; API Comments 6.

[148] *See* 15 U.S.C. § 77aa sched. A(26).

[149] *Business and Financial Disclosure Required By Regulation S-K*, 81 Fed. Reg. 23,916, 23,921 (Apr. 22, 2016) (quoting H.R. Rep. No. 73-85, at 3 (1933), 1933 WL 983, at *4).

[150] Proposing Release, 87 Fed. Reg. at 21,375.

[151] *West Virginia*, 142 S. Ct. at 2609 (quoting Util. Air, 573 U.S. at 324).

[152] *Id.* at 2608 (quoting *Util. Air*, 573 U.S. at 324).

[153] *King v. Burwell*, 576 U.S. 473, 485 (2015); *accord West Virginia*, 142 S. Ct. at 2621 (Gorsuch, J., concurring).

[154] *See* Proposing Release, 87 Fed. Reg. at 21,461.

agencies, such as the EPA and the Department of Energy, to which Congress has explicitly assigned the authority to protect the environment and to regulate the energy sector. It bears emphasis that, as discussed in the Chamber's initial comments, EPA already requires reporting of greenhouse gas emissions pursuant to sections 114 and 208 of the Clean Air Act.[155]

The "political significance" of the rules as proposed is cause for additional skepticism.[156] The comment file in this rulemaking is likely among the largest in Commission history. Commenters from trade associations,[157] individual companies,[158] public interest organizations,[159] environmental groups,[160] individual investors,[161] activists,[162] other governmental agencies,[163] state and local governments,[164] and members of Congress,[165] have an opinion on the proper handling of the climate-related issues addressed in the Commission's proposal. However, if Congress intended to empower the Commission to resolve issues of such "'earnest and profound debate'

[155] *See generally* Revisions and Confidentiality Determinations for Data Elements Under the Greenhouse Gas Reporting Rule, 87 Fed. Reg. 36,920, 36,924-25, 37,016 (Jun. 21, 2022) (proposed rule); Mandatory Reporting of Greenhouse Gases, 74 Fed. Reg. 56,260, 56,260, 56,264-65, 56,286-87 (Oct. 30, 2009) (final rule) ("comprehensive reporting rule," "requir[ing] reporting of greenhouse gas emissions from all sectors of the economy").

[156] *West Virginia*, 142 S. Ct. at 2605 (quoting *Util. Air*, 573 U.S. at 324); *accord id.* at 2620 (Gorsuch, J., concurring) (quoting *NFIB v. OSHA*, 142 S. Ct. 661, 665 (2022)).

[157] *See, e.g.*, Chamber Comments; API Comments; NAM Comments.

[158] *See, e.g.*, ConocoPhillips Comments; ExxonMobil Comments.

[159] *See, e.g.*, Comments of the American Enterprise Institute (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132286-302818.pdf.

[160] *See, e.g.*, Sierra Club Comments (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131996-302457.pdf.

[161] *See, e.g.*, Chris Paladino Comments (May 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-294617.htm.

[162] *See, e.g.*, Nora Coyle Comments (Mar. 28, 2022), https://www.sec.gov/comments/s7-10-22/s71022-273590.htm.

[163] *See, e.g.*, Small Business Administration Advocate Comments.

[164] *See, e.g.*, West Virginia Attorney General et al. Comments (June 15, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131409-301574.pdf; California Attorney General et al. Comments (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131887-302340.pdf ("California AG Comments")

[165] *See, e.g.*, Rep. John Rose et al. Comments (May 25, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131193-301363.pdf; Rep. Patrick McHenry et al. Comments (June 15, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131300-301417.pdf; Rep. Kathy Castor et al. Comments (June 28, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20133259-303498.pdf; Sen. Edward J. Markey et al. Comments (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131934-302384.pdf; Sen. Brian Schatz et al. Comments (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131760-302194.pdf; Sen. Jack Reed et al. Comments (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132548-303088.pdf; Sen. Sheldon Whitehouse et al. Comments (Mar. 15, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20126843-287556.pdf; Sen. John Hoeven et al. Comments (June 10, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131027-300525.pdf; Sen. Kevin Cramer et al. Comments (Apr. 5, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131192-301362.pdf; Sen. Joe Manchin III Comments (Apr. 4, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131155-301360.pdf.

across the country," it would have provided clear congressional authorization to that effect.[166]

Congress did not do so. The Commission cites a series of generic disclosure provisions tacked onto statutory sections concerning core financial information,[167] but these provisions do not amount to the "clear congressional authorization" the major questions doctrine demands.[168] Moreover, in claiming the broad climate power that is asserted here, the Commission "cannot ignore"[169] that a number of bills have been introduced in Congress to require climate-related disclosures, but that none have been enacted.[170] That is a "telling" indication that the Commission's "proposed course of action" reflected in the Proposed Rules is beyond the agency's legitimate reach.[171]

B. The record reveals other statutory problems in the Commission's approach.

Comments submitted in support of the Commission's proposal highlight other statutory flaws in the Commission's approach.

At times echoing the Commission, a number of commenters argued that the Commission should adopt the Proposed Rules because the commenters will use the required disclosures to allocate risk across their "portfolios" or to track their "portfolio's progress in meeting [their] goal to achieve a net zero emissions portfolio."[172] These are not valid reasons for adopting the Proposed Rules. As the Chamber has previously explained, at the time Congress enacted the Securities Act and Exchange Act, the concept of materiality was a background assumption already baked into pre-existing common law.[173] As Commissioner Peirce has explained, materiality turns on the importance of information with respect to an investment decision in a particular company,[174] not "in terms of [a] security's effect on [a] portfolio as a whole."[175]

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[166] *Gonzales v. Oregon*, 546 U.S. 243, 267 (2006); *accord West Virginia*, 142 S. Ct. at 2614; *id.* at 2620 (Gorsuch, J., concurring).

[167] *See* Chamber Comments 26-28.

[168] *West Virginia*, 142 S. Ct. at 2609 (quoting *Util. Air*, 573 U.S. at 324).

[169] *Id.* at 2614.

[170] *See, e.g.*, Climate Risk Disclosure Act of 2019, H.R. 3623; Climate Risk Disclosure Act of 2019, S. 2075.

[171] *West Virginia*, 142 S. Ct. at 2620-21 (Gorsuch, J., concurring).

[172] CalSTRS Comments 2-3.

[173] *See* Chamber Comments 29.

[174] *See, e.g.*, *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) ("An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.").

[175] Statement of Comm'r Hester M. Peirce (Mar. 21, 2022), https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321; *accord* Society for Corporate Governance Comments 9 ("A critical aspect of this definition [of materiality] is that it focuses on whether information is important in the context of a reasonable investor's voting or investment determination with respect to a particular company, and not on whether the information may be useful to an investor for other reasons."); CAQ Comments 13 ("'[M]ateriality is an entity-specific aspect of relevance based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity's financial report.'").

Other commenters have urged the Commission to adopt the Proposed Rules on the ground that certain climate-related information, such as GHG emissions, are *always* material,[176] but that reasoning is legally flawed as well and is inconsistent with the comments summarized above from many investors. When the Supreme Court has addressed materiality, it has almost always done so in the context of claims of fraud, in which the concept of materiality is rooted.[177] The Court has never suggested that issuers have a general obligation to provide information of interest to investors, or information which might enable certain market participants to make even more remunerative investments. The concept of materiality itself does not usually lend itself to per se rules; rather, the principles-based approach on which the Commission has previously relied, and on which the MD&A rules are based, is typically the proper, statutorily-required approach.

C. The record confirms the Chamber's First Amendment analysis.

As the Chamber previously explained, the Proposed Rules raise serious constitutional questions.[178] Recent Fifth Circuit precedent highlights the non-delegation concerns raised by the Chamber,[179] but perhaps even more clearly, the record confirms the Chamber's First Amendment analysis.[180]

The First Amendment "prohibits the government from telling people what they must say."[181] The Proposed Rules do exactly that and fail to survive standard strict-scrutiny analysis.[182] Thus, the Proposed Rules cannot stand.

A number of commenters try to avoid this reality by suggesting that the First Amendment does not apply to the financial markets at all,[183] but that is untrue. As Professors Tushnet et al. acknowledge, "the Supreme Court has *never* expressly held that securities regulation falls outside First Amendment coverage."[184] To the contrary, the Court has recognized that "[f]rom 1791 to the present," "the First Amendment has 'permitted restrictions upon the content of speech in [only] a few limited areas,'" including obscenity, defamation, and fraud.[185] The First Amendment has "never

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[176] *See* California Public Employees' Retirement System Comments 19 (June 15, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131391-301546.pdf. *But see* Taylor Comments ii (finding "no evidence" that GHG emissions were material to investors).

[177] *See, e.g.*, *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988); *TSC Indus.*, 426 U.S. at 449.

[178] *See* Chamber Comments 39-43.

[179] *See Jarkesy v. SEC*, 34 F.4th 446, 459-63 (5th Cir. 2022); Chamber Comments 42-43.

[180] *See* Chamber Comments 39-42.

[181] *Rumsfeld v. Forum for Academic & Institutional Rights, Inc.*, 547 U.S. 47, 61 (2006).

[182] *See* Chamber Comments 39-41.

[183] *See, e.g.*, Comments on Rebecca Tushnet 2 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132173-302670.pdf ("Tushnet Comments") ("The regulation of securities-related speech has likewise traditionally been treated as outside the scope of protected speech.").

[184] *Id.* at 3 (emphasis added).

[185] *United States v. Stevens*, 559 U.S. 460, 468 (2010).

'include[d] a freedom to disregard those traditional limitations.'"[186] Commenters suggest that the Proposed Rules may be lawful anyway, because the government has long required disclosures in the financial context.[187] However, the D.C. Circuit has squarely rejected "this form of argumentation: 'Whatever is is right'; an aphorism that would be as final as it is lazy, did not include the troublesome consequence, that nothing that ever was, was wrong."[188] Financial regulation is subject to the same First-Amendment analysis as any other form of regulation.

Turning to the customary First-Amendment analysis, some commenters assert that the Proposed Rules would be subject to a lesser degree of scrutiny, not strict scrutiny. That would not save the rules anyway,[189] but given the record, it is plain that lesser scrutiny does not apply. To the extent the Supreme Court has subjected some compelled disclosures to lesser scrutiny, it has done so, as the Chamber has previously explained,[190] only where the disclosures involved "commercial advertising" and were "purely factual and uncontroversial."[191] Neither standard is met here. The Proposed Rules do not regulate "commercial speech," as some commenters suggest.[192] Commercial speech "does no more than propose a commercial transaction."[193] While "an advertisement" that "refers to a specific product" may qualify as "commercial speech,"[194] the financial disclosures the Proposed Rules seek to regulate are not advertisements. Moreover, the Proposed Rules plainly force companies to wade into controversial issues. The comment file, in significant respects, has already turned into a debate about the likelihood of future climate regulation,[195] the connection between climate-change and certain severe weather events,[196] and much more—all controversial issues (outside the SEC's expertise) on which the Proposed Rules would require companies to speak. The proposal would require anything but a purely factual disclosure of, say, a company's net income, but, rather, would require companies to make public statements regarding subjective judgment calls about future risks[197]—all in an environment where those statements would be used to "stigmatize" companies and

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[186] *Id.*

[187] *See, e.g.*, Tushnet Comments 3-4; Comments of the Knight First Amendment Institute at Columbia University 2-3 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131800-302235.pdf.

[188] *Nat'l Ass'n of Mfrs. v. SEC*, 800 F.3d 518, 521 (D.C. Cir. 2015).

[189] *See* Chamber Comments 41-42.

[190] *See id.* at 41.

[191] *Nat'l Ass'n of Mfrs.*, 800 F.3d at 522-23.

[192] *See, e.g.*, Tushnet Comments 4-5.

[193] *Id.* (quoting *United States v. United Foods, Inc.*, 533 U.S. 405, 409 (2001)).

[194] *Id.* at 5 (quoting *Spirit Airlines, Inc. v. U.S. Dep't of Transp.*, 687 F.3d 403, 412 (D.C. Cir. 2012)).

[195] *Compare, e.g.*, California AG Comments 7 (strict climate regulation is likely), *with* Competitive Enterprise Institute Comments 19 (June 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131635-302011.pdf (strict climate regulation is not likely).

