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SEC 'Revolving Door' Under Review

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Sen. Charles Grassley (R., Iowa) on Capitol Hill in February.

A Senate panel asked the Securities and Exchange Commission's inspector general to review the agency's "revolving door," which shuttles many SEC staffers into jobs with the companies they once regulated.

In a letter sent Monday, Sen. Charles Grassley (R., Iowa), the ranking minority member on the Senate Finance Committee, asked David Kotz, the inspector general, to review the recent departure of a top official in the SEC's Division of Trading and Markets who took a job with a prominent high-frequency trading firm.

That move coincided with a continuing SEC examination of how high-speed, computer-driven trading in stocks and other securities is affecting markets.

Mr. Grassley also cited a Wall Street Journal article in April that reported how many former SEC employees have quickly turned around and represented clients before the commission, sometimes within days of leaving the agency.

"We need to ensure that SEC officials are more focused on regulation and enforcement than on getting their next job in the industry they are supposed to oversee," Mr. Grassley said in a statement.
"The inspector general's work," said Mr. Grassley, "can be a valuable tool to help the SEC become more open and transparent about its employees' ties to the industry it regulates."

Mr. Kotz declined to comment. But in a response to Mr. Grassley on Tuesday, he revealed a new revolving-door investigation he has undertaken.

"[W]e are currently conducting an investigation of allegations very recently brought to our attention that a prominent law firm's significant ties with the SEC, specifically, the prevalence of SEC attorneys leaving the agency to join this particular law firm, led to the SEC's failure to take appropriate actions in a matter involving the law firm," Mr. Kotz wrote.

It couldn't be determined which law firm he was referring to.

SEC officials began examining the impact of high-frequency trading last summer, but the review took on new urgency after the "flash crash," which sent the Dow Jones Industrial Average tumbling nearly 1,000 points in mere minutes on the afternoon of May 6, before a rapid snapback.

Market experts believe the complex computer algorithms of high-frequency trading firms provided fuel for the brief but record-breaking market meltdown.

Amid the speculation, the Chicago-based high-frequency trading firm Getco LLC hired Elizabeth King, an associate director in the SEC's Division of Trading and Markets, which sets standards for orderly and efficient markets. A Getco spokeswoman said Ms. King has left the SEC and will begin her job on the firm's regulatory and compliance team in the next few weeks.

In his letter, Mr. Grassley said the hiring of Ms. King raises questions about her involvement in both the SEC's flash-crash investigation and its general examination of high-frequency trading.

Ms. King spent 17 years at the SEC. She was associate director for market supervision and oversaw the options and single-stock futures markets, a commission spokesman said.

People familiar with her responsibilities said she "did not have a meaningful role" in the SEC's examination of high-frequency trading.

SEC spokesman John Nester said the commission has a "rigorous program for employees who are considering leaving the commission to help them comply not just with the letter but also with the spirit of the law."

In an emailed statement, a Getco spokeswoman said Ms. King had "recused herself from matters affecting our business beginning in March—well before the market events of May 6."

"Getco is fully committed to the highest ethical and legal standards," the spokeswoman added. "We have elected the most rigorous and transparent level of regulatory oversight for all of our businesses, and our goal is to maintain a world-class compliance program."

Mr. Grassley and the finance committee asked Mr. Kotz to provide a summary of any matters the inspector has reviewed that involve revolving-door issues and conduct a review of Ms. King's departure "so that Congress and the public can more accurately assess the integrity of the SEC's operations."

Mr. Kotz said in his response that he was aware of Ms. King's hiring by Getco and his office had already opened an investigation into "these issues of concern."

As a senior staffer, Ms. King is subject to a one-year "cooling off" period during which federal law prohibits her from representing clients before the SEC.

Last week, Sen. Edward Kaufman (D., Del.) said that restriction doesn't go far enough. Congress or the SEC should consider banning employees from taking jobs with companies affected by rule making in which the staffers had a significant role during the prior year, Mr. Kaufman said in a statement.

"Ms. King, from the day she is hired, will be able to inform Getco of her knowledge of the current views of every commissioner and fellow staffers with whom she worked as to the meaning of the May 6 flash crash and the possible direction of future studies and rule makings involving high-frequency trading," Mr. Kaufman said.

As the Journal reported in April, lower-level employees of the commission can legally appear at the SEC on behalf of clients the day after they leave, as long as they file letters disclosing the representation. Employee disclosures obtained by the Journal under a public-records request showed some staffers made the transition quickly.

As reported, a senior accountant who left the commission's enforcement division in the summer of 2008 filed a letter five days later disclosing that he would be representing a client involved in a "nonpublic investigation" by his old division.

An enforcement lawyer in the commission's Los Angeles office left around the same time and signed on to represent a client 11 days later, a disclosure that he filed showed.

Mr. Grassley's letter also cited recent reports by Mr. Kotz, the SEC's inspector general, that highlighted revolving-door conflicts that cropped up during SEC investigations of Allied Capital Corp. and R. Allen Stanford, who is fighting charges of operating a multibillion-dollar Ponzi scheme.

In the Allied case, Mr. Kotz alleged that SEC staffers were swayed by one former commission employee who worked at the company and another who represented the firm in meetings with the commission. The report on the Stanford case accused a former SEC enforcement official in Fort Worth, Texas, of repeatedly quashing probes of Stanford and then seeking to represent Stanford in private practice.

In his response to Mr. Grassley, Mr. Kotz cited two other cases. In a 2009 report, his office alleged that enforcement director Linda Thomsen, who had left the agency by the time the report was issued, had given improper disclosures and assurances about SEC matters to a former enforcement director working for J.P. Morgan Chase & Co. The SEC later cleared Ms. Thomsen of any wrongdoing. Ms. Thomsen didn't respond to a request for comment.

In a 2008 report, Mr. Kotz alleged that the director of the SEC's regional office in Miami had failed to vigorously enforce an action against Bear Stearns & Co. due to his personal relationship with a former SEC staff attorney who was representing Bear Stearns.

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