OVERSIGHT OF THE U.S. SECURITIES AND EXCHANGE COMMISSION'S OPERATIONS, ACTIVITIES, CHALLENGES, AND FY 2012 BUDGET REQUEST

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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CONTENTS

WITNESSES

THURSDAY, MARCH 10, 2011

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

OVERSIGHT OF THE U.S. SECURITIES AND EXCHANGE COMMISSION'S OPERATIONS, ACTIVITIES, CHALLENGES, AND FY 2012 BUDGET REQUEST

Thursday, March 10, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS AND
GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Schweikert, Royce, Biggert, Neugebauer, Marchant, McCotter, Pearce, Posey, Hayworth, Hurt, Grimm, Stivers; Waters, Sherman, Hinojosa, Miller of North Carolina, Maloney, Perlmutter, Himes, and Peters.

Ex officio present: Representative Frank.

Chairman GARRETT. Good morning. This hearing of the Subcommittee on Capital Markets and Government Sponsored Enterprises entitled, "Oversight of the U.S. Securities and Exchange Commission's Operations, Activities, Challenges, and FY 2012 Budget Request," is hereby called to order.

As we are joined now by some of our colleagues, we will begin with opening statements and then turn to our panel for your statements, followed by questions. Breakfast has just been served. I will yield myself 2 minutes for an opening statement.

I welcome our witnesses to the committee today. I look forward to what I hope will be an educational hearing where members, especially some of our freshmen, have a good opportunity to hear what the different Divisions of the SEC are working on. At least some of the focus, I believe, will be focused, of course, on the SEC's budget. And, of course, when you get into that, there have been press reports about how Republicans are trying to starve the SEC, so on that point, let me just examine the facts for a moment.

Back in 2000, under the last year of the Clinton presidency, the SEC was allocated about $369 million. In Fiscal Year 2011, the SEC has a budget of about $1.14 billion. So in just over a decade, the SEC budget has, in fact, tripled.

Especially in this day and age, when we are running deficits of over about $1.6 trillion, I do not think it is fair to say that the SEC is being starved. In fact, it is just that sort of rhetoric that you hear, that only comes out of Washington, D.C., that language,

which basically gets unleashed in Washington every time someone around here tries to do the fiscally responsible thing. So we want to get into that a little bit.

I am also interested to hear from each of the witnesses about spending priorities that they have for each of their Divisions and offices. I am less interested in this area of hearing about how underfunded the agency is, especially as we wait for the study that is about to come out that will hopefully provide us with some thoughtful recommendations on how the Commission can and must become more efficient, reduce management overhead, and enact other internal reforms.

Before we even think about giving the agency yet another funding increase, at a minimum, the agency will need to show some major progress in implementing some of those recommended reforms.

So at today's hearing, I also hope to explore the lack of economic analysis being done on the SEC's proposed rules, which has led to some D.C. court appeals to basically rebuff Commission rules on a number of occasions in the last several years.

Finally, the SEC's union activities also need to be looked into. Several fundamental questions need to be asked in this area. For instance, is the union hampering reform efforts within the institution? Is it even appropriate for a bunch of basically highly paid government attorneys to be organized into a union, and if so, why?

There is plenty to be discuss today, so I look forward to our witnesses' testimony and a robust question-and-answer session. And with that, I will yield back my time, and yield 5 minutes to the ranking member.

Ms. WATERS. Thank you very much, Mr. Chairman.

Last month, House Republicans passed H.R. 1, a continuing resolution that would slash funding for the SEC. We know that H.R. 1 would have serious consequences for the SEC's ability to police our capital markets, so I am pleased to have a representative from each of the SEC's Divisions to tell us directly about SEC's funding needs and how a lack of funding will impact their respective Divisions.

I have long maintained that cutting funding to the SEC would take Wall Street's cop, its only cop, off the beat. Since H.R. 1 passed the House, we have learned of several enforcement actions the SEC has taken against fraudulent actors.

On February 28th, the SEC charged a major supplier of body armor to the U.S. military and law enforcement agencies for engaging in a massive accounting fraud. On March 1st, the SEC announced insider-trading charges against a Westport, Connecticut-based business consultant who has served on the boards of directors at Goldman Sachs and Proctor & Gamble.

Also on March 1st, the SEC charged a Bay Area hedge fund manager with concealing more than $12 million in investments proceeds that he owed to investors in his fund. On March 3rd, the SEC charged a former financial adviser at UBS Financial Services, LLC, with misappropriating $3.3 million in a scheme that included bilking investors in a private investment fund he established.

So you see, Mr. Chairman, in 4 days, the SEC brought charges against 4 different actors for accounting fraud, insider trading, and

misappropriation of funds. These high-profile cases aside, we know the SEC also does other low-profile work that is just as critical to the functioning of our markets. I am very concerned about the SEC's ability to be our cop on the beat, if it doesn't receive the funding it needs.

In 2008, we saw the consequences of an underfunded and understaffed SEC when our financial markets collapsed. To prevent another crisis, we passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. The law authorizes the SEC to regulate derivatives, provide oversight of investment advisers and broker-dealers, and rein in credit rating agencies.

Dodd-Frank gives the SEC the tools it needs to protect our financial markets. However, in order to fully implement Dodd-Frank, the SEC needs additional funding. If the SEC is funded at the levels in the CR, it would have to lay off hundreds of staff and cut its information technology budget down to 2003 levels. The result would be the inability of the SEC to implement the new systems they need to protect the Nation's securities market.

What does this mean for the average investor? Without adequate funding, the SEC won't be able to do its job of protecting them. As financial markets and investments become more and more complex, the average inventor has confidence in making an investment because he or she knows there is a system in place to protect them. H.R. 1 and other attempts to reduce funding for the SEC will undermine that system.

Thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman GARRETT. I thank the gentlelady.

I yield now to the gentleman from California for 1½ minutes.

Mr. ROYCE. Thank you. A couple of quick observations, Mr. Chairman. First, the Democrats had the House and the Senate for 4 years. Whatever amount of funding they wanted to give the SEC, they could have given them.

But the point is that if more money necessarily meant a more effective SEC, then I would understand the concerns being raised here. But unfortunately, over the last decade, the opposite has been the case, because we have seen the SEC's budget more than triple, and it has repeatedly failed to stop the most egregious cases of fraud.

The agency was largely absent during the financial crisis. Records show that they knew about the Stanford Ponzi scheme since 1997 and it did nothing to stop it. Over a 16-year period, the SEC and other regulator bodies examined Bernie Madoff's firm 8 times, 3 Administrations over that period of time. Neither the examination nor the repeated attempts from industry to alert the SEC were enough.

And as Mr. Markopolos told this committee, this episode was directly attributable to a lack of market experience combined with an investigative ineptitude within the SEC. As he has said, it is not monetary, it is cultural.

The SEC is an overlawyered, overly bureaucratic agency that needs fundamental reform, and simply throwing money at the problem is not the solution, especially given our budgetary crisis.

I yield back.

Chairman GARRETT. I thank the gentleman from California.

I now yield to the other gentleman from California for 3 minutes.

Oh, sure.

The gentleman from Massachusetts, the ranking member of the full committee.

Mr. FRANK. How much time?

Chairman GARRETT. Three minutes, if that is—

Mr. FRANK. I believe we are confronting a great piece of illogic—namely, that because the SEC has not performed well in the past for a variety of reasons, we should punish the American people by depriving it of the resources to do its job in the future.

Some of those reasons were ideological, some may have been incompetence, but the notion that the SEC, which was given new duties to protect investors, to register hedge funds, to deal with unregulated derivatives, should get less money in the current year than it had the year before makes no sense, except if you do not believe in regulation, if you continue to believe, despite all the facts of the past few years, that the market is best left to itself.

By the way, there is an interesting comparison here. A majority of this House voted during the continuing resolution. We were told we have to save money. We voted in this House, over my objection—I lost; a number of others voted with me—to send $1.2 billion to build up Iraqi security forces.

If you were going to look at how money is spent efficiently, the SEC on its worst day will look a great deal better than the Iraqi security forces. And the question is, from what are Americans in greater danger? From problems in Iraq, that the Iraqi security forces very ineffectively, it seems to me, deal with, or from abuses of investors here, of financial crises here? That is the issue.

Yes, the SEC needs expertise. They are not going to get it with a budget that is smaller than before. And the numbers make it very clear.

By the way, the amount that we need for the SEC barely—it is just about equaled for it to be able to do its job a little bit less than the amount the majority has voted to send to Brazilian cotton farmers.

Brazilian cotton farmers are going to get $150 million a year, last year, this year, the next couple of years, in American tax dollars so that we can continue, according to my Republican colleague, to subsidize American cotton farmers.

So much for free enterprise. Probably if you have read—none of that applies to agriculture.

So, it is hardly money. When we can send more than that to Iraqi security forces, when we can send that amount to Brazilian cotton farmers, you are in ideological opposition to the SEC taking on new regulatory powers. And the notion that they can do these new powers better than they have done in the past, with less money that they had in the last year, is not a serious argument.

It is simply an effort to hide behind budgetary considerations, when this comes from people who are prepared to waste far more money in other ways to hide in ideological opposition.

And by the way, we ought to be clear. What the Republicans want is for the SEC to become even more of a profit center, because at the budget level they are talking about, it brings in about prob-

ably a little bit more than would be spent. And the notion that we would not allow the SEC to carry out the responsibilities this Congress gave it, over the objections of my Republican colleagues, but which we gave it, is a great mistake.

Chairman GARRETT. I thank the gentleman.

Moving off of international policy and agricultural policy, to the gentleman from Texas for 1½ minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I want to read a couple of things here. One is, according to the SEC's conduct regulation, "The Securities and Exchange Commission has been entrusted by Congress with protection of the public interest in a highly significant area of our national economy. In view of the effect which the Commission action frequently has on the general public, it is important that the employees maintain unusually high standards of honesty, integrity, impartiality, and conduct."

According to the standards of ethical conduct for employees of the Executive Branch: "Employees shall endeavor to avoid any action creating the appearance that they are violating the law or ethical standards set forth in this part. Where the particular circumstances create an appearance that the law or these standards have been violated should be determined from the perspective of a reasonable person with knowledge of relevant facts."

One of the concerns I have is a recent investigation by Chairman Baucus, Mr. Garrett, Mr. Hensarling and me into Mr. Becker's positions at the SEC. I have called into question where an employee has actually admitted that they may have a potential conflict, and yet that was addressed very lightly. And when I look at the appearance standard in the reasonable person standard, it appears that possibly that was not followed in this issue.

As an agency that is called to call others to very high standards of ethics and transparency, I am very concerned about the standards inside the agency and how those are being enforced. And so, I hope that we will have more time to discuss that today.

I yield back.

Chairman GARRETT. The gentleman yields back.

The gentleman from California, for the remaining 2 minutes.

Mr. SHERMAN. Thank you.

Back in 1996 when I got here, and for many years, experts came and sat where you are sitting now and told me that we were the most prosperous country in the world because we had the best capital markets in the world, because we had the best securities regulators in the world.

Now that we live with this economic catastrophe, we don't hear from them. But the fact is that it is a direct result of the failures of the SEC, that the SEC has not failed to carry out its primary mission, which is to protect the titans of Wall Street, to make sure they are still getting our 401K money directly, but that that our raft is diverted.

So we have our budget hearings. We can have a lap dog, or we can have an emaciated lap dog. This isn't much of a choice for the American people. When you see how the Madoff situation was handled, because it is much simpler than the much more important handling of mortgage-backed securities, you have a hear no evil,

see no evil, protect all the folks on Wall Street who go to the right clubs approach.

And then, you see no one get fired. Yes, if you watch porn, you will be fired, but no one gets fired for intentionally closing their eyes to obvious information, whether it is AAA for Alt-A, or whether it is Madoff, or whether it is Stanford. And so I hope that we will have hearings not just on their budget, but on the culture of the SEC and what we can do to turn them into the watchdogs they ought to be.

I yield back.

Chairman GARRETT. I thank the gentleman for yielding back. And, of course, the gentleman is free to explore those other issues today during your questioning period.

Mr. SHERMAN. I thank the Chair for his decision to give me 20 or 30 minutes to question the witnesses.

Chairman GARRETT. There you go. And if we want to go around for a second time, maybe the panel is going to be here.

But at this point, I yield 1½ minutes to the gentleman from New Mexico.

Mr. PEARCE. Thank you, Mr. Chairman. I appreciate the opportunity to have this hearing. I am glad at the end of the long title that you put that we are discussing the 2012 budget request, because I am not sure how we could ever get all of the things in.

I, like many other members, have looked with dismay at the Madoff situation, but beyond that, I look at the decision models going down the stretch of 2008, and I remember us sitting down here on a Sunday night, discussing whether or not mark-to-market should be suspended. It was pulling capital basically off the ability to loan at a very desperate time when we needed to be lending money.

The decision to stop short sales at the particular point that decision was made was another incongruity that made it look like you all work in procyclical rather than countercyclical—that is, that if it is going good, you try to make it go better; if it is going bad, you try to make it go worse. Your decision models really, I think, bear scrutiny, and I would love to participate in that today.