[196] *Compare, e.g.*, California AG Comments 2, 6 (wildfires are attributable to climate change and are increasing) *with* Ambassador C. Boyden Gray Comments 44-45 (June 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132160-302652.pdf (there is no robust evidence that wildfires are increasing).

[197] *See, e.g.*, Proposing Release, 87 Fed. Reg. at 21,345.

attempt to "shape their behavior."[198] The First Amendment does not allow such compulsion.

* * *

The Chamber stands ready to work with the Commission to improve the Proposed Rules. As we have repeatedly indicated, the Chamber supports policies that provide for the disclosure of material, climate-related information as necessary to protect investors. However, any such policy must be informed by the best science and a careful analysis of the economic tradeoffs. As this letter details, the rules as proposed miss the mark. In our initial comments, we laid out a more practical, durable approach for the Commission to follow, and we urge the Commission to take it. American businesses are already doing significant work in this space, and the Commission can work with them to build on those efforts.

Sincerely,

Tom Quaadman
Executive Vice President
Center for Capital Markets
Competitiveness
U.S. Chamber of Commerce

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[198] *Nat'l Ass'n of Mfrs.*, 800 F.3d at 530.

Exhibit A

OFFICE OF
INSPECTOR GENERAL

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

M E M O R A N D U M

October 13, 2022

TO: Gary Gensler, Chair

FROM: Nicholas Padilla, Jr., Acting Inspector General

SUBJECT: *The Inspector General's Statement on the SEC's Management and Performance Challenges, October 2022*

The Reports Consolidation Act of 2000 requires the U.S. Securities and Exchange Commission's (SEC or agency) Office of Inspector General to identify and report annually on the most serious management and performance challenges facing the SEC.[1] In deciding whether to identify an area as a challenge, we consider its significance in relation to the SEC's mission; its susceptibility to fraud, waste, and abuse; and the SEC's progress in addressing the challenge. We compiled the attached statement on the basis of our past and ongoing audit, evaluation, investigation, and review work; our knowledge of the SEC's programs and operations; and information from the U.S. Government Accountability Office and SEC management and staff. We reviewed the agency's response to prior years' statements, and assessed its efforts to address recommendations for corrective action related to persistent challenges. We previously provided a draft of this statement to SEC officials and considered all comments received when finalizing the statement. As we begin fiscal year 2023, we again identified the following as areas where the SEC faces management and performance challenges to varying degrees:

- Meeting Regulatory Oversight Responsibilities
- Protecting Systems and Data
- Improving Contract Management
- Ensuring Effective Human Capital Management

Information on the challenge areas and the corresponding audit, evaluation, investigation, or review work are discussed in the attachment. If you have any questions, please contact me or Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations, and Special Projects.

[1] Pub. L. No. 106-531, § 3a, 114 Stat. 2537-38 (November 22, 2000).

Attachment

cc: Prashant Yerramalli, Chief of Staff, Office of Chair Gensler
Heather Slavkin Corzo, Policy Director, Office of Chair Gensler
Kevin Burris, Counselor to the Chair and Director of Legislative and Intergovernmental Affairs
Scott Schneider, Counselor to the Chair and Director of Public Affairs
Ajay Sutaria, GC Counsel, Office of Chair Gensler
Phillip Havenstein, Operations Counsel, Office of Chair Gensler
Hester M. Peirce, Commissioner
Benjamin Vetter, Counsel, Office of Commissioner Peirce
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Jaime Lizárraga, Commissioner
Laura D'Allaird, Counsel, Office of Commissioner Lizárraga
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U.S. SECURITIES AND
EXCHANGE COMMISSION

October 13, 2022

OFFICE OF
INSPECTOR GENERAL

The Inspector General's Statement on the SEC's Management and Performance Challenges

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ABBREVIATIONS

CAT	Consolidated Audit Trail
CISA	Cybersecurity and Infrastructure Security Agency
COVID-19	Coronavirus Disease 2019
Enforcement	Division of Enforcement
EXAMS	Division of Examinations
FISMA	Federal Information Security Modernization Act of 2014
FY	fiscal year
GAO	U.S. Government Accountability Office
IT	information technology
Kearney	Kearney & Company, P.C.
LH	labor-hour
NAICS	North American Industry Classification System
OA	Office of Acquisitions
OASB	Office of the Advocate for Small Business Capital Formation
OHR	Office of Human Resources
OIAD	Office of the Investor Advocate
OIG	Office of Inspector General
OIT	Office of Information Technology
OMB	Office of Management and Budget
OMWI	Office of Minority and Women Inclusion
RIA	registered investment adviser
SAM	System for Award Management
SEC, agency, or Commission	U.S. Securities and Exchange Commission
SLC	Service Level Commitment
T&M	time-and-materials
TCR	tips, complaints, and referrals
TRENDS	Tracking and Reporting Examination National Documentation System
WTTS	Workforce Transformation and Tracking System

CHALLENGE: Meeting Regulatory Oversight Responsibilities

The U.S. Securities and Exchange Commission (SEC, agency, or Commission) is charged with overseeing about $118 trillion in annual securities trading on the United States equity markets and the activities of more than 29,000 registered entities, including investment advisers, mutual funds, exchange-traded funds, broker-dealers, municipal advisors, and transfer agents. The agency also oversees 24 national securities exchanges, 95 alternative trading systems, 10 credit rating agencies, and 7 active registered clearing agencies, as well as the Public Company Accounting Oversight Board, the Financial Industry Regulatory Authority, the Municipal Securities Rulemaking Board, the Securities Investor Protection Corporation, and the Financial Accounting Standards Board. In addition, the SEC is responsible for selectively reviewing the disclosures and financial statements of more than 7,900 reporting companies.

As in previous years, agency management and the Office of Inspector General (OIG) recognize that the SEC's ability to meet its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation becomes more challenging as the markets, products, and participants within the SEC's purview increase in size, number, and complexity. The SEC's strategic plan establishes goals and initiatives to ensure that the agency focuses on the needs of investors, as well as its ability to adapt to rapidly changing markets, new technology, innovation, and evolving global risks.[1]

We describe below the challenges of (1) managing resources while meeting the SEC's regulatory agenda; (2) keeping pace with changing markets and innovations; and (3) leveraging technology and analytics to meet mission requirements and respond to significant developments and trends.

Managing Resources While Meeting the Regulatory Agenda

Rulemaking is the process by which federal agencies implement legislation passed by Congress and signed into law by the President and, as part of its regulatory oversight responsibilities, the SEC creates or updates rules (also referred to as "regulations"). Legislation, such as the Securities Act of 1933,[2] the Securities Exchange Act of 1934,[3] the Investment Company Act of 1940,[4] the Sarbanes-Oxley Act of 2002,[5] and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank)[6] provide the framework for the SEC's oversight of the securities markets. The rulemaking process involves several steps that are designed to give the public an opportunity to provide their opinions on whether the agency should adopt or adopt with modifications a proposed rule. According to the Administrative Procedure Act,[7] agencies must follow an open process when issuing regulations, including publishing a

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[1] On October 11, 2018, the SEC issued a strategic plan for fiscal years 2018 to 2022. On August 24, 2022, the SEC released for public comment a draft strategic plan for fiscal years 2022 to 2026. As of the date of this document, the new strategic plan had not been finalized.

[2] Pub. L. 73-22, 48 Stat. 74 (May 27, 1933).

[3] Pub. L. 73-291, 48 Stat. 881 (June 6, 1934).

[4] Pub. L. 76-768, 54 Stat. 789 (August 22, 1940).

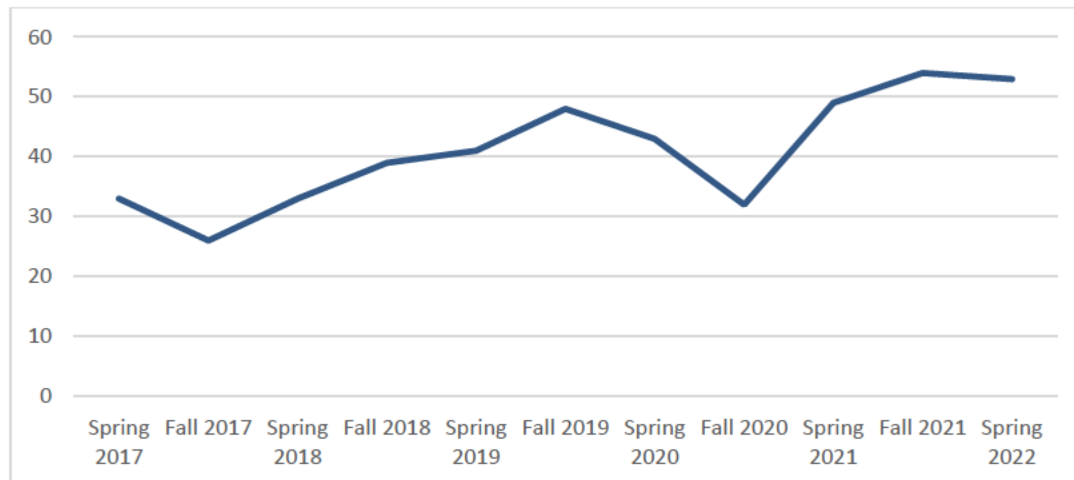
[5] Pub. L. 107-204, 116 Stat. 745 (July 30, 2002).

[6] Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010).

[7] Pub. L. 79-404, 60 Stat. 237, 239 (June 11, 1946).

statement of rulemaking authority in the Federal Register for all proposed and final rules. Moreover, each fall and spring, regulatory agencies are required to publish a regulatory agenda,[8] which is how agencies announce future rulemaking activities and update the public on pending and completed regulatory actions. As Figure 1 shows, the number of rulemaking activities on the SEC's regulatory agenda between spring 2017 and spring 2022 increased overall.

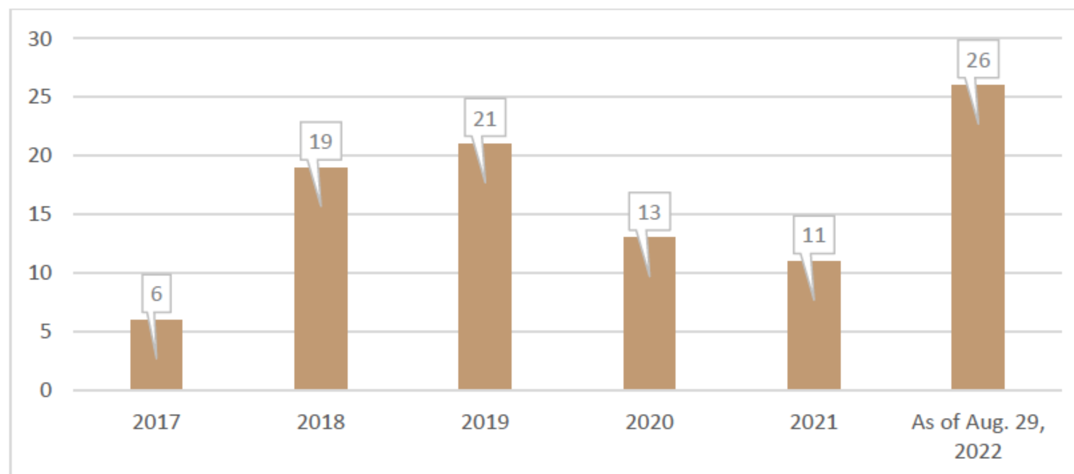
FIGURE 1. Number of Rulemaking Activities on the SEC's Regulatory Agenda (Spring 2017 – Spring 2022)



Source: OIG-generated based on data from the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs (https://www.reginfo.gov/public/ last accessed on September 8, 2022).

Additionally, in only the first 8 months of 2022, the SEC proposed 26 new rules, which was more than twice as many new rules as proposed the preceding year and more than it had proposed in each of the previous 5 years. (See Figure 2.)

FIGURE 2. Number of New SEC Rules Proposed (2017 – August 2022)



Source: OIG-generated based on data from the SEC (https://www.sec.gov/rules/proposed.shtml, as of August 29, 2022).

[8] Pub. L. 96-354, 94 Stat. 1166 (September 19, 1980).

We met with managers from the SEC's divisions of Trading and Markets, Investment Management, Corporation Finance, and Economic and Risk Analysis, some of whom raised concerns about increased risks and difficulties managing resources and other mission-related work because of the increase in the SEC's rulemaking activities. For example, some reported an overall increase in attrition (discussed further on page 21 of this document) and difficulties hiring individuals with rulemaking experience. In the interim, managers reported relying on detailees, in some cases with little or no experience in rulemaking. Others told us that they may have not received as much feedback during the rulemaking process, either as a result of shortened timelines during the drafting process or because of shortened public comment periods. Although no one we met with identified errors that had been made, some believed that the more aggressive agenda—particularly as it relates to high-profile rules that significantly impact external stakeholders—potentially (1) limits the time available for staff research and analysis, and (2) increases litigation risk. Finally, some managers noted that fewer resources have been available to complete other mission-related work, as rulemaking teams have borrowed staff from other organizational areas to assist with rulemaking activities.

Furthermore, the SEC's rulemaking function relies on coordination and collaboration amongst several agency divisions and offices and, as we reported in our October 2021 statement on the SEC's management and performance challenges, agency leaders should take measures to strengthen communication and coordination across SEC components. Indeed, the SEC's fiscal year (FY) 2021 Agency Financial Report states that the SEC values teamwork and recognizes "that success depends on a skilled, diverse, coordinated team committed to the highest standards of trust, hard work, cooperation, and communication."[9] Additionally, the SEC's strategic plan identifies teamwork of the SEC's staff and its leaders, along with other elements, as the "foundation" of the agency.[10] To support the strategic plan's Goal 3 – "Elevate the SEC's performance by enhancing our analytical capabilities and human capital development" – the SEC committed to the following initiative:

> *3.5 Promote collaboration within and across SEC offices to ensure we are communicating effectively across the agency, including through evaluation of key internal processes that require significant collaboration.*[11]

In response to our October 2021 statement on the SEC's management and performance challenges, agency management re-affirmed its commitment to promoting effective and collaborative information-sharing across the agency.[12] Management's continued attention to strengthening communication and coordination across divisions and offices is instrumental to (1) preventing unintentional negative impacts to divisions and offices when modifying agency-wide processes, (2) maintaining positive trends in employee views on collaboration,[13] and (3) achieving the goals established in the SEC's strategic plan.

[9] U.S. Securities and Exchange Commission, *Fiscal Year 2021 Agency Financial Report*; November 15, 2021.

[10] U.S. Securities and Exchange Commission, *Strategic Plan Fiscal Years 2018-2022*, Goal 3; October 11, 2018.

[11] The agency's draft strategic plan for FY 2022 to FY 2026 (Goal 3) similarly emphasizes the importance of continually strengthening and promoting collaboration within and across SEC offices.

[12] U.S. Securities and Exchange Commission, *Fiscal Year 2021 Agency Financial Report*; November 15, 2021.

[13] With regards to the 2021 Federal Employee Viewpoint survey, 71 percent of agency respondents agreed that SEC managers promote communication among different work units (a 4 percentage point decrease from the previous year). In addition, 75 percent of agency respondents agreed that SEC managers support collaboration across work units to accomplish work objectives (a 3 percentage point decrease from the previous year).

Despite management's commitment to cross-functional collaboration and communication, personnel we met with (including those from the Division of Economic and Risk Analysis, the Division of Enforcement [Enforcement], and the Office of the General Counsel, among others) identified coordination and communication as a persistent challenge in the rulemaking process, particularly given potential overlaps in jurisdiction and differences in opinions. We reported on such challenges in a management letter issued in September 2022.[14] Specifically, we reported that, around December 2021, the Office of the Chair modified the process for coordinating internal reviews of draft agency rules, resulting in the Office of the Advocate for Small Business Capital Formation (OASB)[15] and the Office of the Investor Advocate (OIAD)[16] receiving only fatal flaw drafts of proposed rules[17] for a brief period of time.[18] This change was not formally documented or communicated, and the then-directors of OASB and OIAD were not aware of the change until after it took effect. All parties involved acknowledged that the Office of the Chair has the authority to direct the agency's rulemaking process. Moreover, OASB and OIAD personnel stated that they were generally able to carry out their responsibilities. However, changes to internal processes likely to impact OASB's and OIAD's review and comment related to draft proposed agency rules may unintentionally limit their ability to fulfill their advocacy roles and carry out office functions, and may hinder effective collaboration and information sharing across the agency.[19] Although we did not make any formal recommendations, we encouraged the Office of the Chair to consider, as a management practice, notifying OASB and OIAD before future changes to the rulemaking process, potentially impacting these offices, are implemented.

Keeping Pace With Changing Markets and Innovations

As securities markets continue to grow in size and complexity and technological advancements contribute to changes in how markets operate, the SEC's ability to remain an effective regulator requires that it continuously monitor the market environment, and as appropriate, adjust and modernize its expertise, rules, regulations, and oversight tools and activities.

Technological advancements and commercial developments continue to change how our securities markets operate and spur the development of new products.

Source: U.S. Securities and Exchange Commission, Fiscal Year 2021 Agency Financial Report; November 15, 2021.

Securities markets have experienced significant growth in recent years, with a record number of families holding direct and indirect stocks, and (as Table 1 shows) a record number of registered investment

[14] U.S. Securities and Exchange Commission, Office of Inspector General, *Final Management Letter: Changes to the Internal Review Process for Proposed Rules May Impact the Office of the Advocate for Small Business Capital Formation and the Office of the Investor Advocate* (September 29, 2022).

[15] The SEC Small Business Advocate Act of 2016 (Pub. L. No. 114-284, 130 Stat. 1447 [December 16, 2016]) requires OASB to advocate for small businesses and their investors by, among other things, analyzing the potential impact on small businesses and small business investors of Commission-proposed regulations that are likely to have a significant economic impact on small businesses and small business capital formation.

[16] Pursuant to Section 915 of Dodd-Frank and codified at Section 4(g) of the Exchange Act of 1934, OIAD is required to analyze the potential impact on investors from proposed rules and regulations of the Commission.

[17] A fatal flaw draft is the last draft circulated before the Commission votes on a proposed rule, often only a few days before the vote. It is typically the final version of the rule, to be reviewed only for critical issues, and will not incorporate policy revisions.

[18] According to agency officials, the change in the rulemaking process was reversed in early 2022.

[19] Other OIG work completed in FY 2022 also highlighted areas where collaboration and communication within the SEC could be improved. *See* U.S. Securities and Exchange Commission, Office of Inspector General, *The SEC Can Improve in Several Areas Related to Hiring* (Report No. 572; February 28, 2022).

TABLE 1. Number of RIAs (FY 2018 – July 2022)

Date	Number of RIAs
Beginning of FY 2018	12,616
Beginning of FY 2019	13,222
Beginning of FY 2020	13,458
Beginning of FY 2021	13,810
Beginning of FY 2022	14,719
As of July 1, 2022	15,167

Source: OIG-generated based on data provided by EXAMS.

advisers (RIA), which represent the largest portion of the registered firm population overseen by the SEC's Division of Examinations (EXAMS).

In addition, as noted in a March 2022 White House fact sheet accompanying a new Executive Order, the crypto market is highly concentrated and has seen explosive growth in recent years, surpassing a $3 trillion market cap last November, up from $14 billion just 5 years ago.[20] The new Executive Order outlines a national policy for digital assets to include protecting consumers, investors, and businesses.[21]

In recognition of the need to protect investors and respond to the changing environment, the SEC is taking steps to address the increasing risks related to the crypto market such as (1) getting platforms registered and regulated much like exchanges; (2) coordinating with the Commodity Futures Trading Commission on determining how best to regulate platforms where trading of securities and non-securities is intertwined; and (3) identifying how to work with platforms and best ensure the protection of customers' assets. Additionally, the SEC recently announced the allocation of 20 additional positions for Enforcement's Crypto Assets and Cyber Unit, nearly doubling its size, as the volatile and speculative crypto marketplace has attracted tens of millions of American investors and traders.[22] As the SEC continues to increase its workforce and take other steps to protect investors, there is uncertainty about which agency—the SEC or the Commodity Futures Trading Commission—will have regulatory oversight responsibilities over the crypto market and what legal tools and authorities will be available. Such uncertainty can unsettle market factors and elevate risk for Main Street investors.

EXAMS also recognizes and strives to adapt to changing market factors. In its 2022 Examinations Priorities,[23] EXAMS noted significant focus areas that pose unique or emerging risks to investors or the markets, such as environmental, social, and governance investing; standards of conduct issues for broker-dealers and RIAs; and emerging technologies and crypto-assets, among others. EXAMS will continue to conduct examinations of broker-dealers and RIAs, many of which use developing financial technologies, and market participants engaged with crypto-assets, with a continued need to optimize its limited resources as it works to improve and promote compliance with regulatory requirements.

In a report we issued in January 2022, we noted steps EXAMS took to optimize its limited resources and increase efficiency and effectiveness, to include the following:

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[20] The White House (March 9, 2022). *FACT SHEET: President Biden to Sign Executive Order on Ensuring Responsible Development of Digital Assets.*

[21] *Executive Order on Ensuring Responsible Development of Digital Assets*; March 9, 2022.

[22] Gurbir S. Grewal Director, Division of Enforcement, Testimony on "Oversight of the SEC's Division of Enforcement" Before the United States House of Representatives Committee on Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets; July 21, 2022.

[23] U.S. Securities and Exchange Commission, *Division of Examinations 2022 Examination Priorities;* March 30, 2022.

- Moved its Tracking and Reporting Examination National Documentation System (TRENDS) to a new, cloud-based platform, which is expected to improve the system's adaptability, workflow capability, and data standardization;
- Launched a new examination support service, which among other things, assists examiners with data staging, cleansing, transformation, enrichment, and analysis; and
- Advanced its centralized asset verification program, which, according to EXAMS management, has enabled growth in the number of exams involving asset verification, as well as the amount of assets verified during these exams.[24]

Although EXAMS took these and other steps to increase efficiencies, we also reported that controls over the RIA examination planning processes needed improvement. Specifically, we found some staff commenced substantive RIA examination procedures before management approved the examination pre-fieldwork phase, and staff did not always consistently maintain key documents in TRENDS. In addition, we were unable to find documentation indicating that an examination supervisor notified registrants of non-EXAMS staff participation, as required.

We recommended that management (1) develop controls that help ensure timely supervisory approval of an examination's pre-fieldwork phase; (2) reiterate to examination staff and management the importance of and requirements for timely supervisory approval of each examination's pre-fieldwork phase; and (3) review examination documentation requirements regarding communications with registrants to ensure they are clear and examiners maintain such documentation in a consistent manner, and update examination policies as needed. Management concurred with our recommendations, which, as of the date of this document, are open and will be closed upon completion and verification of corrective action taken.

As we begin FY 2023, we will continue to monitor agency plans and actions to improve controls around supervisory approval of examinations' pre-fieldwork phase and documentation requirements regarding communications with registrants.