But the final piece that I wonder about is the leveraging, why no one felt that the holding companies should not be leveraged 40–to–1. I wonder why no one raised a question about that.

So I will be interesting to hear answers on these before we discuss the budgets because if you are going to work procyclical, I do see a reason of depriving you of the resources that you need to drive us deeper into a recession with your decisions.

Thank you.

Chairman GARRETT. And the gentleman yields back.

The gentlelady from New York for a minute-and-a-half.

Dr. HAYWORTH. Thank you, Mr. Chairman.

And thank you, all of our witnesses, for appearing before us today.

My particular interest is your views about the implications of one specific provision of Dodd-Frank, namely Section 953(b), which directs you to issue regulations requiring all public companies to disclose the ratio of the median compensation of all employees, the median total compensation to the total compensation of the CEO.

I would submit respectfully to you, and this is why I am so eager to hear about what you have to say about this, that the substance and the language of 953(b) are problematic. As it is currently formulated, it certainly appears as though it will create far more burdens than benefits, create more heat and light and more work than actual useful information. And that is a significant problem in this era, particularly when we have to have resources dedicated with ever more force toward investment and job creation.

As a Congress, we are charged with looking after the best interests of our citizens. That includes our investors, of course. And it includes the enterprises that create jobs.

The SEC has a crucial providential role in assuring that we do have confidence in our markets. But I submit to you that Section 953(b) is an example of how well-intentioned regulation can in fact create impediments and obstacles. And I would submit as well that it was in fact many well-intentioned actions that were very damaging, indeed contributed materially to the crisis of 2008 to begin with.

So I look forward to hearing your views on how we can mitigate the negative consequences of Dodd-Frank, particularly that section. And I thank you for your testimony.

Mr. Chairman, I yield back.

Chairman GARRETT. And I thank the gentlelady.

I thank the panel for being with us today. And we will begin the panel with Mr. Khuzami.

I understand that there is one written statement for the panel. And, of course, without objection, your written statement will be made a part of the record. Mr. Khuzami, you will be going first, but you will all be recognized for 5 minutes.

Mr. Khuzami?

I am sorry, just pull your microphone a little closer and make sure—I guess the green light should be on. Is that still on? Or I might be losing my hearing.

Mr. KHUZAMI. Let us try one more time. Thank you.

Chairman GARRETT. There you go.

STATEMENT OF ROBERT KHUZAMI, DIRECTOR, DIVISION OF ENFORCEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. KHUZAMI. Thanks for the opportunity to testify today concerning the President's Fiscal Year 2012 budget request for the Commission and to report on the broad responsibilities performed by the SEC, the recent reforms we have undertaken under the leadership of Chairman Shapiro, and the challenges that lie ahead for the agency.

I come to the Enforcement Division as a former Federal prosecutor with the United States Attorney's Office in the Southern District of New York. In that office, I served as chief of the Securities and Commodities Broad Task Force and in the office's counterterrorism unit, where I was a member of the prosecution team that convicted the "Blind Sheik," Omar Ahmad Ali Abdel-Rahman and nine co-defendants for an international terrorism conspiracy, including the 1993 bombing of the World Trade Center.

After that and before joining the Commission, I served as general counsel for the Americas Deutsche Bank AG, and before that, as the bank's global head of litigation and regulatory investigation.

Since my arrival at the Commission, it has been abundantly clear that the SEC's ability to successfully meet the challenges posed by a continuously and rapidly evolving market place is critical to restoring investor confidence and market integrity.

At the same time, we must fulfill the significant additional responsibilities mandated by Dodd-Frank, and we are for that reason requesting a Fiscal Year 2012 budget of $1.407 billion. Under the Dodd-Frank Act, appropriations for the SEC will be fully offset by our industry fees, thus making our funding deficit neutral. Each of my colleagues here today will detail how this funding level is essential for the operations of their Divisions.

And in the Enforcement Division, our funding needs are great, but we also understand that we must be efficient, innovative, and responsible in spending taxpayer money. As I told my staff on the very first day I served as Director, "We need to be as efficient as we can with what we have now. That means improved information technology, better allocation of resources, better distribution of lower value and high value work and more streamlined staffing. And it will require each of us to examine our own individual efforts, think about how we spend our day, how we allocate our time, and how we can be more productive."

To achieve the goals that we set out on that first day, we undertook the most significant restructuring to the Enforcement Division since 1972. We introduced five new national specialized investigative units dedicated to high-priority areas of asset management, market abuse, structured products, Foreign Corrupt Practices Act violations, and municipal securities and public pensions.

We adopted a flatter, more streamlined management structure under which we doubled our staff-to-manager ratio and reallocated managers back to the frontline of conducting mission critical investigations.

We established an Office of Market Intelligence to correct, collect, risk-weight, assign, and monitor the thousands of tips, complaints, and referrals that the SEC receives every year.

We created a COO's office to handle operations such as IT, workflow, budget and project management, tasks formerly handled by lawyers—and, frankly, that is not their core competency.

And we adopted streamlined procedures to initiate formal and informal investigations and issue subpoenas.

We are also adopting new whistleblower authority given to us under Dodd-Frank to compensate individuals who provide the SEC with useful information about securities law violations.

And although statistics alone cannot capture the breadth of the Division's efforts, we have seen significantly increased enforcement activity that occurred despite the dislocation that came with that very significant restructuring.

In each of the past 5 years, we have filed more enforcement actions than in the previous year. In 2010, our actions resulted in $2.85 billion in ordered disgorgement and penalties, a more than 176 percent increase over the amounts ordered in 2008.

We brought emergency relief in 37 actions and obtained 57 asset freezes to preserve investor funds and distributed nearly $2 billion to harmed investors.

During the past year, we have brought significant actions against individuals and companies arising out of the financial crisis, including cases involving companies such as Countrywide Financial, Morgan Keegan, Goldman Sachs, Citigroup, State Street Bank, New Century Financial, Indy Bankcorp, and Colonial Bank, to name just a few.

We have brought significant actions arising out of the Foreign Corrupt Practices Act, as well as actions involving municipal securities and accounting fraud. We filed cases alleging insider trading by corporate directors and by hedge funds, using technology company employees posing as consultants in expert networking firms.

Despite this success, the enforcement program continues to face significant challenges. Whether it be high-frequency trading, hedge fund performance, asset valuation, pension liability analysis, or any number of other areas, we are more and more faced with the need to understand and identify wrongdoing in products, markets, transactions, and practices that are increasingly complex, fast-paced, or both.

For those reasons, our resource needs are most acute in the areas of IT, data access and analysis, human expertise, and paraprofessional and administrative support.

I look forward to working with Members of Congress on these issues. Thank you.

[The joint prepared statement of Directors Khuzami, Cross, Cook, di Florio, and Rominger can be found on page 49 of the appendix.]

Chairman GARRETT. Thank you.

Ms. Cross?

STATEMENT OF MEREDITH CROSS, DIRECTOR, DIVISION OF CORPORATION FINANCE, U.S. SECURITIES AND EXCHANGE COMMISSION

Ms. CROSS. Good morning, Chairman Garrett, Ranking Member Waters, and members of the subcommittee.

My name is Meredith Cross, and I am the Director of the SEC's Division of Corporation Finance. I rejoined the Commission staff in June of 2009. I have been a securities lawyer for over 25 years, with about 18 years in private practice and 9 years of government service. I am pleased to testify today along with my fellow Directors.

The Division of Corporate Finance's core functions are reviewing company filings, making rulemaking recommendations to the Commission that relate to corporate finance matters, and providing interpretive advice to market participants and the public about the securities laws and corresponding regulations for corporate finance matters.

With a staff of approximately 485, we are responsible for the review of about 10,000 reporting companies, including tens of thousands of disclosure documents each year, plus initial public offerings and other public capital markets transactions of corporate issuers, public asset-backed securities offerings, and proxy statements, public mergers, acquisitions, and tender offers.

Approximately 80 percent of the staff of the Division is assigned to this review function. The Sarbanes-Oxley Act requires the Division to review the financial statements of all companies reporting under the 1934 Act at least once every 3 years, and more frequently where circumstances warrant.

This is no small task. Following enactment of the Sarbanes-Oxley Act in 2003, the Division revised its review program to meet the new review mandates and hired significant numbers of new staff accountants, which has enabled us to meet the review mandate each year.

In light of the lessons learned from the financial crisis, the Division recently made some targeted changes to its operations, including adding three new offices: the Office of Structured Finance, which will help us address some complexities and changes in the asset-backed securities market; the Office of Capital Markets Trends, which will evaluate trends in securities offerings and our capital markets to determine if our rules and review approach are adequately addressing them; and a new review group in disclosure operations that will focus on the largest financial institutions.

While the Division has established these offices and will transfer some existing staff to them, our aim to fully staff these offices has been deferred until funding has been resolved.

In addition to the review function, Corporation Finance makes rule recommendations to the Commission to address areas in need of change. The Division expects to recommend changes to existing rules in a number of areas in Fiscal Years 2011 and 2012, including modernizing our core disclosure requirements which haven't been updated in more than 30 years, reducing burdens and facilitating capital formation for small businesses, providing disclosure about credit rating shopping, addressing company and investor concerns about the proxy voting system and updating our beneficial reporting rules.

In addition, Corporation Finance is responsible for preparing a wide variety of rules to implement a significant number of Dodd-Frank Act requirements. We have temporarily reassigned a number of attorneys from throughout the Division for this rulemaking.

Dodd-Frank topics that Corporation Finance is addressing include, among others: asset-backed securities; corporate governance and executive compensation rules such as say-on pay and golden parachutes, compensation committees and compensation consultants; clawbacks of the erroneously awarded compensation, pay versus performance and pay ratios disclosure, and employee and director hedging; specialized disclosures provisions relating to conflict minerals, coal, or other mine safety, and payments by resource extraction issuers to foreign or U.S. Government entities; and finally, with regard to exempt offerings, revisions to the definition of accredited investor and disqualification of offerings involving felons and other bad actors from relying on Rule 506 of Regulation D.

In addition to our review and rulemaking responsibilities, the Division of Corporation Finance responds to tens of thousands of requests for interpretive advice from market participants and the public.

In Fiscal Years 2011 and 2012, we expect our workload in this area may increase beyond that of recent years, primarily as a re-

sult of the Commission's adoption and implementation of the rules required by the Dodd-Frank Act.

Thank you again for inviting me to appear here before you today, and I look forward to answering your questions.

[The joint prepared statement of Directors Khuzami, Cross, Cook, di Florio, and Rominger can be found on page 49 of the appendix.]

Chairman GARRETT. Thank you, Ms. Cross.

Mr. Cook?

STATEMENT OF ROBERT COOK, DIRECTOR, DIVISION OF TRADING AND MARKETS, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. COOK. Thank you. Good morning, Chairman Garrett. Thank you, Ranking Member Waters and members of the subcommittee. Thank you for inviting me to testify today on behalf of the Division of Trading and Markets for the Securities and Exchange Commission regarding the Division's operations, activities, challenges, and the Fiscal Year 2012 budget request.

It is a pleasure to appear here today with my colleagues from the—

Mr. PEARCE. Mr. Chairman, can he pull the microphone closer to him?

Mr. COOK. Can you hear me better now? Sorry about that.

I joined the Division of Trading and Markets as Director in January of last year. Before coming on board, I was a lawyer in private practice, where I focused on derivatives and securities regulation and transactional matters.

I would like to start today by briefly describing the core functions of the Division and then discuss some of our activities related to the Dodd-Frank Act.

Broadly speaking, the Division is responsible for establishing and maintaining standards for fair, orderly, and efficient securities markets. We work to establish regulatory standards from markets and market intermediaries, including 15 securities exchanges, over 60 active alternative trading systems and over 5,000 registered broker-dealers. We also oversee FINRA, the MSRB and the SIPC, and we have responsibility for rules relating to 9 active clearing agencies, around 500 transfer agents, and 10 credit rating agents.

Our core functions include: processing proposed rule changes from exchanges, clearing agencies and other SROs, which address issues ranging from fee structures to trading rules; initiating changes to market rules to keep pace with market developments; establishing or approving rules governing broker-dealer activities, including rules pertaining to capital adequacy, protection of customer assets, anti-money laundering and sales practices; actively participating in international working groups to help ensure that international standards are consistent with Commission policy and in the interests of the United States; leading and administering Commission initiatives with respect to a wide range of trading practices; and supervising the capacity and resilience of our largely electronic exchanges to minimize potential disruptions to market continuity.

The Division also leads Commission efforts to respond to significant equity market events, such as the severe market disruption of

May 6, 2010, following which we published two joint reports with the staff of the CFTC and led the development and implementation of key regulatory responses.

The Division's mission has become ever more challenging with the exponential growth in the size and complexity of the U.S. securities markets. In this fiscal year and the next, the Division plans to focus on several key initiatives to improve market oversight.

First, we will continue to explore the issues raised in the Commission's 2010 concept release and public roundtable on equity market structure, including high-frequency trading and undisplayed liquidity.

Second, we plan to continue to work on proposals regarding large trader reporting and a consolidated audit trail system, both initiatives designed to enhance market surveillance.

Third, we plan to continue to identify and, as appropriate, develop rules to respond to significant equity and options market developments. This process includes the development of a "limit-up, limit-down" functionality for equity markets and the review of proposed exchange mergers and business combinations.