Use of Technology and Analytics to Meet Mission Requirements and Respond to Significant Developments and Trends

As we reported in previous years, agency management and the OIG continue to recognize the importance of technology and analytics in the SEC's ability to efficiently and effectively meet mission requirements and respond to significant developments and trends in the evolving capital markets. The SEC's strategic plan (Goals 2 and 3, and related strategic initiatives) reflects the importance of these efforts.[25] Additionally, according to the SEC's FY 2023 Congressional Budget Justification, the economy's reliance on the rapidly changing field of data analytics is growing, and the Commission needs to adjust by

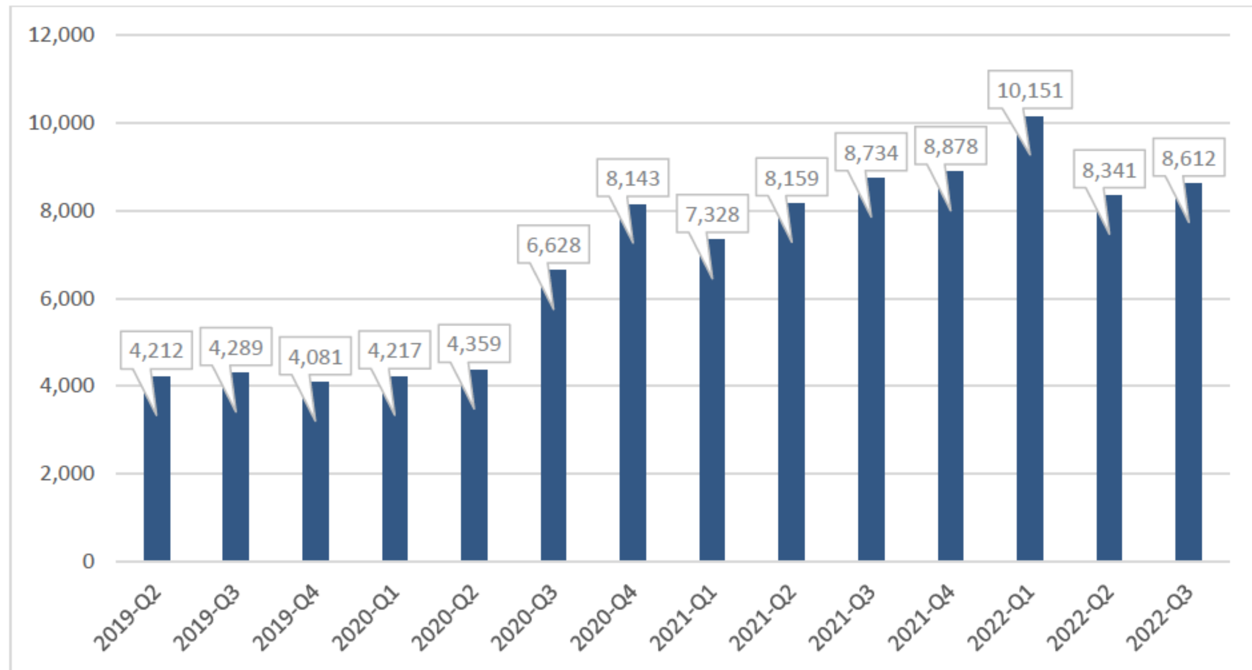
[24] U.S. Securities and Exchange Commission, Office of Inspector General, *Registered Investment Adviser Examinations: EXAMS Has Made Progress To Assess Risk and Optimize Limited Resources, But Could Further Improve Controls Over Some Processes* (Report No. 571, January 25, 2022).

[25] The agency's draft strategic plan for FY 2022 to FY 2026 (Goals 1, 2, and 3) similarly emphasizes that the SEC must effectively use technology and data.

re-evaluating how it assesses data and incorporates machine learning and deep learning into its examination and enforcement functions.[26]

Notably, Enforcement analyzes a massive volume of data each year including thousands of tips, complaints, and referrals (TCR) related to allegations of possible violations of the federal securities laws or conduct that poses a risk of harm to investors. Enforcement receives TCRs from the public, self-regulatory organizations, other federal and local agencies, and other entities. As Figure 3 shows, the SEC received a record number of TCRs in the first quarter of 2022.

FIGURE 3. Number of TCRs Received (2019, Quarter 2 – 2022, Quarter 3)



Source: OIG-generated based on data provided by Enforcement's Office of Market Intelligence. FY 2021 totals exclude 12,935 TCRs related to the market volatility event, and totals exclude TCRs submitted as test TCRs to validate the system.

In an evaluation report we issued in February 2021, we reported on the SEC's process to plan and develop a future TCR system and we recommended actions to further strengthen the SEC's TCR program and TCR system management and development.[27] We also encouraged management to monitor the upward trend in TCRs, and determine whether additional actions, resources, or staff allocations were needed. Management has since taken actions to address our recommendations and is working to implement a new TCR management system. According to Enforcement's Office of Market Intelligence, the organization implemented a risk-based process to assess and triage TCRs through the use of analytics and automation, which will be incorporated into the new TCR system. In planning for the new system, the agency continues to assess the application and data, conduct market research on potential technologies, and prepare a strategic plan.

[26] U.S. Securities and Exchange Commission, *Fiscal Year 2023 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2021 Annual Performance Report*; March 28, 2022.

[27] U.S. Securities and Exchange Commission, Office of Inspector General, *The SEC Can Further Strengthen the Tips, Complaints, and Referrals Program* (Report No. 566; February 24, 2021).

Although we acknowledge the Office of Market Intelligence's use of analytics and implementation of a new TCR system, the TCR program—along with many other critical programs and systems within the SEC—must rely on personnel to correctly input data into systems. For example, with the handling of TCRs, agency staff from divisions and offices must be sure to correctly transfer TCRs to the Office of Market Intelligence. As noted in a management letter our office issued in May 2021, we identified 2 matters of 3,303 we reviewed that were not transferred from the Office of Investor Education and Advocacy to the TCR system.[28] Moreover, in FY 2022, we investigated the former SEC Ombudsman and found that the former Ombudsman failed to enter TCRs on investor matters received by the Office of the Ombudsman that warranted entry, as required by the SEC's *Commission-Wide Policies and Procedures for Handling TCRs*. Specifically, the agency's policy and corresponding administrative regulation[29] state that all SEC staff are responsible for entering TCRs into the TCR system or forwarding them to a TCR point of contact within specified timeframes, and "when in doubt, staff should err on the side of entering a TCR." Instead, the former Ombudsman directed staff within the Office of the Ombudsman to refer investors to enter their own TCRs on matters related to alleged securities law violations or fraud. As previously noted, through the TCR program, the SEC receives and responds to credible allegations of possible violations of the federal securities laws. Improper handling of TCRs may impede the SEC's ability to timely and effectively protect investors.

Improper handling of TCRs may impede SEC investor protection efforts

Ongoing and Anticipated OIG Work. In FY 2023, we will continue to assess how well the SEC effectively and efficiently meets its regulatory oversight responsibilities. We will follow-up on open recommendations intended to improve controls around the examination program, and we will complete an ongoing audit of the SEC's whistleblower program and an evaluation of Enforcement's efforts and goals to expedite investigations, where possible and appropriate. Finally, we will initiate a review of the SEC's oversight of entity compliance with Regulation Best Interest and Form CRS.[30]

[28] U.S. Securities and Exchange Commission, Office of Inspector General, *Final Management Letter: Actions May Be Needed To Improve Processes for Receiving and Coordinating Investor Submissions* (May 24, 2021).

[29] U.S. Securities and Exchange Commission, SEC Administrative Regulation 3-2, *Tips, Complaints, and Referrals (TCR) Intake Policy*; November 29, 2016.

[30] Regulation Best Interest, the new Form CRS Relationship Summary, and two separate interpretations under the Investment Advisers Act of 1940 are part of a package of rulemakings and interpretations adopted by the Commission on June 5, 2019, to enhance and clarify the standards of conduct applicable to broker-dealers and investment advisers, help retail investors better understand and compare the services offered and make an informed choice of the relationship best suited to their needs and circumstances, and foster greater consistency in the level of protections provided by each regime, particularly at the point in time that a recommendation is made.

CHALLENGE: Protecting Systems and Data

Because the work of the SEC touches nearly every part of the nation's capital markets and advances international regulatory, supervisory, and enforcement cooperation, it is critically important to protect agency systems and data. In 2022, the Administration along with the Cybersecurity and Infrastructure Security Agency (CISA) warned that malicious cyber activity against the United States homeland could have an impact on our nation's organizations, and threats are more pronounced because of international events.[31] The U.S. Government Accountability Office (GAO) also reported that cyber risks are growing, and cyberattacks targeting critical infrastructure—including financial services—could affect entire systems and result in catastrophic financial loss.[32] Individuals or groups with malicious intentions attempt to intrude into agency systems to obtain sensitive information, commit fraud and identity theft, disrupt agency operations, or launch attacks against other systems and networks. Even in the absence of those intentions, inadequate safeguards can lead to the unauthorized disclosure, modification, use, or disruption of information that can compromise the integrity of agency operations. Therefore, the SEC must continue to take steps to safeguard the security, integrity, and availability of its information systems and sensitive data.

SEC management has recognized that "efficient, effective, and responsible use of data and information technology (IT) is a crucial focus of the agency."[33] In its FY 2023 Congressional Budget Justification, the agency requested additional funds for IT initiatives to expand progress in key areas such as cybersecurity, secure cloud infrastructure, and data management. CISA is also continuing to publish guidance to make the federal civilian workforce more resilient to cyber threats.

The SEC's FY 2023 budget request addresses plans to hire additional personnel within the Office of Information Technology (OIT) who would provide expertise in cloud computing; strengthen security controls, policies, and procedures; and help the agency comply with requirements mandated in a recent Executive Order to move the agency toward a "zero trust" approach to cybersecurity.[34] Additionally, as we describe further below, opportunities exist to better protect SEC systems and data, including by evaluating and addressing the underlying cause(s) and impact of a material weakness related to insufficient user access controls, strengthening the agency's cybersecurity posture, and continuing to mature its information security program.

A critical element of the SEC's strategy is to protect the agency's two most important assets, its people and its data, both of which are vital to executing the SEC's mission.

Source: U.S. Securities and Exchange Commission, Fiscal Year 2021 Agency Financial Report; November 15, 2021.

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[31] The White House (March 21, 2022). *FACT SHEET: Act Now to Protect Against Potential Cyberattacks;* and CISA, *Shields Up* website (https://www.cisa.gov/shields-up, last accessed on September 9, 2022).

[32] U.S. Government Accountability Office, *CYBER INSURANCE Action Needed to Assess Potential Federal Response to Catastrophic Attacks* (GAO-22-104256, June 2022).

[33] U.S. Securities and Exchange Commission, *Fiscal Year 2023 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2021 Annual Performance Report;* March 28, 2022.

[34] Executive Order 10460, *Improving the Nation's Cybersecurity*; May 12, 2021.

Evaluating and Addressing the Cause(s) and Impact of a Material Weakness Related to Insufficient User Access Controls

In its FY 2021 Agency Financial Report, the SEC disclosed a newly discovered material weakness associated with lack of controls related to user access to a Commission system. Specifically, the SEC reported that the information tracking and document storage system for documents related to recommendations for certain Commission actions did not include controls sufficient to prevent access by staff who should not view such documents.[35] This is important because, while the Commission has both investigatory and adjudicatory responsibilities, the Administrative Procedure Act contemplates the separation of those functions among the agency staff who assist the Commission in each.[36] Therefore, agency employees who are investigating or prosecuting an adjudicatory matter before the Commission generally may not participate in the Commission's decision-making in that or a factually related matter. However, the identified user access control deficiency did not ensure the necessary separation of the Commission's enforcement and adjudicatory functions for administrative adjudications. The SEC's FY 2021 Agency Financial Report further noted that, while a review of the affected system was underway, action had been taken to remediate the control deficiency.

Then, in April 2022, the Commission released a statement that provided additional information about the control deficiency, along with the results of the SEC's review of the impact of the control deficiency on two ongoing federal court litigations: *SEC v. Cochran*, No. 21-1239 (S. Ct.), and *Jarkesy v. SEC*, No. 20-61007 (5th Cir.). The statement reads, in part:

> *The Commission has determined that, for a period of time, certain databases maintained by the Commission's Office of the Secretary were not configured to restrict access by Enforcement personnel to memoranda drafted by Adjudication staff. As a result, in a number of adjudicatory matters, administrative support personnel from Enforcement, who were responsible for maintaining Enforcement's case files, accessed Adjudication memoranda via the Office of the Secretary's databases. Those individuals then emailed Adjudication memoranda to other administrative staff who in many cases uploaded the files into Enforcement databases.*[37]

With respect to these two matters, according to the Commission's statement, agency enforcement staff had access to certain adjudicatory memoranda, but this access "did not impact the actions taken by the staff investigating and prosecuting the cases or the Commission's decision-making in the matters."

The SEC is continuing to review and has not yet disclosed the full impact the internal control deficiency caused by the insufficient user access controls had on the remaining affected adjudicatory matters. The Commission's statement indicated that the agency's review team will continue to assess the remaining

[35] U.S. Securities and Exchange Commission, *Agency Financial Report Fiscal Year 2021*; November 15, 2021.

[36] Pub. L. 79-404 60 Stat. 240 (June 11, 1946).

[37] U.S. Securities and Exchange Commission, *Commission Statement Relating to Certain Administrative Adjudications*; April 5, 2022.

affected adjudicatory matters, and additional findings will be published "in the near future." Furthermore, the Commission stated that, going forward, it will work to better protect the separation of adjudicatory work-product within the system for administrative adjudications, including by enhancing systems for controlling access to Adjudication memoranda.