Our core functions have been substantially expanded by the mandates of the Dodd-Frank Act. All told, the Division is responsible for over 25 separate rulemaking initiatives, with adoption deadlines of 1 year or less.

Most notably, we have been charged with responsibility for developing the registration and regulatory regime for participants in the security-based, over-the-counter derivatives market, namely, security-based swap execution facilities, data repositories, dealers, major participants, and clearing agencies.

Going forward, this will mean that the Division will be registering these new entities, monitoring market developments, and promulgating new rules and guidance where necessary.

The Division is responsible for implementing many other aspects of the Dodd-Frank Act, a number of which will increase the demands on the Division's personnel, including rules related to enhanced oversight of financial market utilities, proprietary trading activities of broker-dealers under the Volcker Rule, certain incentive-based compensation arrangements at broker-dealers, and audit requirements for broker-dealers.

Pending the creation of new offices for credit rating agencies and municipal securities, the Division is also continuing to carry out our existing functions in these areas, including the preparation of rules required by the Act.

While the Division's workload continues to be dominated by a diverse range of core functions that are vital for protecting investors and markets, the scope of its responsibilities has expanded tremendously. Many of these rulemakings are the first step in a new, ongoing supervisory and regulatory function for the Division that will extend into Fiscal Year 2012 and beyond.

Thank you for inviting me to share with you the work of the Division of Trading and Markets. I look forward to answering your questions.

[The joint prepared statement of Directors Khuzami, Cross, Cook, di Florio, and Rominger can be found on page 49 of the appendix.]

Chairman GARRETT. Thank you, Mr. Cook.

Mr. di Florio?

STATEMENT OF CARLO DI FLORIO, DIRECTOR, OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. DI FLORIO. Good morning, Chairman Garrett, Ranking Member Waters, and members of the subcommittee. Thank you for the opportunity to testify today on behalf of the United States Securities and Exchange Commission.

I joined the SEC on January 25, 2010, just over 1 year ago. Prior to that, I was a partner in the financial services regulatory practice of PricewaterhouseCoopers in New York, where my practice focused on corporate governance, enterprise risk management, and regulatory compliance.

The SEC's examination program helps protect investors and ensure market integrity by examining for fraud, monitoring risk, improving compliance, and informing policy as the eyes and the ears of the agency in the field. Our exams assess whether registrants are treating investors fairly and complying with the Federal securities laws and regulations designed to protect investors and prevent fraud.

The examiners in the national exam program take a risk-based approach to examining over 20,000 registrants, including investment advisers, broker-dealers, mutual funds, hedge funds, derivatives dealers, credit rating agencies, SROs, national exchanges and transfer agents, and clearing agencies.

Our Fiscal Year 2012 budget requests new examiner positions so we can fulfill our new responsibilities under the Dodd-Frank Act, execute our core mission, and enhance our limited coverage of registered investment advisers.

In addition, we are also very focused on the resources we have been provided. Under the direction of a new leadership team over the past year, OCIE has undertaken a broad self-assessment of our strategy, our structure, our people, our processes, and our technology. This has resulted in a comprehensive restructuring and improvement plan to become stronger and more efficient.

For example, we are building a national exam program supported by a new governance framework that breaks down silos and facilitates coordination, consistency, effectiveness, and accountability across the country and across Divisions.

We have implemented a new central risk analysis and surveillance unit to enhance our ability to target those firms and practices that present the greatest risk to investors, markets, and capital formation.

We have begun to recruit experts and launch new specialty groups that will bring deep technical experience and expertise to our exam program in such areas as derivatives, complex structured products, hedge funds, credit rating agencies, high-frequency trading, and risk management.

We are working to implement a new certified examiner training program that will establish technical training and certification standards across the country. And we are streamlining the exam process and clearly defining new expectations, beginning to auto-

mate our exam tools, implementing an internal compliance program to monitor our performance and ensure our quality control.

No matter how much we improve our current program, however, the fact remains that our examiners can only cover a small portion of the 20,000-plus registrants that we regulate. For instance, our examiners were only able to examine 9 percent of registered investment advisers, and over one-third of registered investment advisers have never been examined.

With the addition of the positions sought in the Fiscal Year 2012 budget, we will be able to more effectively fulfill our new responsibilities, strengthen our core mission, and expand our impact on investment adviser exams.

Equally important, it will help us invest in the risk assessment and surveillance capabilities needed to allocate our limited resources to their highest and best use to protect investors and ensure market integrity.

Thank you, and I welcome the opportunity to answer your questions.

[The joint prepared statement of Directors Khuzami, Cross, Cook, di Florio, and Rominger can be found on page 49 of the appendix.]

Chairman GARRETT. Thank you, Mr. di Florio.

Ms. Rominger, please? And I would like to welcome you to the panel for the first time.

STATEMENT OF EILEEN ROMINGER, DIRECTOR, DIVISION OF INVESTMENT MANAGEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION

Ms. ROMINGER. Thank you. Chairman Garrett, Ranking Member Waters, and members of the subcommittee, thank you for the opportunity to testify today.

My name is Eileen Rominger. Today marks my 16th day on the job as Director of the Division of Investment Management at the SEC. Although I am new in this role, I have had over 30 years of experience in the asset management industry, managing client portfolios and leading teams of portfolio managers. Most recently, I was chief investment officer at Goldman Sachs Asset Management, responsible for portfolio management teams that encompassed about 500 people in 8 different countries.

I have met with hundreds of retail clients over the years, and I am well aware of the challenges that they face with increasing complexity in the investment choices available to them. I am dedicated to working with the Commission staff to address these challenges, to enhance transparency so that they can make informed choices, while maintaining a healthy asset management industry that sets the standard for the rest of the world.

The Division of Investment Management assists the Commission in its mandate of investor protection and support of capital formation. The Division oversees and regulates America's $38 trillion investment management industry. We administer the Investment Company Act and the Investment Advisers Act and develop regulatory policy for investment advisers, mutual funds, and other investment companies.

The rulemaking program of the Division of Investment Management is currently focused on implementing the provisions of Dodd-

Frank as they relate to investment companies and advisers. As the rules are adopted, much of the work will shift to the Division's Disclosure, Interpretive Advice, and Exemptive Relief Programs.

Dodd-Frank meaningfully changed the universe of regulated entities for which the Commission is responsible by increasing the threshold for investment adviser registration to $100 million in assets under management and by requiring advisers to hedge funds and other private funds to register with the Commission.

Approximately 750 new private fund advisers will be added to the registrant pool, but the number of registered advisers is anticipated overall to shrink by about 28 percent. At the same time, their assets under management will rise, and the complexity of those assets will actually increase pretty substantially.

Dodd-Frank also requires reporting by certain investment advisers that are exempt from registration.

In November, the Commission proposed rules and rule amendments to implement these new investment adviser requirements. These included new exemptions from registration created by Dodd-Frank for advisers to certain private funds relating to venture capital funds and advisers with less than $150 million under management. We are reviewing the comments and developing our recommendations for the Commission to adopt final rules.

Systemic risk reporting is another important area in which we must implement the requirements of the Dodd-Frank Act. In January, the Commission proposed reporting requirements for private fund investment advisers to assist the Financial Stability Oversight Council in monitoring for potential systemic risk. We will carefully consider the comments received and expect to prepare a rule adoption for the Commission to consider this year.

The Division hopes to hire additional staff with the expertise necessary to monitor, analyze, and make good use of the information that will be collected. In addition to implementing the provisions of Dodd-Frank, the Division is working on a number of important initiatives in other areas.

In January 2010, the Commission adopted important reforms in money market fund regulation, including a requirement for them to report their portfolio holdings on a monthly basis. This year, we plan to improve our monitoring of money market funds and our ability to analyze trends in their portfolio exposures, their liquidity levels, and their average maturity.

We are also considering further reforms aimed at lessening the susceptibility of money market funds to runs, including those options that were outlined in the President's Working Group report on money market funds that was released last October.

In the last year, there have been a number of other important investor protection initiatives. These include Rule 12b-1, relating to distribution fees, which the Commission has proposed to rescind and replace with a new rule and regulatory framework.

The Commission has also proposed changes to rules regarding target date funds specifically relating to the naming conventions and marketing materials. We are thoughtfully reviewing those comments and will evaluate whether to recommend that the Commission adopt these reforms.

In addition to our role in Commission rulemaking, a large part of our responsibilities also involve providing formal and informal legal guidance in the form of interpretative and no-action letters, as well as exemptive relief from the provisions of the Investment Company and Investment Advisers Acts. We also review filings of registrants in order to monitor and enhance compliance with disclosure and accounting requirements.

Pursuant to the requirements under the Sarbanes-Oxley Act, the Division reviews the annual reports of all registered investment companies no less frequently than every 3 years. The other responsibilities of the Division include provision of technical advice and active participation in international groups such as IOSCO and also provision of legal and policy guidance to the Division of Enforcement on matters concerning investment managers.

Again, thank you very much for the opportunity to testify today, and I look forward to your questions.

[The joint prepared statement of Directors Khuzami, Cross, Cook, di Florio, and Rominger can be found on page 49 of the appendix.]

Chairman GARRETT. Thank you for your testimony.

I thank the panel as well.

So, I will begin, and before I get into the weeds on some of the questions, if I bring up on the screen up here—

After you do that, you can begin my time.

Just to dispel the myth with regard to the first issue, regarding lack of funding for the agency, I know it is a little hard, but that chart basically shows the SEC budget obligations from the year 2000 to 2011. And you can see it is almost a straight line up, and what that is, is a basic average year-over-year increase on average of over 10.8 percent from 2000 to 2011.

Now, if you go to the next chart to find out—

Next chart? Starting the next chart—how about that one?

That chart asks the question, what was the actual rate of inflation during those years? It goes up and down, of course, but the average period was 2.5 percent. So that last chart showed you that they were getting around over 10.8 percent each year. This is the actual increase in inflation overall, 2.5 percent.

So this final and third chart put these things together for you and shows you—there you go—what would have been their funding, had they been increased on funding level at a constant level of 2.5 percent year over year over year, compared to the initial charts. I think that sort of dispels the myth that there has been an agency that has been starved.

Understandably, there has been a larger marketplace, more to regulation, and Dodd-Frank increases all the responsibilities, as all have said, but overall, it is a stark difference between where they would be, had they been like most other businesses, families, what have you, living within the means of the average increase of 2.5 percent—instead, actually over 4 times as much of the 10.8 percent year-over-year.

So, that is the funding aspect. But let us get into some of the things that you are actually working on right now.

Mr. Cook, just a quick question here with regard to a consolidated audit trail, and doing so in real time. Can you tell me where

we are on that? Are you still pursing a real-time consolidated audit trail, briefly?

Mr. COOK. The Commission has not yet acted on that. We are reviewing all the comments that have come in. As you are alluding to, part of the proposal was a real-time reporting element, and we are looking at the comments to determine whether that should stay as one of the elements and how that fits together with the rest of the cost of the program.

Chairman GARRETT. Okay, because that is one of the points, obviously. It is going to be pretty expensive to do something like that, right? And, secondly, would real-time be absolutely necessary? Because an end-of-day aggregation would be just as adequate, because I don't know if anyone is going to be able to just stay up on top of it. Is that true?

Mr. COOK. It is a good question, Congressman. We are trying to strike the right balance between finding something that is very cost-effective that will give us the information we will actually be in a position to use, but also, if we are going to go through this process of building something out like this, and it will be a multiyear process to build this audit trail, that we build something that is not just what we need today, but will be something that we can use in the future.

We have been thinking a lot and looking closely at new technologies that we weren't aware of when the original proposal came out that we are hopeful will allow us to substantially reduce the cost.

Chairman GARRETT. So it is something—in other words, you haven't done it yet, but you are still considering going forward with it?

Mr. COOK. Yes.

Chairman GARRETT. Okay.

Mr. Khuzami? Somewhere here I have an article that was in Bloomberg a little bit ago and I will just—I guess last June it was—and I will just ask you—I will pick through and find it—but what it was, it was talking about some of the efforts to try to bring that technology to the workforce there, to the lawyers and what have you, and the article was talking about giving BlackBerries, which every one of us up here have, to make sure that the folks on enforcement staff would actually be able to be in communication with.

My understanding just from that article was that there was pushback to that from the unions and the pushback was, according to the piece, that "we don't want our paid staff, the lawyers, having to be responsible to respond after business hours, after 5 p.m."

Is it the case that there was pushback from the unions, and that was part of the impediment of doing that?

Mr. KHUZAMI. Congressman, there were some initial comments to that effect, but in my experience, it dissipated quickly. People are using them, and I certainly have never had a situation where I haven't been able to reach someone or someone has told me that they haven't been able to reach someone for that reason.

Chairman GARRETT. But that was pushback from—where did the pushback come from?

Mr. KHUZAMI. The issue was raised by—I can't remember whether it was the union or some other individual or group of individuals but, like I said, I don't think it gained any traction.

Chairman GARRETT. Okay. We are all here on a 24/7 process. You would think the folks that we are talking about, these are attorneys, are they not, in a lot of cases?

Mr. KHUZAMI. There is a large percentage of lawyers in the Enforcement Division. That is correct.

Chairman GARRETT. And, I guess you would agree that they are sort of well-paid folks, so asking them to work after 5 p.m. would be appropriate responsibility.

Mr. KHUZAMI. Clearly. And I have seen no shortage of people willing to commit and work hard, so I don't think that issue is any kind of impediment.

Chairman GARRETT. Okay. So another that came out, Mr. di Florio, with regard to push back, I guess, from the unions, there was an attempt to implement a quality control review after each examination. And, basically, the idea from other members' comments here with regards to the Madoff examination, what have you, right? So you know what I am talking about.

But I understand in this case—correct me if I am wrong—again, there was pushback by the unions in this area. And I understand that the post-examination quality process—and tell me if this is not correct—is still not implemented due to continued union objection. So first of all, is that the case?

Mr. DI FLORIO. Chairman, since I joined a year ago, I have not had any problem pursuing quality control in the examination process. We have implemented a number of quality control mechanisms as we have streamlined our exam process, and we have not had pushback from the union with regard to the initiatives I have implemented. I am not familiar with initiatives that may have been the case before I joined.

Chairman GARRETT. So none of the things that you have tried to do during this time have had a pushback?

Mr. DI FLORIO. We have a process where we engage the union in the recommendations and the initiatives, but we did a comprehensive review with over 25 initiatives for improvement identified, and we are moving those forward, certainly in consultation with the union.

Chairman GARRETT. Okay. So were there any recommendations out of the report that were supposed to be implemented prior to you coming into your position, that were not implemented, that you have looked back on and said, these have still not been pursued and implemented because of any other impediments whatsoever?

Mr. DI FLORIO. I don't believe so, Mr. Chairman, but I will look into that when I get back and get back to you, if there were any issues.

Chairman GARRETT. Okay. And, as always, the time goes faster than the list of questions that are before me.

To the ranking member?

Ms. WATERS. Thank you. Thank you very much, Mr. Chairman.

Mr. Khuzami, Chairman Garrett just placed a chart for all of us to examine, and he basically said that the increases that you have

received over several years were far greater than the rate of inflation.

Why is it improper to look at those increases that way? Could you explain that to us? What I am seeing here is that you are operating at about 2005 levels, and you make the case for erratic funding, and you talk about trading volume more than doubling, the number of investment advisers have grown about roughly 50 percent, and the funds that they manage have increased nearly 55 percent, and on and on and on.

He is comparing your increases with the rate of inflation, and it seems as if that is not, perhaps, the right way to do it. Could you talk to us about that?

Mr. KHUZAMI. Congresswoman, as I said, let me just start by saying we understand the need to be as efficient and effective as we can, and that informed so much of the restructuring effort that we underwent in the Enforcement Division.

With respect to the increases over the years, I think if you look below the level, the actual staff members that have increased have not been that significant, because some of those increases went to certain dedicated efforts. The IT funding has been volatile, and that is particularly problematic if you are talking about trying to secure IT systems that sometimes you have to plan for years out.

I think our staff has actually decreased about 11 percent between 2004 and 2008. I think you can go back and forth on that, but I think the biggest consideration is, as you say, the complexity of the market and the challenges we face. We have 38,000 regulated entities, transfer agents, broker-dealers, and investment advisers to regulate and oversee. And we are an agency of 3,800 people.

Ms. WATERS. Would anybody else like to add to that explanation of why the rate of inflation may not be the correct way to look at what your needs are?

Mr. Khuzami, the spokesman for today?

Mr. KHUZAMI. I just want to make one other point, too. The banking regulators and our colleagues whom we work closely with—I think the rough numbers show that they have approximately one staff member for every one regulated entity. And we are roughly at a 1–to–10 ratio. Now, those numbers may not be exact, but they are close.

And I think that underscores the extent to which, while we are thankful for the increases that we have gotten, there is a significant market out there, and it is getting more complex and more fast-paced, and that is the basis for funding requests above and beyond the new Dodd-Frank obligations.

Ms. WATERS. So let me ask Mr. Carlo di Florio. You are the Office of Compliance Inspections and Examinations. Based on Dodd-Frank and the additional requirements that we are putting on the SEC, could you explain to us why you need the funding in order to carry out your function?

Mr. DI FLORIO. Thank you, Ranking Member Waters. As I mentioned in my statement, there are 20,000-plus registrants that we are responsible for regulating, and we only have 859 examiners to be able to address those registrants.

As Mr. Khuzami alluded to, the ratio that we have as a regulatory authority relative to what the bank regulators have or even

FINRA is drastically greater. So we are at a 1–to–23 ratio of examiners to registrants. And as a result, we have not had the ability to examine over one-third of investment advisers, and we have only been able to examine 9 percent of investment advisers in Fiscal Year 2010.

So in addition to that, you introduce the new requirements regarding hedge funds and derivatives and credit rating agencies under Dodd-Frank. There is a significant amount of new requirements being added, and we feel that additional positions will help us both execute our core mission more effectively and address the new requirements under the Dodd-Frank Act.

Ms. WATERS. Thank you very much.

I yield back the balance of my time.

Chairman GARRETT. Thank you.

Mrs. Biggert, for 5 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman.

I have a question, I believe, for Ms. Cross. I introduced a bill, H.R. 33, a clarification bill to allow church plans to invest in collective trusts so that, like corporate and other secular pension plans, church pension plans for clergy can have the benefits of collective buying power, and collective trusts generally allow pension plans to pool their assets, diversify their investments, and share the risks and transaction costs of other pension plans.

And I was informed that both staff at the SEC and my staff discussed this issue and agreed upon the language included in H.R. 33. So, can you confirm that the SEC supports H.R. 33 and also would support its quick consideration and passage?

Ms. CROSS. Thank you for your question, Congresswoman. First off, let me note that we wholeheartedly embrace the idea that the participants in the church plan should have the same opportunities as participants in other plans and there shouldn't be regulatory obstacles. The Commission hasn't taken a position on the bill, so I need to start there.

From the staff's perspective, the only thing that we want to make sure is that there aren't regulatory gaps that would work to the detriment of the people in the church plans, compared to other people in these kinds of employee benefit plans. We would like to take a careful look and make sure there wouldn't be regulatory gaps, and if there are, work with your staff quickly to address them.

Mrs. BIGGERT. I appreciate that. Thank you. I hope that you will support it.

I have another question, and I am not sure who to address it to.

In January, as required by Dodd-Frank, Section 914, the SEC staff issued a study on enhancing investment advisers examinations. And the report offered three options for Congress to consider to strengthen the Commission's investment adviser examination program.

I would like to know which option you see as being the most effective, efficient, and cost-effective for the SEC? But, more importantly, which option do you see as the least burdensome and least costly for small businesses?

I have heard from constituents who are very concerned about new fees, which they see as equivalent to new taxes under any of

these proposals. Did you take into consideration the cost to advisers and small businesses?

Mr. DI FLORIO. Congresswoman, I will initially answer that—

Mrs. BIGGERT. Okay.

Mr. DI FLORIO. —and share the perspective that the 914 study laid out the three options of first increasing examinations of investment advisers through user fees on the investment advisery industry, which would allow the exam function in the SEC to grow and close that gap of being able to examine further investment advisers.

The second option was to, through dues, establish a self-regulatory organization for the investment advisory program similar to what you have with regard to FINRA and the broker-dealers.

And then the third option was to enable FINRA to extend their authority and review of an investment adviser, where it is a dual registered broker-dealer investment adviser.

All three of those options are reasonable and feasible options. As you mentioned, there are some investment advisers, smaller businesses, medium-sized businesses, who feel that it is more efficient to invest in the SEC since it already has the infrastructure, is already doing the exams, and grow that program.

There are others who feel that it would feel that it would be more efficient to invest in a self-regulatory organization that is closer to the industry, and that would be done through dues.

We believe that the important objective is to increase the number of exams done of the investment advisers, and either one of those options are reasonable and would be effective in achieving that objective.

Mrs. BIGGERT. Okay. Thank you. So that would be, I guess, one and two?

Mr. DI FLORIO. Correct.

Mrs. BIGGERT. Okay. Thank you.

And then I have one more question, if I have time. Last month when Chairman Shapiro testified before the committee, I asked her about the SEC interaction with the Department of Labor, which has proposed a new definition of fiduciary that would significantly modify 35 years of established law.

And then I also had an opportunity to ask Secretary Solis of the Department of Labor about the same issue. I was concerned that the Department of Labor was not listening or really working with the SEC. So has there been further discussion about the fiduciary between the Department of Labor and the SEC?

Ms. ROMINGER. Congresswoman, I will answer that.

The Investment Management Division has a long history of very extensive interaction with the Department of Labor, and it has been actively involved with them on a number of issues, including recent conversations around target date funds and on other issues.

Their definition of fiduciary as it relates to ERISA is really something that falls within their jurisdiction because of their very specific focus on retirement investing. But rest assured, we are very committed to working closely with them.

Mrs. BIGGERT. Thank you.

I yield back.

Chairman GARRETT. Thank you.

The gentleman from California, to compress his 20 minutes of questions into 5 minutes?

Mr. SHERMAN. Mr. Cook, if you allow the pitcher to select the umpire, at the end of the game, that pitcher would be awarded the Cy Young Award. The only thing that both the Democrats and Republicans on the investigatory commission of the meltdown agreed on was that the system of allowing those who issue bonds to pick their credit rating agency was at the core of the suffering that the American people are enduring today.

As part of Dodd-Frank, we passed Section 939(f), which resembled an amendment I suggested in this committee that was further improved by Senator Franken and then kind of mashed around during the conference committee process. It gives you 2 years as an absolute maximum. For 7 or 8 months, you haven't published a single piece of paper to even start a process, which is critical.

I don't think investors are going to be dumb enough to accept AAA on Alt-A in the future, but there are so many other bond products that could be exaggerated and form the basis of next decade's meltdown.

Are you going to take the full 2 years, the absolute maximum given you by the statute? And why should it take 2 years?

Mr. COOK. Congressman, we will move forward with this study, which is a very important study, as quickly as we can. We are hoping to—

Mr. SHERMAN. But you have accomplished nothing in the first 8 months.

Mr. COOK. Yes, we recommend to the Commission, and hopefully, it will be out shortly, a solicitation of comments from the industry so that we can take those into account in developing this study. There are other studies that we have to do that have a 1-year timeframe, so frankly, we have been trying to prioritize our work in this area, as well as our work in other areas.

Mr. SHERMAN. Are any of those studies designed to deal with a problem that was more at the core of the meltdown? Eight months, nothing happens. Sounds like business as usual. I am not so sure that business as usual is what we expect from the SEC.

Is it your interpretation of the code section that when this process is over, we are going to end the system where the bond issuer selects the credit rating agency?

Mr. COOK. My understanding of the statute is that we will study the conflicts and alternative ways of addressing the conflict and either then pursue the version that was in the bill that had been passed by the committee or another version, if we find that is appropriate.

Mr. SHERMAN. But another version to achieve the objective.

Mr. COOK. Yes, to achieve the same objective.

Mr. SHERMAN. Thank you.

Mr. DI FLORIO. Congressman, I would also—

Mr. SHERMAN. Yes?

Mr. DI FLORIO. I was just going to say I would also add that the bill requires, and we have begun to execute, comprehensive exams of all credit rating agencies, looking at things including conflicts of interest. That is an extensive process. We are three-quarters of the way through that—

Mr. SHERMAN. That is a different process. I am really focused on the 939(f) process, but I do have a question or two for you.

Let us talk about Madoff. He files financial statements year after year showing billions of dollars. The first thing you look at on a financial statement is the auditor's letter. Is it an unqualified opinion? Who signed it? You look at the Madoff letter. It is signed by an accounting firm nobody has heard of—take 10 minutes to realize the accounting firm was too small to do the audit and to be independent of the client.

So if somebody had spent even an hour in anytime in a decade, looking at those financial statements, they would have discovered the Madoff problem. Who at your organization decided not to spend an hour at anytime in a decade looking at Madoff's financial statements? How much time was spent reviewing his filings year after year after year after year? And has anybody been fired for deciding not to look at his statement?

Mr. DI FLORIO. Congressman, the process that was in place regarding looking at firms and those kinds of risks has changed significantly.

Mr. SHERMAN. I am not asking about the changes. I am asking about the past.

Mr. DI FLORIO. With regard to specific—

Mr. SHERMAN. How much time was spent looking at the Madoff material in the decade prior to his catastrophe?

Mr. DI FLORIO. In fairness, a significant amount of time was spent looking at Madoff and examining Madoff.

Mr. SHERMAN. If you had spent half an hour looking at his filings—you didn't have to go out to his office, you just had to look at what he filed with you for half an hour—this thing is obvious.

Mr. DI FLORIO. And so today we have procedures specifically—

Mr. SHERMAN. I am not asking about today. I am asking why your organization, whose job it is to impose accountability on the biggest financial institutions in this country and in the world, has zero accountability for its own employees. You are the accountability list accounts.

Mr. DI FLORIO. An independent party firm was brought in to do an extensive investigation of the individuals involved in the Madoff matter. That independent third party has issued its recommendation—

Mr. SHERMAN. How much does whitewash cost?