In conjunction with the ongoing FY 2022 evaluation of the SEC's implementation of the Federal Information Security Modernization Act of 2014 (FISMA), we assessed the SEC's incident response related to this control deficiency, and found that the agency generally complied with applicable requirements. Nonetheless, the OIG will continue to independently review the control deficiency to understand and, as appropriate, report the full impact of this material weakness. We also will continue to monitor the agency's progress towards redesigning or replacing the systems in question.

Strengthening the SEC's Cybersecurity Posture

The SEC is aware that protecting information systems and data is a priority, as cyber actors may exploit poor security configurations (either misconfigured or left unsecured), weak controls, and other poor cyber hygiene practices to gain initial access or as part of other tactics to compromise a system. In FY 2022, the SEC's OIT made progress by taking corrective action sufficient to close one cybersecurity-related recommendation from a previous OIG report.[38] However, as Table 2 summarizes, work remains to close other cybersecurity-related recommendations we issued before FY 2021.

TABLE 2. Certain Open Cybersecurity Recommendations as of October 2022*

Report Title	Date Issued	Recommendation(s)
Opportunities Exist To Improve the SEC's Management of Mobile Devices and Services (Report No. 562)	9/30/20	Recommendations 5 and 6 Current estimated corrective action completion date: February 2023

Source: OIG-generated based on recommendation tracking and follow-up records.

** This does not include recommendations issued in connection with mandated annual information security evaluations, which we discuss on pages 13 and 14 of this document.*

Recognizing there is more work to be done, in FY 2023, the SEC plans to increase efforts to:

- Support the implementation of security services within agency-selected cloud capabilities.
- Enhance identity, access, and privilege management protocols and operations across platforms.
- Modernize security operations capabilities focusing on automation, integration of shared services and experts through managed services, and proactive capabilities to identify threats.
- Continue the implementation of a secure application development structure across all agency development teams and projects.[39]

[38] U.S. Securities and Exchange Commission, Office of Inspector General, *The SEC Can More Strategically and Securely Plan, Manage, and Implement Cloud Computing Services* (Report No. 556; Nov. 7, 2019), Recommendation 3.

[39] U.S. Securities and Exchange Commission, *Fiscal Year 2023 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2021 Annual Performance Report;* March 28, 2022.

The SEC also has an open recommendation from a recent GAO report on assessing security controls related to telework. The CARES Act of 2020 contains a provision for GAO to monitor the federal response to the pandemic. Specifically, GAO was asked to examine federal agencies' preparedness to support expanded telework. In September 2021, GAO issued its report, which contained two recommendations for the SEC regarding the assessment and documentation of relevant IT security controls and enhancements.[40] Although the agency's comments to the report state that the SEC expected to complete actions to remediate the recommendations by the second quarter of FY 2022, as of September 15, 2022, remediation work was still underway for the recommendation related to ensuring that the agency documents relevant IT security controls and enhancements in the security plan for the system that provides remote access for telework. GAO concluded that if agencies do not sufficiently document relevant security controls, assess the controls, and fully document remedial actions for weaknesses identified in security controls, then agencies are at increased risk that vulnerabilities in their systems that provide remote access could be exploited.

The SEC also faces cybersecurity challenges with respect to its access, use, and security of data available through the Consolidated Audit Trail (CAT). Pursuant to an SEC rule (Rule 613), self-regulatory organizations have submitted a national market system plan to create, implement, and maintain a consolidated order tracking system, or CAT, that when fully implemented will capture customer and order event information for orders in national market system securities, across all markets, from the time of order inception through routing, cancellation, modification, or execution. In its FY 2023 budget request, the SEC noted that the CAT continues to roll out functionality as the phased launch of broker-dealer reporting and regulator functionality progresses. Because CAT data is highly sensitive, the SEC must continue working to establish an environment and applications to appropriately secure the data accessed and used by the SEC as it becomes available.

Maturing the SEC's Information Security Program

Effective information security controls are essential to protecting the SEC's information systems and the data contained therein. To help the SEC establish and maintain effective information security controls and to comply with FISMA, the OIG annually evaluates the SEC's implementation of FISMA information security requirements and the effectiveness of the agency's information security program on a maturity model scale.[41] The OIG contracted with Kearney & Company, P.C. (Kearney) to conduct the FY 2021 independent evaluation and, on December 21, 2021, issued the report titled, *Fiscal Year 2021 Independent Evaluation of SEC's Implementation of the Federal Information Security Modernization Act of 2014* (Report No. 570).[42]

As stated in Report No. 570, since FY 2020, OIT improved aspects of the SEC's information security program. Among other actions taken, the SEC refined its management of security training roles and responsibilities, enhanced its security training strategy, implemented the agency's policy for specialized security training, optimized a vulnerability disclosure policy, refined its configuration management

[40] U.S. Government Accountability Office, *COVID-19: Selected Agencies Overcame Technology Challenges to Support Telework but Need to Fully Assess Security Controls* (GAO-21-583, September 2021).

[41] Pub. L. No. 113-283, § 3555, 128 Stat. 3073 (2014).

[42] As previously stated, the FY 2022 FISMA evaluation is ongoing and will be completed in the first quarter of FY 2023.

processes related to reconciliation of software code in production, improved its incident response information-sharing capabilities, and improved its contingency planning capabilities. Notably, these improvements occurred despite the unique challenges presented by Coronavirus Disease 2019 (COVID-19).

In FY 2021, the SEC's maturity level was primarily "Consistently Implemented" or "Managed and Measurable"

Although the SEC strengthened its program, Kearney determined for FY 2021 that the agency's information security program did not meet annual Inspector General FISMA reporting metrics' definition of "effective," which requires the simple majority of domains to be rated as Level 4 ("Managed and Measurable").[43] As stated in Report No. 570, the SEC's maturity level for the five Cybersecurity Framework security functions ("identify," "protect," "detect," "respond," and "recover") and related domains was primarily Level 3 ("Consistently Implemented") or Level 4 ("Managed and Measurable"). Although the SEC's program, as a whole, did not reach the level of an effective information security program, the agency showed significant improvement at the domain level. Specifically, the agency's assessed maturity level for the Security Training domain increased from Level 2 ("Defined") to Level 5 ("Optimized"). Table 3 shows the SEC's FISMA ratings in FY 2020 and FY 2021.

TABLE 3. Summary of SEC FISMA Ratings (FY 2020 and FY 2021)

Domain	Assessed Rating By FY	
	2021	2020
Risk Management	Level 3: *Consistently Implemented*	Level 3: *Consistently Implemented*
Supply Chain Risk Management	Level 1: *Ad Hoc*	*Not Applicable*
Configuration Management	Level 2: *Defined*	Level 2: *Defined*
Identity and Access Management	Level 2: *Defined*	Level 2: *Defined*
Data Protection and Privacy	Level 3: *Consistently Implemented*	Level 3: *Consistently Implemented*
Security Training	Level 5: *Optimized*	Level 2: *Defined*
Information Security Continuous Monitoring	Level 3: *Consistently Implemented*	Level 3: *Consistently Implemented*
Incident Response	Level 4: *Managed and Measurable*	Level 4: *Managed and Measurable*
Contingency Planning	Level 4: *Managed and Measurable*	Level 4: *Managed and Measurable*

Source: OIG-generated based on Exhibit 1 from Report No. 570.

Report No. 570 included eight new recommendations to strengthen the SEC's information security program, and highlighted opportunities to improve in all nine FY 2021 Inspector General FISMA reporting metric areas. To date, the SEC has taken corrective action sufficient to close three of these eight recommendations. However, five recommendations from prior year FISMA reports remain open (two from

[43] *FY 2021 Inspector General Federal Information Security Modernization Act of 2014 (FISMA) Reporting Metrics, Version 1.1*; May 12, 2021.

FY 2017,[44] one from FY 2018,[45] and two from FY 2020[46]). We commend agency management for the actions taken to date, and encourage management to promptly act on all opportunities for improvement identified in previous FISMA reports to help minimize the risk of unauthorized disclosure, modification, use, and disruption of the SEC's sensitive, non-public information, and to assist the agency's information security program reach the next maturity level.

Finally, we continue to track the agency's progress related to an audit of the SEC's enterprise architecture (*Additional Steps Are Needed For the SEC To Implement a Well-Defined Enterprise Architecture*; Report No. 568, issued September 29, 2021). In our report, we highlighted six recommendations to improve the SEC's implementation of a well-defined enterprise architecture (four of which remain open), and one recommendation to improve the SEC's oversight of enterprise architecture support services contracts (which is closed). We understand that the agency has efforts underway to develop an enterprise roadmap for future years, and the remaining four recommendations will be closed upon completion and verification of corrective action taken.

Fully implementing recommended corrective actions from these audits and evaluations may assist the SEC as it seeks to mature aspects of its information security program, generally, and its IT program and program management, specifically.

Ongoing and Anticipated OIG Work. In FY 2023, we will continue to assess the SEC's efforts to secure its systems and data and mature its information security program. Specifically, we will continue to assess the reported user access control deficiency matter, follow-up on open recommendations, complete the ongoing FY 2022 FISMA evaluation, and initiate the FY 2023 FISMA evaluation. We will also review the SEC's efforts to establish a secure environment and applications to use CAT data, determine whether the SEC implemented adequate security controls to safeguard information and IT resources during maximum telework, and assess steps the SEC has planned or taken to address "zero trust" requirements.

[44] U.S. Securities and Exchange Commission, Office of Inspector General, *Audit of the SEC's Compliance With the Federal Information Security Modernization Act for Fiscal Year 2017* (Report No. 546; March 30, 2018).

[45] U.S. Securities and Exchange Commission, Office of Inspector General, *Fiscal Year 2018 Independent Evaluation of SEC's Implementation of the Federal Information Security Modernization Act of 2014* (Report No. 552; December 17, 2018).

[46] U.S. Securities and Exchange Commission, Office of Inspector General, *Fiscal Year 2020 Independent Evaluation of SEC's Implementation of the Federal Information Security Modernization Act of 2014* (Report No. 563; December 21, 2020).

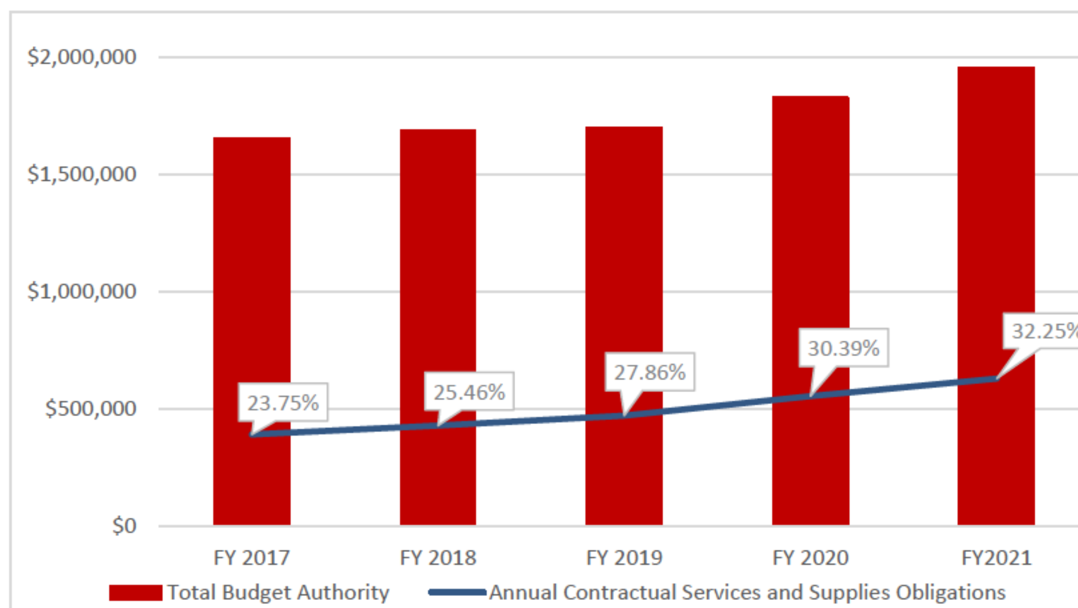
CHALLENGE: Improving Contract Management

Synopsis and Trends in SEC Contracting

The SEC substantially relies on contractor support to accomplish its mission. Contractor support is obtained through a variety of methods, including enterprise-wide contracts, U.S. General Services Administration multiple award schedule contracts, government-wide acquisition contracts, and multi-agency contracts. As markets are ever evolving and increasing in complexity, the SEC relies on contractors for technical and subject matter expertise including, but not limited to, professional legal and investigation-related services; support in areas of accounting, analytics, and examinations; and human resources support services.

To fund its contract requirements, the SEC's FY 2023 budget request included nearly $610 million for contractual services and supplies,[47] which represents about 28 percent of the total $2.149 billion requested for agency operations. As we reported in last year's statement on the SEC's management and performance challenges, annual obligations for contractual services and supplies, when expressed as a percentage of the SEC's total annual budget authority, has been increasing. This trend continued in FY 2021, with annual obligations for contractual services and supplies equaling about 32 percent of the SEC's total annual budget authority. (See Figure 4.)

FIGURE 4. SEC Annual Contractual Services and Supplies Obligations, in Thousands, as a Percentage of Total Annual Budgetary Authority (FY 2017 – FY 2021)

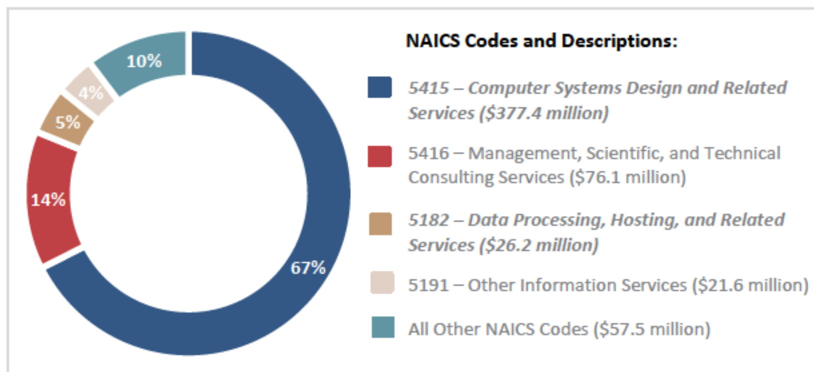


Source: OIG-generated based on annual actual obligations by object class as reported in the SEC's Congressional Budget Justifications for FY 2019 through FY 2023.

[47] According to OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget* (August 2022), the contractual services and supplies object class covers purchases in object classes 21.0 through 26.0 (Travel and transportation of persons; Transportation of things; Rent, Communications, and Utilities; Printing and reproduction; Other contractual services; and Supplies and materials).

As contract obligations are approaching nearly a third of the agency's annual budget authority, it is essential that the SEC's acquisition workforce effectively manage these resources. Government contracts continue to be an attractive target for fraudsters. In 2021, GAO issued two reports related to contract fraud schemes within the government, focusing on programs within the Department of Defense and the Department of Energy.[48] The SEC is not invulnerable to such schemes and must remain vigilant, closely monitoring areas of risk. For example, GAO identified fraudulent billing schemes as a risk to the procurement process, and the SEC OIG has participated in cross-agency investigative efforts to fight fraudsters who impersonate government officials and submit false purchase orders associated with real government contracts, the terms of which are publicly available.

FIGURE 5. Top NAICS Codes Associated With the SEC's FY 2022 Contract Obligations



Source: OIG-generated from data retrieved from SAM.gov on October 6, 2022.

Although the SEC procures a wide range of services and supplies, the majority of the agency's contract support by dollars obligated is for IT services. These services include, among others, application management, business solutions delivery, IT infrastructure and support services, information security, IT governance and program strategy, data management, and software services. We reviewed the top North American Industry Classification System (NAICS) codes[49] associated with SEC contracts in FY 2022, as reported through the System for Award Management (SAM.gov),[50] and noted that, of the nearly $560 million obligated to contract actions that year and included in the system, the SEC obligated about 72 percent (or about $404 million) to vendors doing business under just two IT service-related NAICS codes: one for computer systems design and related services, and another for data processing, hosting, and related services. (See Figure 5.) This represents a slight increase over FY 2021 and a more significant increase over FY 2020 (when obligations under the same two NAICS codes totaled about $401 million and $351 million, respectively).[51]

[48] U.S. Government Accountability Office, *DOD FRAUD RISK MANAGEMENT Actions Needed to Enhance Department-Wide Approach, Focusing on Procurement Fraud Risks* (GAO-21-309, August 2021); and *DEPARTMENT OF ENERGY CONTRACTING Improvements Needed to Ensure DOE Assesses Its Full Range of Contracting Fraud Risks* (GAO-21-44, January 2021).

[49] NAICS is a comprehensive industry classification system that covers all economic activities and groups establishments into industries based on the similarity of their production processes. Among other things, U.S. statistical agencies use NAICS to provide uniformity and comparability in the presentation of statistical data describing the U.S. economy. Federal Acquisition Regulation 19.102(b) requires contracting officers to assign one NAICS code to all government solicitations, contracts, and task and delivery orders based on the product or service being acquired and its principal purpose. In this document, "top NAICS codes" refers to those codes that represent the largest amounts in terms of total annual amounts obligated.

[50] SAM is a U.S. General Services Administration Federal Government computer system that, among other things, allows users to create and run reports of detailed information on contract actions that are required to be reported by federal agencies. These are actions with an estimated value of $10,000 or more.

[51] Based on data retrieved from SAM.gov on October 6, 2022.

A growing majority of contract support concentrated in IT services—and, therefore, in those segments of the agency's acquisition workforce that procure, administer, and oversee contracts for such services—potentially increases the risk to the SEC. Indeed, since 2015, GAO has reported that management of IT acquisitions and operations is a high risk area needing attention by the executive branch and Congress, stating, "federal IT investments too frequently fail or incur cost overruns and schedule slippages while contributing little to mission-related outcomes. These investments often suffer from a lack of disciplined and effective management, such as project planning, requirements definition, and program oversight and governance."[52] We have previously reported on needed improvements in the SEC's management of IT investments.[53] And while last July the SEC completed efforts sufficient to close our remaining recommendations for corrective action stemming from that report, the agency has also increased its investments (and, therefore, its potential risk) related to IT service contracts.

Management of IT acquisitions and operations is a high risk area across the executive branch

Notably, the SEC procures many of its IT services through its OneIT enterprise contract vehicle, which has a 10-year ordering period and a contract ceiling of $2.5 billion. In September 2018, the SEC began awarding time-and-material (T&M), labor-hour (LH), and firm-fixed price task orders under the OneIT contract vehicle, which included separate pools for small businesses only (restricted) and all awardees, including large businesses (unrestricted). As of June 2022, the agency had awarded task orders to 27 companies, including 5 large businesses and 22 small businesses, obligating a total of almost $450 million for task orders under this vehicle. The SEC's Office of Minority and Women Inclusion (OMWI) collaborated with key stakeholders to advertise to vendors opportunities and specifics of the OneIT program. This advertising included a publically available brochure targeted to minority-owned and women-owned businesses. OMWI received positive feedback and is looking to expand the concept to other large SEC contracts being awarded. As such, the SEC's Office of Acquisitions (OA) and OMWI are continuing to work collaboratively to increase outreach to minority-owned and women-owned businesses and continue efforts to increase the SEC's vendor diversity.

Focus on Diversity, Equity, and Inclusion

OA and OMWI are collaborating to voluntarily implement the requirements of Executive Order 13895, which states that the federal government should pursue a comprehensive approach to advancing equity for all, including people of color and others who have been historically underserved, marginalized, and adversely affected by persistent poverty and inequality.[54] This advancing of equality includes promoting equitable delivery of government benefits and equitable opportunities, such as government contracting and procurement opportunities, which should be available on an equal basis to all eligible providers of goods and services.

[52] U.S. Government Accountability Office, *HIGH-RISK SERIES Dedicated Leadership Needed to Address Limited Progress in Most High-Risk Areas* (GAO-21-119SP, March 2021).

[53] U.S. Securities and Exchange Commission, Office of Inspector General, *The SEC Has Processes To Manage Information Technology Investments But Improvements Are Needed* (Report No. 555; September 19, 2019).

[54] Executive Order 13895, *Advancing Racial Equity and Support for Underserved Communities through the Federal Government*; January 20, 2021. Independent agencies are strongly encouraged to comply with the provisions of this Executive Order.

Additionally, recent OMB guidance implements commitments to increase the share of contracts awarded to small disadvantaged businesses to 15 percent by 2025.[55] To do this, OMB directs federal agencies to take specific management actions, including increasing the number of new entrants to the federal marketplace and reversing the general decline in the small business supplier base.

Diversity, equity, and inclusion is a focus of OA and, in its FY 2023 budget request, OA requested two additional positions to support a number of priorities, including support for workload increases to review and expand diversity, equity, and inclusion efforts in contracting opportunities. Furthermore, OMWI continues to collaborate with OA to promote access to contracting and sub-contracting opportunities for minority-owned and women-owned businesses, through outreach activities. In March 2022, we initiated an audit to (1) assess the SEC's processes for encouraging small business participation in agency contracting, in accordance with federal laws and regulations; and (2) determine whether, in FYs 2020 and 2021, the SEC accurately reported small business awards. The audit is ongoing and will be completed in FY 2023.

T&M Contracts

Since our 2019 statement on the SEC's management and performance challenges, we have reported that T&M contracts (including LH contracts) lack incentives for contractors to control costs or use labor efficiently and, therefore, are considered higher-risk.[56] Last year, we noted again that the SEC's use of T&M contracts has continued to increase. We encouraged management to assess the SEC's use of these contracts and to formulate actions to reduce their use whenever possible. In response, agency management committed to continuing to closely monitor its use of T&M contracts and "exercise rigorous oversight of these types of contracts."[57] Management further noted that OA has made a number of improvements to better manage T&M contracts, including a new independent government cost estimate guide, contract compliance reviews, information sharing on T&M invoicing, and an automated determination and findings workflow for "more robust and consistent support for the use of T&M" contracts. To date, we have not fully assessed the effectiveness of management's reported additional controls;[58] however, the annual amount obligated to T&M contracts continues to raise concerns about risk to the SEC. As Figure 6 shows, according to data from *usaspending.gov*, the total amount obligated to T&M contracts increased since FY 2018 from about 40 percent to about 53 percent of all SEC contract obligations (which are declining).[59] In addition, as of October 7, 2022, 476 of the SEC's 1,055 total active contracts (or about 45 percent) were T&M contracts.

[55] Office of Management and Budget, Memorandum M-22-03, *Advancing Equity in Federal Procurement*; December 2, 2021.

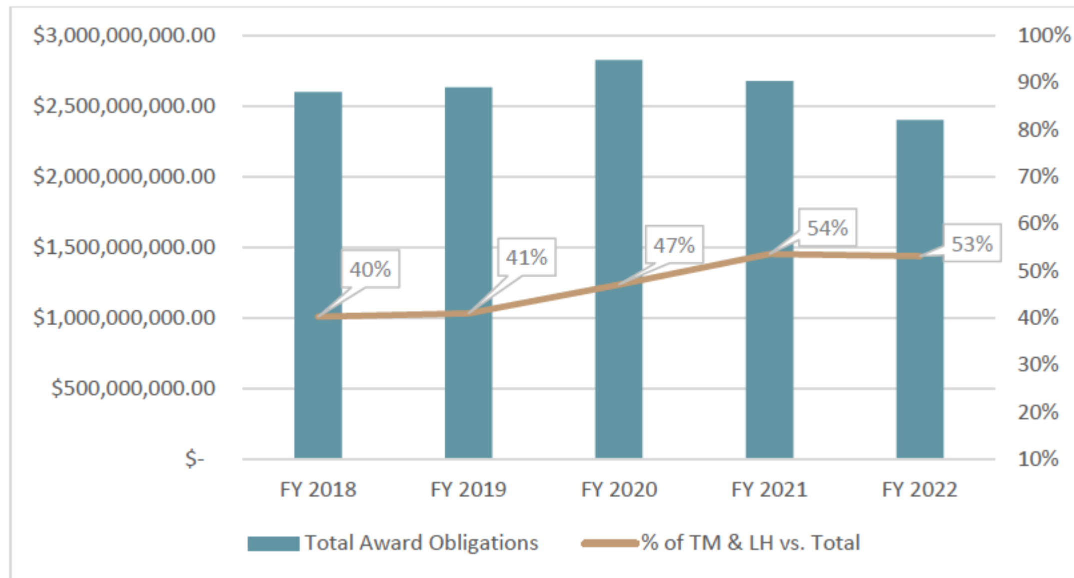
[56] As stated in Federal Acquisition Regulation 16.602, *Labor-hour contracts*, LH contracts are a variation of T&M contracts and differ only in that materials are not supplied by the contractor.