Mr. DI FLORIO. I am sorry?

Mr. SHERMAN. When buy whitewash at the hardware store, how much does it cost? It is 2 years. Nobody has been fired. Nobody is to blame. Nobody is accountable. And that is the only agency we have, or we have no agency at all.

Mr. DI FLORIO. There are individuals going through the disciplinary process now, and that is reaching a conclusion. And the government rules are defining that process, but it is close to reaching a conclusion.

Mr. SHERMAN. Could you submit to this committee a due process for dealing with employees, so that if something like this happened again, the responsible parties would be fired within a couple of weeks? That was a question.

Mr. DI FLORIO. We would be happy to work with the parties, the Office of Management and Budget and others, that represent the government rules, that define our disciplinary process, to share our experience on that process. We would be happy to inform any amendments or reforms to that process.

Chairman GARRETT. I thank the gentleman.

The gentleman from Texas?

Mr. NEUGEBAUER. Sorry. I didn't—

You said in your testimony, I think, that the request for the $369 million is deficit neutral. So I assume you are going to make up the $369 million by doing what?

Mr. KHUZAMI. Congressman, what I meant by that is that there is also the legislation, the transaction fees and revenues that the Commission bring in, that our budgets were going to be tied to those amounts.

Mr. NEUGEBAUER. But in reality, we are taking money out of the economy. Is that correct?

Mr. KHUZAMI. It is coming from the people who engage in securities transactions and registrants.

Mr. NEUGEBAUER. I think that is kind of the Washington mentality up here is that if the money is coming from fees, somehow that doesn't count. But what we're all working on here is trying to make sure we leave enough capital in the system to create jobs. And so, while it may be deficit neutral, it is not economic neutral to the economy. Would you say that?

Mr. KHUZAMI. I would certainly agree that money is coming from somewhere. That is correct. My personal view is that is a good investment in contributing to sound markets and investor confidence, which I think aids and benefits everybody.

Mr. NEUGEBAUER. Ms. "Rominger", is that correct? Yes?

Ms. ROMINGER. "Rominger."

Mr. NEUGEBAUER. "Rominger." Thank you. To people with a name like "Neugebauer", I am sure you have had to repeat that just a couple of times.

You said your Division was hoping to hire folks with special expertise, and I assume those folks more than likely would come from the private sector. Is that correct?

Ms. ROMINGER. They could come from a variety of different places.

Mr. NEUGEBAUER. And so with some of these specialists, one of the concerns I have and I made in my opening testimony is that, making sure that there is a process in your organization for conflicts of interest. I think all of us would have been extremely disturbed that someone who had investment ties to Mr. Madoff was actually in working on the negotiations of settlements with some of the investors.

And when we sent letters over there, the ethics approval process was, somebody sent an e-mail to somebody that said, "Hey, do you think there is a conflict of interest?" A few minutes later, they get acknowledged, "Everything seems to be fine."

For an agency that holds high standards for the people who fall under your purview, it appears to me within the organization, that same standard doesn't hold true for the people working inside the organization.

And back to Mr. Khuzami's statement about making sure there is integrity in the marketplace, I think it brings, as some of my colleagues have said, a little bit of question of the integrity within the organization; are you policing yourselves?

You want to police these organizations, but the question is, are you policing yourself? What kinds of things—as you hire these new people, how will you assure us that these people have been vetted properly and that conflicts of interest are addressed, and that we don't have these kinds of issues coming up in the future?

Ms. ROMINGER. I share your expressed view that our standards must be held very, very high in this area. And I have not hired anyone yet, but certainly when I do so, I will make sure that we comply with every element of the enhanced ethics standards that are in place at the SEC.

Mr. NEUGEBAUER. So what is the process today? If you start hiring people, what are you going—how does that work in your organization? And I will leave that open to any of you. Does anybody want to address that?

Mr. DI FLORIO. I would be happy to, having had a little more experience in this matter.

Mr. NEUGEBAUER. You have been here more than 14 days?

Mr. DI FLORIO. Right. Under Chairman Shapiro's leadership, there has been extensive review of the ethics and compliance program and process. A new Chief Compliance Officer has been brought on board. A new Ethics Counsel has been brought on board. An electronic system to log and manage any possible financial disclosure conflicts has been implemented.

We all have to go through extensive training now regarding the ethics and conflicts issues, and that is repeated annually so there is a much more robust process and policy in place today, again, under Chairman Shapiro's leadership.

Mr. NEUGEBAUER. So when did that start?

Mr. DI FLORIO. Our new Ethics Counsel came on board just in the past few months. The Chief Compliance Officer came on board just a few months prior to that, so much of this has happened in the past year. The new electronic system to document, log, and monitor financial disclosure conflicts has come online just in the past year plus. So it is all relatively new, but all very positive developments and a reflection of industry-leading practices for managing ethics conflicts.

Mr. NEUGEBAUER. Don't you find it a little odd that has happened in the last few months? An agency that holds other people to such high standards that all of a sudden you decide, hey, maybe that works for us, too?

Chairman GARRETT. We will let the gentleman answer that—

Mr. DI FLORIO. I think Chairman Shapiro, since she came on board, started a process of initiating a number of reforms, including taking a fresh look at the entire process, recruiting and identifying the right people to take on those leadership positions and the ethics function and the compliance function.

So it is a process that has made, I think, good progress over the past 2 years and will need to continue in the near-term to come.

Chairman GARRETT. I thank the gentleman—

Mr. KHUZAMI. Congressman, if I just might add, before these new measures were taken, my personal involvement is I dealt with the ethics office on conflict matters. I found them to be careful and candid and, frankly, erring on the side of caution in the circumstances that I dealt with them. And the rules and obligations both for individuals coming in as well as going out of the Commission, I think, are clear and well known.

So I don't want to leave the impression that the ethics world started only a few months ago. There were systems in place, and from my experience, they have worked effectively.

Mr. NEUGEBAUER. I think there is evidence, evidently, with some cracks in the system.

Chairman GARRETT. I thank the gentleman.

The gentleman from North Carolina?

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

We have discussed in this committee a lot how to revive bank lending, but before the crash, roughly half of all lending was the securitization market. In the last couple of years, there has been one issue of a couple hundred million for residential mortgage-backed securities, and that is it. And that would be an asterisk compared to what the market was before.

I have talked to mortgage investors, and they have said that there is no way that anyone is going to buy asset-backed debt, based upon the way the market was before. The way it worked before is they would get a call saying we are going to market in a couple of hours with a mortgage-backed security that has a AAA rating. Are you in?

And they are not interested in doing that again, and they can contrast the kind of disclosures, the kind of standardization that is available to investors who are buying stock issues, public offerings of stock—the waiting periods, the opportunities potential investors have to do their own due diligence, the standardization of what they are getting—and really said that is what they need for debt as well.

The SEC has recently issued a rule in this area, and there had been repots that the issuers of mortgage-backed securities did in fact have third-party review of the mortgages, and I think the phrase from the J.P. Morgan Chase e-mails was that some of the mortgages were "poo," but they did not tell the rating agencies that the mortgages were "poo." In fact they represented the mortgages to investor as "non-poo."

And the investors say that the SEC has not gone far enough to say that just that kind of due diligence by the issuer itself or by third parties would be made available to them. They should still—they aren't going to trust that either, and the result may just be that there is less due diligence by the issuer, and that they want the chance to look at themselves to do their own due diligence to see what it is they are buying. And they want standardization as well, waiting periods, all of that.

Do you think you have statutory authority to issue rules like that? Do you need Congress to act? What kind of reaction have you gotten to the rule that you have issued? Obviously, the securitization market has not exactly sprung back to life.

Ms. CROSS. I think this one is for me. We have a rule proposal that we put out in April 2010 that would significantly reform the offering process for asset-backed securities, including imposing a 5-business-day waiting period between the time that you have a complete prospectus, which includes asset by asset loan level data in structured .xml form for people to be able to look at every single asset and the computer program of the waterfall so they can see how the assets would pay out in different scenarios.

We have full authority to adopt those rules. Those rules were out when Dodd-Frank was passed. And so we thought it was important that the reforms worked together with the Dodd-Frank ABS/MBS rules and regulatory reforms, including the joint project now that is going on with risk retention.

The Dodd-Frank Act actually requires us to require loan level data, which is consistent with our rule proposal. We look forward to implementing that.

There are a number of other pending projects through the Dodd-Frank Act that will be important to basically sync up all the requirements so that when this is all put together, there will be a robust regulatory environment that will be workable, because it doesn't do any good to put something together and then people don't use it. We are working to make it workable.

But we have full authority to do what you are talking about, and I believe we have proposed this.

Mr. MILLER OF NORTH CAROLINA. Okay. Do your proposed rules allow potential investors to actually examine a sampling of loan files?

Ms. CROSS. I don't think that is in our proposal. The way our proposal works is they get an actual data dump on every single loan.

Mr. MILLER OF NORTH CAROLINA. Oh, I see.

Ms. CROSS. And so I haven't heard the request to see the loan files, but I will certainly talk with my staff about whether we have been getting that request and whether that is something that we need to address in the proposal.

Mr. MILLER OF NORTH CAROLINA. I yield back.

Chairman GARRETT. The gentleman from California?

Mr. ROYCE. Thank you, Mr. Chairman.

Let us see. Ms. Rominger, I wanted to ask you a question, and it would be about the oversight of private funds, of just thinking about the problems that the financial system went through, these funds did not seem to play a role in the financial crisis, and they certainly didn't receive any bailouts. And they tend to be much smaller in size.

And from the testimony we have gotten, they don't have the kind of leverage that the other financial institutions had. And so, despite all these factors, Dodd-Frank mandates registration for them with the SEC. And I was going to ask what concrete steps has the SEC taken to ensure it has the capability to adequately oversee these funds?

And I was doing so in light of some of the things we heard from Mr. Markopolos. What he really drove home with us was that many of the people within the SEC that he had encountered over the many years that he kept bringing this problem to the SEC, this

Bernie Madoff problem, he said they just failed to grasp a relatively simple fraud, a basic little Ponzi scheme. This is a part of the market that the agency has very little experience with.

Now, when we start talking about this, the question of private funds, is this going to be like it was with the SEC when they didn't have portfolio managers, they didn't have people who really could comprehend the kinds of frauds that they were supposed to look into?

The SEC has been tasked with overseeing this now, and I wanted to ask you about that.

Ms. ROMINGER. Thank you, Congressman. That is an excellent question, because of course, you know in the private fund arena, there is a vast range both in terms of the size of those funds—

Mr. ROYCE. Right.

Ms. ROMINGER. —their assets under management, their investment strategies and the imbedded complexity of those strategies.

And the way that the rules have been proposed really scale the requirements to acknowledge that and to acknowledge that the information that is appropriate to our request from a relatively small or straightforward strategy, is very different than what should be requested from a larger or more complex strategy that could be more pertinent to the issue of systemic risk.

So that scalability, I think, is a feature that attempts to get at what I think is the concern about requiring something that goes beyond what is necessary.

Mr. ROYCE. Thank you. I was going to ask Mr. Cook a quick question, too. And this goes to Section 913 of Dodd-Frank, which requires the SEC to study the effectiveness of current standards of care for broker-dealers and investment advisers.

In January, the SEC released a study that recommended the adoption of a uniform fiduciary duty standard for broker-dealers and investment advisers that would harmonize the differing standards that are out there currently.

Can you point to any economic research or empirical data or economic analysis that shows the need for this harmonization? And what benefit does a fiduciary standard provide that could not be provided by simply improving disclosures so all parties understand who they are dealing with and what they can expect from either their investment adviser or broker-dealer?

Mr. COOK. Congressman, I think that there have been studies to show that investors are confused about the nature of the relationship that they have with a different source of providers.

And so one of the rationales for doing this would be so that when an investor walks in to an investment adviser or to a broker-dealer, that they would not have to become an expert in those various regimes that apply.

I think going forward we certainly will need to think about, as we implement this, the nature of the two regimes, how they apply to different types of financial intermediaries, and how we can best tailor this fiduciary duty and the harmonization of duties beyond that to different types of business models.

Mr. ROYCE. Thank you, Mr. Chairman. I am out of time.

Chairman GARRETT. The gentleman from Colorado, or not?

Mr. PERLMUTTER. Mr. Chairman, I would like to pass to Mr. Peters, and then come back to me.

Chairman GARRETT. Then we shall do so, for 5 minutes.

Mr. PETERS. Thank you, Mr. Perlmutter. I appreciate the passing.

And thank you, Mr. Chairman.

Like some of my colleagues, I have a concern about some of the SEC registration requirements that have been put on place for private equity firms, in particular, the smaller and medium-sized private equity firms.

During the consideration of the Dodd-Frank Act, I worked with Mr. Meeks and Mr. Garrett on an amendment that would have exempted private equity firms with up to $500 million in assets. Unfortunately, we were only able to secure an exemption for those under $150 million.

We did, however, include language directing the SEC to come up with regulations that take into account the risks posed by these smaller and mid-sized firms when the rules are actually issued.

Private equity firms are not highly leveraged and are not a source of liquidity in the markets. And just like venture capital, many of these small private equity firms engage in a buy and hold investment strategy designed to bring about returns through long-term growth opportunities. Such funds don't pose systemic risk to the financial sector and to the larger economy.

I have concerns that treating a $200 million private equity fund the same as we are treating basically multi-billion dollar hedge funds doesn't make a lot of sense. And it certainly doesn't make sense for those funds to have to spend hundreds of thousands of dollars perhaps in compliance. And I have seen some estimates of anywhere from $200,000 to $600,000 of compliance for these private equity firms.

And that certainly to me doesn't seem to make a lot sense for the SEC as well, with your very limited resources, and we are hearing today all of the many demands on those very limited resources that you are going to be required to spend money to review these registration materials.

So, Ms. Rominger, first off, congratulations on your 16 glorious days with the SEC. But I would like ask you whether you think you think small or medium-sized private firms do pose the same risks either investors or systemic risks that a large hedge fund may pose.

Ms. ROMINGER. Thanks, Congressman. That is a great question. And one of the things I was surprised to learn, actually, in joining the SEC is that somewhere over about half of our registrants actually are below $150 million in assets under management, which was a figure I wasn't familiar with, but it does seem like there are quite a few registrants that would fit into that size category.

I think that the principle is that our madate is to protect investors, regardless of the type of portfolio strategy that they are considering investing in, including private equities.

But clearly, we value input. We recognize the need to scale our requirements to the complexity and the size of firms and to be very attentive to the cost-benefit of a proposal. So we will take all of that into consideration.

Mr. PETERS. In listening to your answer there, if there are firms that may pose more risk than others, does it make sense to be treating them all the same way? Or will you definitely be differentiating these in you rules?

Ms. ROMINGER. Again, ultimately it is a decision by the Commission, but about half of our registrants would fall into that category of having $150 million under management. The goal has been to give investors the information that they might need to make their investment choices, regardless of portfolio strategy.

Mr. PETERS. Although you would recognize portfolio strategy does make a difference as to the amount of information that may be necessary for an investor?

Ms. ROMINGER. Yes, clearly, there are differences in complexity and different types of funds, yes.

Mr. PETERS. So if that is the case, do you believe it would be possible to come up with some sort of scheme where firms that don't pose as much risk may file some just basic information on Form ADV1 this July and delay maybe the imposition of some further more burdensome and, as we can see, potentially very costly requirements until we can put in place a regulatory scheme that protects investors, which is first and foremost, and the economy, but also doesn't waste SEC resources by requiring firms to file detailed information that the Commission doesn't need and, quite frankly, maybe investors don't need?

Ms. ROMINGER. Those are very helpful comments and I look forward to incorporating those comments and others into the work that my team does, as I become more involved in the process under way for these funds.

Mr. PETERS. Good. I look forward to working with on that in some future conversations. Thank you for your time.

Ms. ROMINGER. Thank you.

Chairman GARRETT. I thank the gentleman.

The gentleman from Arizona, Mr. Schwiekert?

Mr. Posey?

Mr. POSEY. Thank you, Mr. Chairman. That microphone—we need to get it fixed.

If I understand correctly, despite the fact the SEC says it is underfunded presently for its operations, the SEC is promulgating a rule so that you are going to branch out and regulate the environmental stewardship of companies within your purview? Is that correct? Am I correct when I hear that?

Ms. CROSS. I am not sure what you are referring to. Under the Dodd-Frank Act, there are a few rules we are required to adopt: one relating to Congo conflict minerals; one relating to payments to resource extraction issuers to government; and one relating to mine safety. Are those what you are referring to?

Mr. POSEY. The information that I got is program-specific. If that is all there is, then I am not really that concerned.

Ms. CROSS. On the rule proposals, those are rule proposals that we have out now that are required by the Dodd-Frank Act, and we are in the process of getting comments on them. We don't have any rule proposals with regard to the environment out, besides those.

Mr. POSEY. Okay.

Since I have been here, I have been seeking some sort of accountability for the blunders of the Madoff scandal. I don't think that is any secret at the SEC. And so far, to our knowledge, there has been no discipline in the agency for allowing Madoff to plunder all those victims. No one has even been lectured, to our knowledge. No one has had their wrist slapped. Of course, nobody has been fired or demoted or been given any time off.

Most of the people that I represent think that is abhorrent. They are offended by that and, quite frankly, I don't blame them. It doesn't bode well for the agency that it lets just a few incompetent employees cast such a bad shadow over so many other employees, hopefully, who get up and try and do a good day's work for their government every day.

I have heard it said by those who have watched some of the other proceedings that it appears the agency is more concerned with protecting incompetent employees than protecting consumers on the street. And I think they arrived at that conclusion, because each time I have asked the Secretary or somebody from the agency what was happening in regard to accountability for the negligence, ineptitude, or whatever it was with the employees, they said, "Well, we are still working on that. We have a process we have to go through."

And the IG made a pretty clear inference of what was wrong. Books available in the public domain make it pretty clear the depth and level at which people were involved. And at this time, Madoff is in prison and we still can't slap the wrist of an employee, and that just doesn't seem logical.

So when we look at going forward with a reformed agency, you would think that the first step of reforming the agency would be to establish some kind of accountability and credibility from where we have been and where we are. You make a plan. You say, where do we come from, where are we, where are we going to go?

And I think without properly setting a foundation by admitting some culpability or establishing some type of accountability for the agency, you are just not going to get a whole lot of sympathy and support that you otherwise would have. I would like your comments on that.

Mr. KHUZAMI. Certainly, Congressman. Look, the experience of the Madoff matter has left a deep imprint on the agency. And I have said it in these halls before and I will say it again. It was a horrible tragedy, and one for which we failed in our mission and one for which we are doing many things across the agency to rectify.

Speaking narrowly about the question of discipline, let me just give you some numbers and some timelines just to put it in context and then speak to the broader question.

The Inspector General's report identified a total of 56 people mentioned in the report. Since that time, 35 people have left voluntarily. That leaves 21 persons. There are six disciplinary proposals working their way through the system. The reason it has taken some period of time, frankly, is because no proceedings began until after the Inspector General issued its report, which I believe was, give or take, September of 2009.

Chairman Shapiro then ordered an outside law firm to conduct an independent, full, and complete review with recommendations, which took a period of time. Those recommendations were then reviewed, and the process got under way.

The process dictated by Office of Personnel Management rules and regulations has certain protections and certain procedures that have to be followed. We hope that we are close to the end of that process, but I want the Congress and the American people to know we are not turning a blind eye to this. We understand the importance of it. We understand the expectations of the American people, and we are prepared to address it.

With respect to the broader issue, as I said, it has informed so much of what all of us here have done since we have arrived. My restructuring of the Enforcement Division, the biggest one since 1972, was focused largely on the shortcomings that were identified as a result of that and other matters, increased expertise so that the people could understand complex matters.

It wasn't just a Ponzi scheme. We do dozens and dozens and dozens of Ponzi schemes every year. It was a complicated split-strike conversion strategy having to deal with options, and that is not an excuse. Mr. Markopolos identified the problems. But what it did reveal was that we didn't have enough places to go in order to fully understand, in that case, options trading other types of expertise. So we have created specialized groups in order to do that.

We understand that investment advisers who self-custody their own assets are a potential warning flag. Accounting firms that leave their engagement are potential red flags. So we are doing things like canvassing all hedge funds for aberrational performance. Anybody who is beating the market indexes by 3 percent and doing it on a steady basis, we are going to look for them.

Mr. POSEY. Let me interrupt because they are going to call me out of time here in a minute. But my point is not the future, but what we are doing about the misdeeds of the past. If half the people no longer work there, that is not a satisfactory discipline. That is not an answer.

I said one time it is like a pedophile leaving a neighborhood and going to another neighborhood. And my response is, they are all good people. I am not saying they are not good people. I am saying I hope, I hope the nicest thing we could say about them is they are incompetent. That is the nicest thing we could say about them for allowing to happen what did happen. And just saying they are no longer at the agency or we don't know where they are, that is not satisfactory.

I think we would like to know where they are. Are they investigating or examining for another agency? Or are they retired? And it would just be good to know what happened to the people who were identified and who the agency has admitted were culpable in all this stuff, so that we don't—

Chairman GARRETT. The gentleman's time has expired.

Mr. POSEY. —put them in place.

Thank you, Mr. Chairman—for their failure.

Thank you.

Mr. KHUZAMI. Let me just—the only reason I raise this is we don't have jurisdiction over people who are no longer at the agency,

with respect to disciplinary issues. But I understand your request for the information about where they might be, and I will see if we can provide it.

Mr. POSEY. Thank you.

Chairman GARRETT. The gentleman from Colorado?

Mr. PERLMUTTER. I thank the Chair. Let us just kind of try to wrap this subject up. What disciplinary actions—in general, without naming names, so that we don't have some kind of breech that gives somebody who might be culpable in some fashion or another something to discuss—are being taken, Mr. Khuzami?

Mr. KHUZAMI. At this point, Congressman, they are proposed recommendations, and I think they range across sanctions from counseling through removal from Federal service.

Mr. PERLMUTTER. Okay.

Mr. KHUZAMI. And let me—I just want to say one other thing. Fifty-six people were identified in the report. The report doesn't indicate that all 56 people engaged in wrongdoing or somehow were responsible for what occurred.

Mr. PERLMUTTER. I understand that, but I guess what I want to know, what Mr. Posey wants to know, even though he is sort of editorializing a lot, is what actually is being done. And so you said anywhere from some kind of disciplinary action, removal from the SEC to some other kinds of things.

What are the kinds of penalties that these people could suffer if you find that there was either gross negligence or some kind of culpable action?

Mr. KHUZAMI. In a general matter, the disciplinary recommendations span everything from counseling to reprimands to suspensions to removal from service.

Mr. PERLMUTTER. And potentially, if somebody was found to be on the take, there could be criminal actions as well, which I am not saying there was any indication of that, but that is a possibility too—

Mr. KHUZAMI. that is.

Mr. PERLMUTTER. —I would assume.

Mr. KHUZAMI. I will say the Inspector General's report, I believe that there was no improper motive and no failure of people to work long and hard—

Mr. PERLMUTTER. Okay.

Mr. KHUZAMI. —with respect to this matter.

Mr. PERLMUTTER. And just for chronological sake, this all occurred in 2008 or before, right? Mr. Markopolos came to us and said that in a span of 2000 to 2008, he had suggested to the SEC on a number of occasions that there was something wrong here.

Mr. KHUZAMI. That is correct.

Mr. PERLMUTTER. Okay. And since 2008, you have been investigating and trying to come up with what actually happened, correct?

Mr. KHUZAMI. Correct.

Mr. PERLMUTTER. I would ask the chairman if he could make those slides available. You don't have to put them back up, but I would like a copy of those, because I think they prove just the opposite point that you would like them to prove.

Based on what I saw, there was a flat—there was no increase 2005, 2006, 2007 into 2008 at a time when there was inflation, and this agency did not have the cops on the beat to stop the crash in any way that occurred in the fall of 2008, which in my opinion caused millions of people to lose their jobs.

So I would ask the chairman to make those available to all of us, if he could.

Chairman GARRETT. I will be glad to provide the charts to you, which show, actually, a 10.8 percent year-over-year on average between 2000 and 2011.

Mr. PERLMUTTER. That is why you have to have the bar chart and your little line chart. You and I have spent some time in the courtroom proving cases. I would like those charts.

My question to the panel as a whole is, what is happening on nano-trading or high-frequency trading? What has happened with any kind of investigation regarding that crash back last May, with anybody?

Mr. COOK. I will take that, Congressman. As you know, the SEC, jointly with the CFTC, studied the events around May 6th and issued a report, a staff report in September. That will continue to inform our review of high-frequency trading. It is a review that began in January of last year as part of the concept release that we had issued and it is, frankly, still under review.

We also just received the recommendations from the Joint Advisory Committee that was formed right around the time of the May 6th flash crash. It helped advise us on cross-agency issues and how to think about them. They have made a number of recommendations. Many of them have already been implemented or are well along the way to implementation, and others we will be studying very closely as we move forward.

Mr. PERLMUTTER. Thank you.

And then I would just sort of finish with this, that at a time when I feel like we are finally getting some confidence back in the markets, the time when you all have been getting your job done, my friends on the Republican side want to cut your funding, reduce your funding. And this country suffered so much in the last 2 years that that kind of effort is just the wrong way to go.

So with that, I yield back to my friend.

Chairman GARRETT. Your friend appreciates your yielding back, even though we are cutting everyone's funding.

The gentlelady from New York?

Dr. HAYWORTH. Thank you, Mr. Chairman.

We are talking, of course, about the direct cost of administering the enormous job that all of you have made all the more so by Dodd-Frank. And I submit that another aspect of considering the cost of the SEC, if you will, is how much what you do requires from our issuers.

That is, obviously, the other half of the equation, if you will, because for every regulation that you must promulgate and assure that it is carried out, obviously, there is a whole team on the other side, while you have been on those teams that have to invest resources in compliance and, of course, also consider the liabilities that are conferred by every new layer of regulation with which they may find one or another snag.

I introduced the topic of Section 953(b) earlier, and I would be eager for any of you to comment.