[57] U.S. Securities and Exchange Commission, *Fiscal Year 2021 Agency Financial Report*; November 15, 2021.

[58] We plan to initiate an audit of this issue in FY 2023.

[59] According to *usaspending.gov*, total (that is, cumulative) award obligations for all active SEC contracts as of October 7, 2022, was about $2.40 billion, of which total award obligations for T&M contracts was about $1.28 billion.

FIGURE 6. Percentage of SEC T&M Award Obligations Compared to Total SEC Award Obligations (FY 2018 – FY 2022)



Source: OIG-generated based on data retrieved from usaspending.gov on October 7, 2022.

As we have reported in prior years' statements on the SEC's management and performance challenges, Federal Acquisition Regulation Subpart 16.6, *Time-and-Materials, Labor-Hour, and Letter Contracts*, states, a T&M contract:

- ". . . provides no positive profit incentive to the contractor for cost control or labor efficiency."
- ". . . may be used only when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence."

Furthermore, in June 2022, GAO reported that T&M and LH contracts are considered riskier than fixed price contracts because contractors bill the government by the hour and could conceivably work less efficiently so that they could charge more hours. As a result, GAO recommended that selected agencies assess steps they can take to use lower-risk contract types, and highlighted potential opportunities for agencies to assess ongoing use of T&M contracts in their acquisition portfolios.[60] Moreover, the Federal Acquisition Regulation encourages contracting officers to assess contract types periodically, after experience obtained during the performance of a T&M contract provides a basis for firmer pricing. A January 2021 OMB memorandum also discourages agency reliance on high-risk contracts, such as T&M contracts, stating that, "By managing contract types effectively, agencies have better leverage to ensure timely, efficient, and cost-effective completion of contractor work supporting critical and high priority goals."[61]

[60] U.S. Government Accountability Office, *Opportunities Exist to Reduce Use of Time-and-Materials Contracts* (GAO-22-104806, June 2022). GAO included in its review four Department of Defense agencies and field activities (the Air Force, Army, Defense Finance and Accounting Service, and Washington Headquarters Services), and three civilian agencies (the Social Security Administration, the Department of Homeland Security, and the Department of State).

[61] Office of Management and Budget, Memorandum M-21-11, *Increasing Attention to Federal Contract Type Decisions* (January 5, 2021).

Ongoing and Anticipated OIG Work. In FY 2023, we will continue to assess the SEC's contract management and acquisition processes through audits and evaluations and the work of our Acquisitions Working Group. We will complete an ongoing audit of the SEC's small business contracting program. In addition, we will assess the SEC's use of T&M contracts to help ensure such contracts are used only when appropriate and effective controls are in place to minimize the risk to the government. Lastly, we will report on any acquisition-related matters identified as a result of other ongoing and planned reviews of SEC programs and operations, and continue to support the SEC's efforts to train contracting officers and contracting officer's representatives about the potential for procurement-related fraud.

CHALLENGE: Ensuring Effective Human Capital Management

Although each component within the SEC is critical to achieving effective human capital management, the Office of Human Resources (OHR) is ultimately responsible for the strategic management of the SEC's human capital. OHR consults with management, establishes and administers human capital programs and policies, and ensures compliance with federal laws and regulations and negotiated agreements. It is critical that OHR develops and maintains the knowledge, skillsets, and expertise to guide the SEC through the challenges that inevitability arise in the management of a large professional workforce.

Indeed, retention, attrition, recruitment, and hiring of skilled personnel have all emerged as challenges within the SEC, along with the challenges associated with managing the agency's workforce throughout the COVID-19 pandemic.

Retention, Attrition, Recruitment, and Hiring

The SEC recognizes the importance of an effective, highly-skilled, and diverse workforce. As such, in its strategic plan, the SEC states that it "will focus on recruiting, retaining, and training staff with the right mix of skills and expertise."[62] Moreover, Goal 1 of OHR's Human Capital Strategic Plan is to "Attract Diverse and Highly Talented People to the Agency."[63] OMWI also plays an important part in the agency's recruitment and retention efforts by providing leadership and guidance in ensuring diversity and inclusion with respect to the SEC workforce. In its Diversity and Inclusion Strategic Plan, the SEC highlights the importance of diversity, equity, and inclusion in the workplace, stating, "we recognize that our people are our most important asset. We also recognize that diversity, inclusion, and opportunity are essential to the agency's ability to effectively carry out its mission. These fundamental and value-enhancing tenets of our mission-oriented culture dictate that we continuously work to attract, hire, develop, and retain high-quality, diverse talent."[64]

Effective management of an entity's workforce, its human capital, is essential to achieving results and an important part of internal control.

Source: U.S. Government Accountability Office, Standards for Internal Control in the Federal Government (GAO-14-704G, September 2014), Principle 10 - Design Control Activities, section 10.03.

Retention and Attrition

Despite OHR's and OMWI's efforts and the SEC being recognized as one of the best places to work in the federal government,[65] the SEC seems to be facing challenges to its retention efforts. As the figures below demonstrate, the SEC has seen a significant increase in attrition over the last few years, from 3.8 percent in FY 2020 to an estimated 6.4 percent in FY 2022 (as of September 20, 2022)—the highest attrition rate in 10 years. Most concerning is the increased attrition in Senior Officer and attorney positions, expected to be about 20.8 percent and about 8.4 percent for FY 2022, respectively.

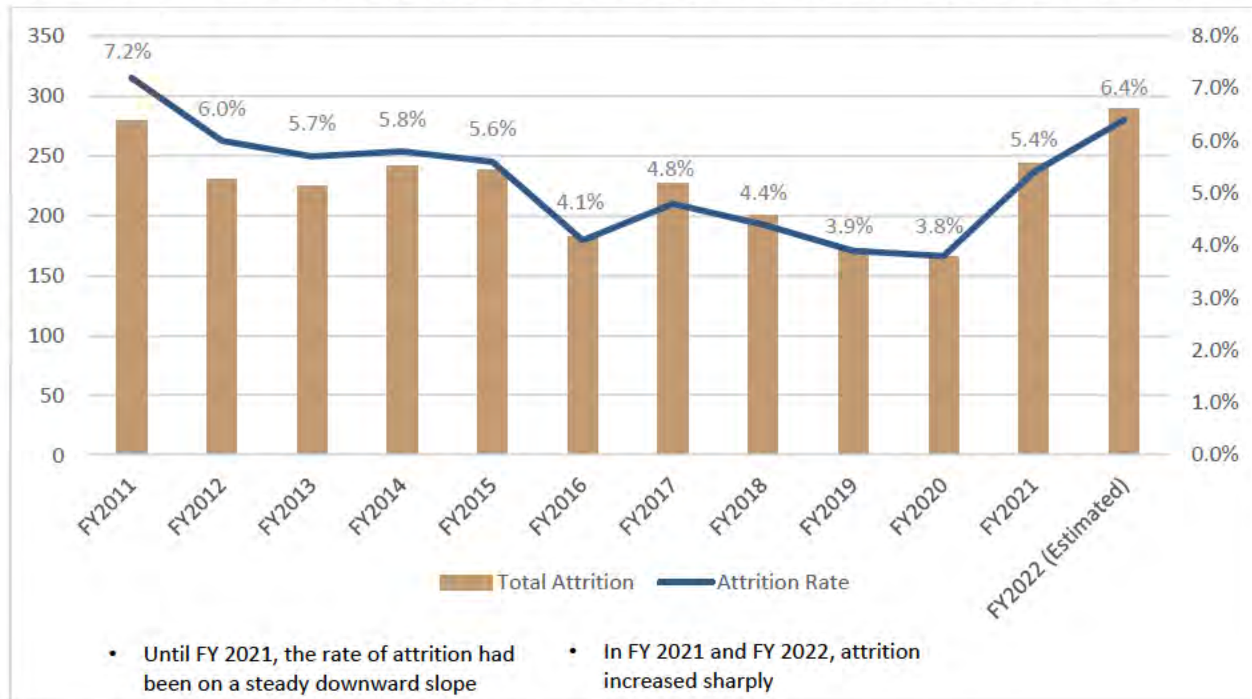
[62] U.S. Securities and Exchange Commission, *Strategic Plan Fiscal Years 2018-2022*, Strategic Initiative 3.1; October 11, 2018. The agency's draft strategic plan for FY 2022 to FY 2026 (Goal 3) similarly emphasizes the importance of attracting, hiring, developing, and retaining high-quality, diverse talent.

[63] U.S. Securities and Exchange Commission, Office of Human Resources, *FY 2020-2022 Human Capital Strategic Plan*; March 2020.

[64] U.S. Securities and Exchange Commission, *Diversity and Inclusion Strategic Plan*, Fiscal Years 2020-2022, Introduction.

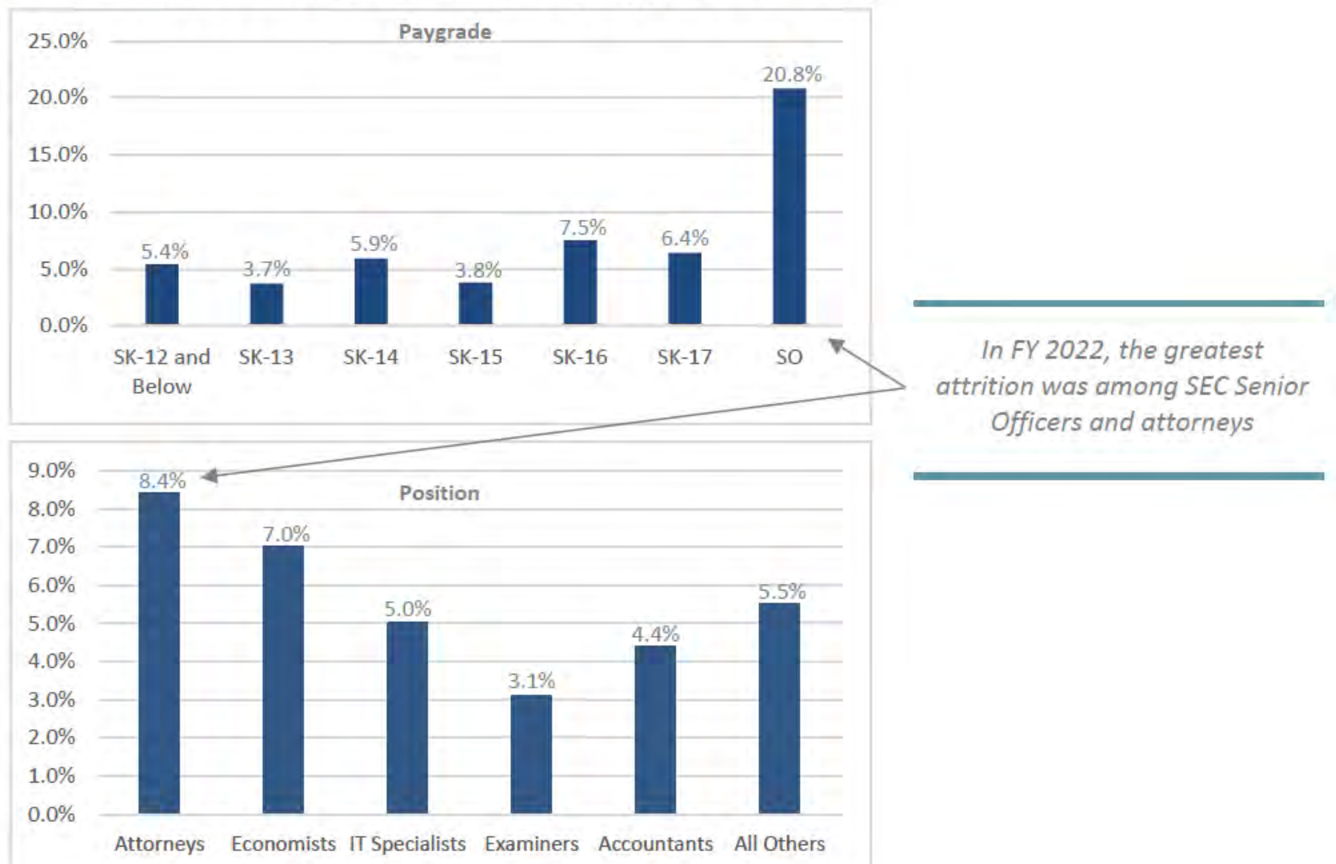
[65] Partnership for Public Service, *2021 Best Places to Work in the Federal Government Rankings*.