And I think, Ms. Cross, you may be the first in line regarding the way in which it was written regarding what would seem to be fairly conspicuous deficiencies in the way in which it specified as it stand now in trying to determine—

Ultimately, the big concept is, is this really useful to do, you know how do we—we can get into the weeds about specifics, but is it ultimately going to provide useful information? So whatever you can comment about the challenges of getting to those specifics and about whether or not it really should supplant the existing requirements regarding compensation disclosure. So, please.

Ms. CROSS. Thank you very much, Congresswoman. I have to start by saying that the decision of whether this information is useful is a policy call that is included in the Dodd-Frank Act.

Our job at the SEC is to implement the requirements of the Dodd-Frank Act in a manner consistent with investor protection and all of our other missions, including a good cost-benefit analysis and weighing the concerns that the registrant community, the corporate community, is raising about this particular proposal—or this particular requirement.

We have not done a rule proposal on this one yet. It does not have a deadline under the Dodd-Frank Act, and we are doing the ones with deadlines first.

We have an e-mail box where people have been putting in their comments in advance, and we have had many meetings with registrants. People are very concerned about this provision being costly.

I have to say, I wish I had something else to say. It is very prescriptive how it is written in the statute. It doesn't actually give us leeway. It is written so that it has to be in every filing, it has to be every employee, it has to be compensation as calculated under Rule 402 the day before the Act was signed.

I don't know that we have leeway. So we always want to implement the rules in a way that is workable, but we have to do what Congress has directed us to do. And so, I will say now I have concerns about how workable we can make them.

Dr. HAYWORTH. And I appreciate your candid assessment. May I challenge you just that little bit further to ask because it is a legitimate question? Yes, we are the Congress. We can change these things.

Would it make sense for us to undertake a change in that requirement, perhaps even—I am not asking you advocate for its elimination necessarily, but would it be reasonable to endeavor to change it in ways that would presumably eliminate the relative ratio of burden to benefit, if you will?

Ms. CROSS. I am not speaking for the Commission. I am speaking for myself. I think that if Congress wants to have this pay ratio disclosure, the spirit of it, there are changes you could make to it to make it less difficult.

I don't know that those would be consistent with the policy behind it, but using the median employee is a complex thing. An average is not as complex. Using the 402 calculation instead of W–

2—there are a lot of things you could think about that might make this more workable.

But I do want to be careful, because the policy—I don't want to undermine the policy if Congress has in mind—

Dr. HAYWORTH. I respect that, and I don't want to put you on the spot in that way, but I respect all of you as experts. You have lived these things, and we need to heed your thoughts on these matters, because if we don't, then good intentions lead to stasis at best and to harm at worse.

And there is a tremendous devotion of resources that could really go into computing a median, assuming or determining a median, assuming that we could actually successfully define all the ways in which employees are designated, in which types of compensation are fit into the calculations. Just a quick reading of it—

Ms. CROSS. It is a complex requirement, and I think that, again, we have been working on our Dodd-Frank rulemaking initiatives to balance where we can the benefits and the burdens. In this instance, it is a very clear requirement, and absent other direction, I believe that it is what it is.

Dr. HAYWORTH. Yes, ma'am. I am very grateful for your guidance in that regard.

And I yield back my time, Mr. Chairman. Thank you.

Chairman GARRETT. The gentleman from Virginia, Mr. Hurt?

Mr. HURT. Thank you Mr. Chairman.

I want to welcome you all and thank you for being here. Obviously, as we discuss your budget, we have to take into account the fact that certainly the scope of your regulation necessarily reflects what your requirements will be. And I think that some of these discussions about the scope of your regulation will help us figure out where we end up in terms of funding for your agency.

And let me also thank you for your work, the important work that you do.

I come from a rural district in Virginia and we have many, many Main Streets all across this rural district. And the relationship of small banks to our business community is the lifeblood for job creation. I have places in my district that have unemployment as high as 25 percent, so job creation is very important, getting capital on the street is very important, and you all know how important that is to job creation.

With respect to the derivative regulation under Dodd-Frank, obviously, small banks are going to be subject to new, clear requirements under the SEC and the CFTC unless they are exempted as end-users. And when you stop and think about the high cost of regulations and the small part of the swaps market that small bank comprise, I would like to know from you, Mr. Cook, whether or not the SEC will exercise its authority to exempt small banks as end-users?

Mr. COOK. Thank you, Congressman. The proposal that the Commission issued with respect to end-users did include an exemption for small financial institutions. This is an exemption, as you may know, that the statute directed us to consider providing to basically cover small banks and exempt them from the mandatory clearing requirement.

That is in the proposal, so it is something we are requesting comment on, and the Commission will take those comments into consideration.

Mr. HURT. Thank you.

My second question deals will be for Ms. Rominger, and it deals with the private equity investment advisers. I know that Mr. Royce and Mr. Peters have talked a little bit about it. And you talked scalability. I would like to know a little bit more about what you mean there?

I would subscribe to some of the same sentiments that have been expressed with respect to private equity investment advisers, and I think that overregulation of them could certainly lead to lost opportunities to preserve jobs and create jobs, because obviously at least a big part of what they do relates directly to jobs.

And so I would like to hear more about the scalability issue that you talked about. And I would also like to know whether or not under Section 206A of the Investment Advisers Act, whether or not you all would consider exempting private equity firms pursuant to Dodd-Frank until Congress can take further action with respect to that issue?

Ms. ROMINGER. Right now, it is my understanding that we are receiving comments on the proposals. I have been impressed in my short time at the Commission with the high degree of thought and content that comes through in the comment process. And we certainly will be very, very attuned to some of the issues that you are mentioning and raising here and that will come through in the comment process.

Mr. HURT. Do you agree that you said the SEC has that exemptive authority under the Act, and will the SEC consider that?

Ms. ROMINGER. This is a matter that I look forward to spending a great deal more time on with my staff—

Mr. HURT. Is there anybody else who can help on this question?

Ms. CROSS. I don't think we have someone here at the table who is familiar with what the exemptive authority might be under this provision, but we would be happy to get back to you with a written response.

Mr. HURT. Okay. I would appreciate that. And in the event that you are not, that is not something that is viewed to be within the authority of the SEC, certainly I would ask you to consider postponing the registration requirements to the extent that can be done to allow Congress to give further guidance on this issue.

Ms. CROSS. And we are certainly happy to get back to you with a written response.

Mr. HURT. And one last question to anybody, but maybe we can start with you, Ms. Rominger.

I am very concerned about the implementation of Dodd-Frank and the hundreds of new registrants that will suddenly have to be regulated. Have there been any efforts to identify what kind of burden this is going to be on the States, who also have in many cases concurrent jurisdiction over these matters? Are we going to be passing huge, unfunded mandates down to the States when we suddenly have this increased registration? And that could go to anybody.

Ms. ROMINGER. Their degree of preparedness, I would imagine, spans a range. And I certainly hope that they would be prepared to take this on.

Mr. DI FLORIO. I would just add in addition to what Ms. Rominger said, there has been an ongoing dialogue between the SEC and the States regarding the transfer of private fund advisers under $100 million. And the States—we get calls bi-weekly to talk about the transfer and the readiness around that transfer.

The States are very organized in regard to their strategy with regard to those advisers. So there is an ongoing dialogue that is cross-functional in the agency with the States about that transfer.

Mr. HURT. Mr. Chairman, could I just follow up?

Mr. SCHWEIKERT. [presiding] The time has expired.

Mr. HURT. Thank you.

Mr. SCHWEIKERT. But if Congressman Stivers would like to yield you some time, he is more than welcome to do so.

Congressman?

Mr. STIVERS. Thank you, Mr. Chairman.

Thank you to the panelists for coming today, and I would like to thank you for what you do to regulate the securities industry.

And I just want to kind of put all this budget stuff in context. America is broke. We are running at a $1.5 trillion annual deficit, and we have a $14 trillion national debt. And my daughter Sara, who is 18 months old, owes $45,000 as her share of the national debt.

I am not asking about your specific expenditure here, but how many of the panelists think it is morally okay for us to borrow $1.5 trillion from our kids every year? If you do think it is okay, raise your hand, because I don't think it is okay, and I don't see anybody raising their hand.

I know that you are required to do a lot of new things under Dodd-Frank, so I am not trying to be negative here. You are required to create 123 new rules. You are required to do 32 new studies. And I guess my point is during this time of really expansive government and, frankly, in a time when we can't afford everything we are doing, I think it is a time to really focus and prioritize, so I wanted to ask some questions about that.

Has the SEC looked at all its activities and tried to recommend things that can be cut or reduced or savings that can be found in the SEC, because maybe you have and I haven't seen it, and I don't know the right person to ask. Would anybody like to take a shot at that one?

Ms. CROSS. I can start us off. We are just now going to be receiving the recommendations from the study that was done of our organizational structure from the Boston Consulting Group. And we will very carefully review those recommendations and see what cost savings are available from that. I think that will be—

Mr. STIVERS. That is a great answer. Thank you. And I appreciate you doing that.

Ms. CROSS. Okay.

Mr. STIVERS. Second question, do you do cost-benefit analysis on every rule that you perform, and do you make that public?

Ms. ROMINGER. Yes, we do, for rulemaking. In the second half of the rules after we describe in the beginning of the release what the

rule proposal is, the second half of it includes a robust cost-benefit analysis. And we have a new Division of Risk, Strategy, and Financial Innovation that has top-notch economists in it, who help us with that.

We get public comment on the cost-benefit analysis and often make changes to our final rule based on the comments we receive on a cost-benefit analysis.

Mr. STIVERS. Thank you.

I know that under Dodd-Frank there was language that required you to look at the fiduciary duty. And broker-dealers are currently just under a suitability standard for investors, and there is a proposal to take them to a fiduciary standard, fiduciary duty standard.

I have seen studies that say that will increase costs for consumers and increase litigation. Have you looked at that as part of your cost-benefit analysis with regard to that particular regulation?

Mr. COOK. We haven't issued any proposed rules on that. And there is no statutory timeframe to issue the proposed rules, so if the Commission does issue proposed rules, there will be a cost-benefit analysis of that.

Mr. STIVERS. And it will include the potential increased cost of litigation and increased cost to consumers of changing that standard for broker-dealers?

Mr. COOK. We will work with our economists to take into account all of the direct costs.

Mr. STIVERS. I would like to ask you to specifically take a look at that.

Now, I would like to look at something that Mr. Royce, Mr. Peters, and Mr. Hurt have all talked about, and that is private equity funds. We have a lot of mezzanine-based funds in all our jurisdictions that help create jobs. I have one, for example, in my area, and they do all FDIC funds now, but they have some old legacy funds that would require them to register, because they don't get an exemption if they have any non-FDIC funds.

But they—frankly, it would cost them about $300,000 to register and then about $50,000 a year in round numbers on an ongoing basis. Is there any thought—and those old funds are obviously just running off—to taking a look at folks like that and saying okay, you kind of meet the spirit here?

Ms. ROMINGER. This is why it is so valuable to get feedback through the comment process. And your points are well taken.

Mr. STIVERS. Great.

And the last question on derivatives. I want to thank you for what you have done on derivatives regulations in a very thoughtful way that looks at the Securities and Exchange Act of 1934, has similar definitions to the Act, but the CFTC has not been as thoughtful.

Are you working with them to harmonize things? And you can give me a yes or no, because I am out of time.

Mr. COOK. Yes.

Mr. STIVERS. Oh, good.

Mr. COOK. We have certain rules that we have to issue jointly, and there are certain rules that we are seeking to—we have to collaborate and reach a comparable result where it is appropriate, so we will be working with them to—

Mr. STIVERS. You recognize where your roles today—

Mr. COOK. We recognize that there are some differences, and we recognize we need to focus on that in terms of reducing the burdens on the industry.

Mr. SCHWEIKERT. Thank you, Mr. Stivers, and Mr. Cook.

The Chair is going to take the next couple questions. Why not?

Mr. Cook, just particularly because you happen to be in the center and have actually one of the areas I am most interested in, in your budget mechanics, how much of your Division or your area is going into data and using data mining to find compliance? How much is moving in improving your technology chewing up your budget?

Mr. COOK. Right now, not enough, certainly. One of the areas that we are weakest on, frankly, is our ability to monitor the market and to obtain the types of data from the market that, frankly, many of the trading firms get today on a routine basis.

The value of getting that data is to help us understand market quality, market metrics. And it is a very cumbersome process today to bring that all in from many different trading platforms. May 6th was a good example of the challenges that data presented, and so one of the things we would like to build out is a better analytics and data analysis capability to be able to respond to those sorts of things.

Mr. SCHWEIKERT. You sort of beat me to where I was going with that. Doesn't part of this sort of data mining, data aggregation already exist in the private marketplace?

Mr. COOK. The capacity to bring together and analyze quickly some of the data that is out there in the market in the private sector is quite significant in some firms.

Mr. SCHWEIKERT. I expect much of that is proprietary, so has there been the discussion of not completely having to reinvent the wheel?

Mr. COOK. Absolutely.

Mr. SCHWEIKERT. Can you contract or buy, whether it be on the other side of the Chinese wall, but having even a contractor provide you those data and that access and their analytics?

Mr. COOK. Yes, sir. There certainly are challenges in this area in terms of being a regulatory agency and how much of that sort of relationship it makes sense to develop with a private firm. However, we are certainly interested in considering all avenues with an eye to what is going to be most cost effective, frankly.