FIGURE 7. Total SEC Attrition (in Number of Positions) and Attrition Rate (FY 2011 – FY 2022)



Source: OIG-generated based on data provided by OHR.

FIGURE 8. SEC FY 2022 Expected Attrition by Paygrade and Position



Source: OIG-generated based on data provided by OHR.

The SEC is not alone in facing a crisis to retain mission-critical talent during what has been dubbed "The Great Resignation." Critical elements of the federal workforce are in a state of stress. For example, according to the Partnership for Public Service, FY 2021 government-wide attrition rates averaged 6.1 percent, with certain groups experiencing even higher rates, such as women (6.4 percent) and executives (9.2 percent).[66]

The SEC may be able to address some of the concerns surrounding attrition by ensuring that it provides for succession planning through robust employee development and performance management. For example, in August 2022, the SEC launched a new program called LEAD (Leadership, Evaluation, Accession, and Development) to help SEC employees develop the leadership skills necessary to apply for future Senior Officer opportunities. However, performance management remains an area of opportunity for growth. For example, the SEC has discontinued the Performance Incentive Bonus program it implemented just 1 year ago. In addition, one recommendation from our 2018 report entitled, *The SEC Made Progress But Work Remains To Address Human Capital Management Challenges and Align With the Human Capital Framework,* remains open.[67] This recommendation—for the SEC to finalize standard operating procedures for the agency's performance management program—is an important component of the SEC's effort to ensure effective performance management. Agency management has reported that remediation work is underway, yet limited resources and competing priorities have created delays. In FY 2023, GAO is set to issue its triennial report on personnel management within the SEC,[68] which should provide further guidance to the SEC in this area.

Recruitment and Hiring

Recruitment is a major area of interest to both OHR and OMWI. Recruitment efforts are critical to ensuring a skilled and diverse candidate pool from which to fill SEC vacancies. In its FY 2023 Congressional Budget Justification, the SEC requested a total of 5,261 positions, an increase of 454 positions from FY 2022, in which the SEC was authorized 4,807 positions. With FY 2022 attrition rates estimated to be at 6.4 percent—or about 289 positions—efforts to recruit and hire an additional 454 new positions in FY 2023 could present challenges for OHR, OMWI, and SEC management. Moreover, the federal government is facing stiff competition from the private sector as increased wages and workforce engagement make private sector positions attractive to both new and seasoned professionals. The federal government hiring process also has been cited as a detriment when attracting talent to the federal government. For example, the federal government takes on average 98 days—more than twice as long as the private sector—to hire a new employee. [69] During our recent audit of the SEC's hiring process, discussed in more detail below, we found that of the 438 external hiring actions that we included in our analysis, nearly 50 percent took 100 business days or more to complete.[70]

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[66] Partnership for Public Service. "Who Is Quitting and Retiring: Important Fiscal 2021 Trends in the Federal Government."

[67] U.S. Securities and Exchange Commission, Office of Inspector General, *The SEC Made Progress But Work Remains To Address Human Capital Management Challenges and Align With the Human Capital Framework* (Report No. 549; September 11, 2018).

[68] Section 962 of Dodd-Frank includes a provision for GAO to report triennially on the SEC's personnel management, including the competence of professional staff; the effectiveness of supervisors; and issues related to employee performance assessments, promotion, and intra-agency communication. *See* Pub. L. No. 111-203, 124 Stat. 1376, 1908-1909 (2010) (codified at 15 U.S.C. § 78d-7).

[69] Partnership for Public Service. "Roadmap for Renewing Our Federal Government."

[70] U.S. Securities and Exchange Commission, Office of Inspector General, *The SEC Can Improve in Several Areas Related to Hiring* (Report No. 572; February 28, 2022).

To address some of these recruitment concerns, OHR recently issued its FY 2022-2024 Recruitment and Outreach Strategic Plan, which identifies strategies to attract diverse talent and to aid in filling mission critical occupations that have been deemed hard-to-fill. Such strategies include creating branding and marketing that speaks to prospective applicants; developing and implementing a multi-media recruitment and agency branding campaign that highlights the successes of current SEC employees; developing a comprehensive internal communications strategy; and creating an overarching recruitment, outreach, and engagement tool to enhance the recruitment process.

Given the importance of an effective process when recruiting and hiring new employees, and the likelihood that the SEC will be heading into an intensive hiring effort, the OIG recently reviewed the SEC's hiring process and identified areas for improvement. The OIG's audit report, *The SEC Can Improve in Several Areas Related to Hiring*, addressed a number of critical areas related to the SEC's hiring process.[71] First, we determined that management can improve its controls to ensure Workforce Transformation and Tracking System (WTTS) data fields are accurate, consistent, and complete. We found that:

- 83 of the 91 hiring actions sampled (or about 91 percent) had at least one data entry issue in the WTTS data fields we reviewed, and almost 9 percent of the WTTS data entries we reviewed were either inaccurate, inconsistent, or incomplete;
- the SEC's WTTS data continued to include unannotated anomalies; and
- certain hiring actions were not consistently identified in WTTS.

These conditions occurred because (1) OHR's WTTS job aid did not include sufficient instructions regarding the dates and information expected in key WTTS data fields, and (2) some data fields were not included on the WTTS reports used by OHR staff to ensure the SEC's hiring action data was accurate, complete, and consistently recorded. As a result, OHR can further improve the reliability of the SEC's WTTS data to assist in workforce management and internal and external reporting of agency hiring information.

In addition, our assessment of OHR's quarterly Service Level Commitment (SLC) reviews found that (1) OHR did not perform SLC reviews in a consistent manner, (2) the review process was inefficient and prone to inaccuracies, and (3) SLC reviews did not align with the SLC presented to and agreed upon by the other SEC divisions and offices. This occurred because OHR did not establish clear guidance, including in the SLC itself, for the variety of hiring types and scenarios that can occur, or how to measure each one. The organization also did not ensure it could measure the SLC steps, as presented, in WTTS and did not effectively use the WTTS reporting capabilities in its SLC reviews. As a result, OHR limited its ability to rely on the SLC and SLC reviews as key controls for efficiently and effectively identifying areas of needed improvement in the SEC's hiring process, and for collaborating with the divisions and offices OHR serves.

Furthermore, we found that the SEC's pay-setting guidance needed improvement and OHR could clarify the new hire pay-setting information shared both internally and externally. Specifically, (1) the pay-setting

[71] Id.

information available to SEC employees and hiring officials was not comprehensive, (2) the internally published pay matrices were outdated, and (3) publicly advertised SEC salary information was misleading for new hires. We also identified inaccuracies in some of the underlying pay band information included in the 2021 pay matrices, and other pay-setting concerns. Incomplete, outdated, and misleading new hire pay-setting guidance and information have caused confusion and may have limited hiring officials' ability to review and respond to pay-setting requests. Although it does not appear that inaccurate information in the 2021 pay matrices impacted any newly hired SEC employee's pay, it could have had certain hiring scenarios occurred. We also concluded that OHR generally complied with the key hiring authority requirements tested; however, staffing case files for 18 of 32 attorney hiring actions we reviewed (about 56 percent) lacked supporting documentation, including proof of law degrees and/or bar membership. This occurred because OHR did not clarify review processes and documentation requirements for attorney qualifications. In addition, OHR's internal reviews of staffing case files needed improvement. As a result, the SEC risked hiring attorneys who did not meet all qualifications required for their position.

Lastly, we identified a matter that did not warrant recommendations related to (1) the SEC's SLC as compared to the Office of Personnel Management's end-to-end hiring process model timelines, and (2) feedback from the SEC divisions and offices OHR serves. We discussed this matter with agency management for their consideration.

We made 11 recommendations to further strengthen the SEC's controls over hiring actions, including recommendations to improve (1) the reliability of WTTS data, (2) assessments of the agency's hiring timelines, (3) the agency's compensation program, and (4) staffing case file documentation requirements. Management concurred with all 11 of our recommendations and, as of the date of this document, had taken action sufficient to close 5 of them. The remaining recommendations are open and will be closed by the OIG upon completion and verification of corrective action.

Responding to COVID-19: Workforce Perspectives

Responding to the COVID-19 pandemic has been a central concern of the SEC, and the federal government as a whole, throughout FY 2022. Since the outset of the national public health crisis and economic threats caused by COVID-19, the SEC's operational efforts have centered, first and foremost, on the health and safety of its employees, the employees and customers of its registrants, and individuals generally. From March 2020 through August 8, 2021, the SEC was in a mandatory telework posture, which aligned with other federal government agencies. Indeed, the federal government workforce quickly increased from 3 percent of employees teleworking every day to nearly 60 percent, as the 2020 Office of Personnel Management Federal Employee Viewpoint Survey shows.[72] However, as vaccines became more widely available, the SEC shifted its focus to how to best and most safely allow employees to return to the workplace.

[72] Office of Personnel Management, *Government-wide Management Report: Results from the 2020 OPM Federal Employee Viewpoint Survey*; April 26, 2021.

Safety remains a top priority when planning for employee return to the workplace

On August 9, 2021, the agency began to allow vaccinated employees to voluntarily return to the workplace. In calendar year 2022, peak occupancy across all SEC building locations has averaged around 7 percent. The SEC has not yet mandated that its employees return to the office in pre-COVID-19 levels. On July 25, 2022, the agency announced that, because of the recent uptick in COVID-19 community levels, the planned return-to-office date was shifted from September 6, 2022, to January 9, 2023. Occurring alongside the agency's monitoring of community levels, the SEC is also negotiating a new collective bargaining agreement with the National Treasury Employees Union, which will include updated provisions related to telework and remote work. The parties are also engaged in bargaining related to the mandatory return-to-office plan. While these negotiations are ongoing, both the National Treasury Employees Union and SEC leadership make regular announcements to staff and management, respectively, about their progress. At this point, further negotiations require assistance from the Federal Mediation and Conciliation Service as the parties endeavor to avoid invoking the Federal Services Impasse Panel for a final decision on the terms of the new collective bargaining agreement and return-to-office plan. The uncertainty surrounding the plans for return-to-office and the potential for expanded telework and/or workplace flexibilities makes it more difficult to plan for future human capital management solutions.

Ongoing and Anticipated OIG Work. In FY 2023, we plan to evaluate the agency's workplace safety protocols developed in response to the COVID-19 pandemic, including the COVID-19 workplace safety plan and related measures, such as those established pursuant to OMB Memorandum M-21-15, Executive Order 13991, and other applicable guidance. We also will complete a review of the agency's upward mobility program. Furthermore, we will monitor the SEC's progress in addressing prior open audit recommendations related to human capital management. To assess the SEC's efforts to promote diversity, equity, inclusion, accessibility, and opportunity, we will complete an ongoing audit of the agency's small business contracting. We will also assess the operations and controls over the agency's equal employment opportunity program.

OIG General Office Contact Information

EMPLOYEE SUGGESTION PROGRAM

The OIG SEC Employee Suggestion Program, established under the Dodd-Frank Wall Street Reform and Consumer Protection Act, welcomes suggestions by all SEC employees for improvements in the SEC's work efficiency, effectiveness, productivity, and use of resources. The OIG evaluates all suggestions received and forwards them to agency management for implementation, as appropriate. SEC employees may submit suggestions by calling (202) 551-6062 or sending an e-mail to OIGESProgram@sec.gov.

COMMENTS AND IDEAS

The SEC OIG also seeks ideas for possible future audits, evaluations, or reviews. We will focus on high-risk programs, operations, and areas where substantial economies and efficiencies can be achieved. Please send your input to AUDPlanning@sec.gov.

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