We issued a request for information last year to learn from potential providers of software and a data analytics tool—what is available out there that we could buy off the shelf. How much would it need to be customized to be able to serve our needs?

Mr. SCHWEIKERT. My concern is having been on both sides of that equation, when you hire programmers and build it or contract it out, it always seems to take much longer and much more expensive. It would be fascinating if the marketplace has products that you could actually capture. You would obviously respect the proprietary, because—

I didn't know if that is a path you had been looking at. And that is true for all the Divisions. Is this a common issue across all the different layers?

Mr. DI FLORIO. It is a common issue, certainly, I think, across the entire SEC, Congressman. And your point is well taken.

We have made two very positive developments very recently of bringing on a new COO and a new head of IT, both who come from the private sector and have spent significant time with massive data aggregation analytics and are very knowledgeable about the systems that are out there. We will certainly be leveraging them to inform the process going forward.

Mr. SCHWEIKERT. And I probably need to do this quickly. Does anyone else want to touch this one?

Mr. KHUZAMI. I could just give you one small fact that shows the challenges that we face in this area. We get three to four terabytes of information on average per month in the course of our investigations in the Enforcement Division.

The entire Library of Congress print book edition is 20 terabytes of information. We get massive amounts of data, and we don't have the capability to do the kind of data analytics that we should be doing on that information in order to make sure we have it all, we extract the useful information, we see that patterns and relationships that are necessary.

Mr. SCHWEIKERT. Okay. I am going to try and do a couple of these other bits quickly, but part of the reason for that question is I know we are discussing budget and growth, but I have also seen many very efficient regulatory agencies, the ability to use data and their data sets as the greatest cost savings account.

But it is getting over the hump of that programming and what is out there. And in 25 seconds, Mr. Cook, talk to me about some of the muni conflict of interest regs that are coming.

Mr. COOK. The MSRB that you may be referring to is a proposal that they are working on to deal with the registration and regulation of muni advisers and to address the situation, so-called hat-switching where someone might serve as an adviser to a municipal entity and then switch and become an underwriter.

Mr. SCHWEIKERT. Okay. For me to be respectful to my fellow members, without objection, I would like to go to a second round, and I was going to give the next 5 minutes to the gentlewoman from New York.

Ms. WATERS. I don't need the 5 minutes, so you may give them to Dr. Hayworth.

Mr. SCHWEIKERT. Thank you.

The gentlewoman from New York?

Dr. HAYWORTH. I thank the chairman and the gentlelady from California.

Section 975 of Dodd-Frank, of course, as you know, requires that municipal advisers register with the SEC. And in May of 2009, the head of SEC's Office of Municipal Securities said that establishment of the program would be easy because there would probably only be about—the number is here only about 260 non-broker-dealer municipal advisers.

But since the SEC has now written the rules, they actually encompass thousands more individuals, with some interesting exemptions, including engineers who provide engineering advice, government officials regarding strategies to improve energy efficiency in

government buildings, that they would be subject to registration and disclosure rules.

It is striking that there is so much potential for you to create definitions that may be ripe with potential for skirting, if you will, or getting around them. How do you make them fair without incurring—again, I keep going back to the cost of these promulgating these regulations. How do we keep things fair and reasonable, rational?

Do you feel as though you are able to have a voice in how these things in away that won't confer unusual costs on our municipalities that have to deal with these things and on the engineering firms who provide these services?

Mr. COOK. Thank you, Congresswoman. It is a challenge in this area to get it right, I think, because we don't want to inhibit the certain sorts of functions that occur day-to-day that aren't really our fight.

In terms of that estimate you mentioned, I think that may well have been based on both a different set of data than we have today and also a different standard of what it means to be an adviser. I think that estimate may have been based on estimating how many independent entities out there that are advisers and a different definition. The statutory definition is somewhat broader than that.

But the muni adviser definition rule has been proposed, has not been adopted. We have gotten a lot comment letters on it, and we are going to be looking at those very carefully.

Engineering is one area where we have received some comments. We actually did include an exception for engineers providing engineering advice. But, of course, it begs the question as well, what does that mean? What are the services that are ancillary to engineering?

And I think what we want to try to do is provide the guidance people need to have legal certainty to be able to continue functioning and providing valuable services that were never intended to be registered as advisers, but at the same time not create exceptions that overwhelm the rule. So that is the challenge, and we certainly are benefiting greatly from the comments we have received on it.

Dr. HAYWORTH. And I appreciate that. It would seem that drawing rules so very broadly again will lead to that problem of contributing to stasis, conferring excessive costs, getting in the way of progress, ultimately impeding effective government that can be cost-effective and can free resources for job creation, which is what we are talking about.

I hope that you will be able to bring to bear, and certainly I think this committee would like to help you bring to bear, a great measure of common sense. I do get the sense from all of you that you have a lot of common sense.

And I want you to feel free, speaking for myself, but I think I speak for the members of the committee, to feel free to tell us in addition to the comments you get from the public, which are very important, but please tell us what we can do on the statutory side to make it possible to fulfill a mission without tying everybody up into such knots that we get less done than we should.

Thank you.

Mr. Chairman, I yield back.

Mr. SCHWEIKERT. Dr. Hayworth, thank you for the 5 seconds. And you always speak for the committee.

Mr. Hurt? A couple of minutes.

Mr. HURT. Thank you, Mr. Chairman

Just a brief follow up with Mr. Di Florio, who was talking about the communications with States. What has been the forum for that? And you indicated that there was regular contact. What has been the forum for that?

And do you have any cost estimates? Have they expressed to you cost estimates of what it is going to take for them to comply with the kind of trickledown effect of Dodd-Frank at a time when States are having a terrible time balancing budgets? At least they balance the budget.

Mr. DI FLORIO. Congressman, the forum has been bi-weekly teleconferences. The party has been NASAA, which has been organizing on behalf of the State regulators, and they have not shared specific cost estimates in the context of those discussions.

Mr. HURT. Okay. If you get information about that, I would certainly be interested to know, and I guess we can contact that agency ourselves.

And then just to follow up, Ms. Cross, thank you very much for your offer to provide information. I think it was you who offered to provide information relating to the exemptions for private equity firms. And I certainly look forward to receiving that. Thank you very much for your time.

Mr. SCHWEIKERT. Thank you, Mr. Hurt.

The chairman now yields himself, let us see, the next 6 hours? You notice that no one—they are just not sure. I am so sorry. I am going to give myself just a couple of minutes, because I really want to come back.

You talked about your comments starting to light up when you did some of the muni. So did my e-mail, and on many different levels. One of the questions that was coming at me was from those folks who are already—broker-dealers, investment advisers in the banking world—regulated. What will the proposed rules and how will it touch those folks.

And then there is the other side of that, the proposed rules and where you think it is going to go in regards to influence of the municipality to go out and bond or do a defeasance, these sorts of things.

And I am going to start with Mr. Cook, and we will move around to who has something to share.

Mr. COOK. The proposed definition does have carve-outs for certain other regulated entities like investment advisers and the like, but the area of overlap is something that we will have to be sensitive to.

I know one issue that has been raised, for example, is that banks, who are holding deposits for a municipality, cash deposits, have expressed concern that the definition of municipal adviser would include providing advice about that cash deposit. So that is an issue we are focusing on and talking to other regulators about and will—

An example, I think, of the point you are raising, is that there may be overlapping regulation and therefore not a need to impose a new regime on certain sorts of entities—

Mr. SCHWEIKERT. Mr. Cook, I know you guys are going through sort of the modeling of what is the rule.

But in my experience as having been a country treasurer, okay, over here I have the law firm that is also doing some of the advising to the municipality. Okay, on the same side, somewhere on the other side of the Chinese wall, you may have lawyers who are also representing the property owners or some of the others they may part of that general obligation. Over here is the law firm that is helping move some money around, but what if that law firm is also providing certain other banking services?

I know we have a web here where a lot of these folks are touching each other. And I have a real concern, if this is really a discussion about budget, how do you guys write rules that are effective and work—at the same time also don't blow up your budget and make you have to come back to us and say please, we need more resources?

Mr. COOK. I will take a stab at that. I think it is a challenge, but I think what it means is that we need to be very thoughtful. And I think the tools we have are the common process, which is enormously important to help identify issues that may be raised by the rules that we propose, taking the time we need to get it right, and frankly, a sense of humility about what we know and what we don't know.

And I think that is some of the leverage we have to try to make sure that as we, given the resource constraint environment we are in and the obligation nevertheless to promulgate certain rules, that we strike the right balance.

Mr. SCHWEIKERT. Does anyone else wish to touch this one? Give me—and we will try to finish up here in the next couple of minutes so you can at least go get some lunch—share with me what you think is the biggest crisis within that market, within the muni market and the folks providing the advice? How big of a distortion do we have?

Mr. COOK. We have seen some instances, and I don't know if there may be some on the enforcement side, if you mean what are the—

Mr. SCHWEIKERT. The problem that we are trying to fix.

Mr. KHUZAMI. I think that the concern is that people who would be advising municipalities about both the issuance of their securities and the product that they could invest the proceeds in are not subject to oversight now in the same way that advisers to you or me or anyone else providing similar sorts of investment advice are.

And that can lead to concerns such as conflicts of interest, whose interests are they really acting in? I believe that was the policy rationale behind the act.

Mr. SCHWEIKERT. In that case, just having spent some time in this world, I saw some issuances—actually they were, I think, defeasances at the time—where the fee was pretty close to almost what was being saved. So in that case since you are doing the rulemaking, in many ways it is how do you get access to who is actually receiving compensation.

And, motivation is there and the disclosures that come with that, and I don't know if that creates a much more narrow cap. My fear was you would get the bad guys, but don't do something that blows up your budget, because now you are touching so many people who are two or three off.

Mr. COOK. Right. And it is not just our budget. It is the costs imposed on those people who weren't intended to be covered by the statue.

Mr. SCHWEIKERT. All right. Does anyone else have anything that they are burning to share? You have been a wonderfully cooperative group. And, actually, what you do is absolutely fascinating, being a freshman Member reading all the things you touch.

And some of it is impossible, and I am not sure it is necessarily money-based, as the scale of the markets seem to change and move faster than often we can never catch them. And that is why my fixation on you having data mining abilities, because in many ways, this may be about technology and data, and not necessarily the old shoe leather world of regulation.

And I am trying to convince my brothers and sisters around here that it is time to step into the next century of technology.

With that, the Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Thank you for spending time with us today.

[Whereupon, at 12:28 p.m., the subcommittee was adjourned.]

A P P E N D I X

March 10, 2011

OPENING REMARKS OF THE HONORABLE RUBEN HINOJOSA
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS AND GSES
"OVERSIGHT OF THE SECURITIES AND EXCHANGE COMMISSION'S
OPERATIONS, ACTIVITIES, CHALLENGES AND FY 2012 BUDGET REQUEST"
MARCH 10, 2011

Mr. Chairman,

Thank you for holding this hearing today.

Our economy is slowly emerging from the worst economic crisis since the Great Depression. We on the Democratic side of the aisle are finding ways to increase jobs and help our communities recover.

As it now stands, the Securities and Exchange Commission's Fiscal Year 2012 funding will be fully offset; will be deficit-neutral; and, will provide the SEC the funding it needs to meet its increasing responsibility and improve its oversight function.

At a time when we need to reduce the deficit and the federal debt, the SEC's Fiscal Year 2012 budget will increase neither. Arguments that such an increase is unwarranted or ill-conceived likely will come from those who played a significant role in the recent economic crisis or those who protect them to the detriment of their constituents.

Mr. Chairman, now is the time to beef up the Securities and Exchange Commission and ensure that the entities that fall under its jurisdiction are not allowed to make unscrupulous decisions that harm the American consumer and lead to yet another economic crisis of epic proportions on a global scale.

We need to ensure the SEC has the funds it needs to police the markets that former Federal Reserve Board Chairman Alan Greenspan thought would take care of themselves. They did not, and here we are in our current economic mess.

I yield back the remainder of my time.

Testimony on Budget and Management of the U.S. Securities and Exchange Commission

By

Robert Khuzami, Director, Division of Enforcement
Meredith Cross, Director, Division of Corporation Finance
Robert Cook, Director, Division of Trading and Markets
Carlo di Florio, Director, Office of Compliance Inspections and Examinations
Eileen Rominger, Director, Division of Investment Management
U.S. Securities and Exchange Commission

Before the
United States House of Representatives Committee on Financial Services
Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises

Thursday, March 10, 2011

Chairman Garrett, Ranking Member Waters, Members of the Subcommittee:

Thank you for the opportunity to testify today on behalf of the U.S. Securities and Exchange Commission.

As Directors of five major divisions and offices of the SEC, each of us came to the agency within the past two years dedicated to furthering the Commission's vital mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. We appreciate the opportunity to discuss the President's FY 2012 budget request for the Commission, as well as to report on the broad responsibilities performed by the SEC, the recent reforms we have undertaken, and the challenges that lie ahead.

Our testimony today will discuss a number of significant steps that we have taken over the past two years in our divisions and offices to reform and improve our operations. As part of that effort, we have revitalized and restructured our enforcement and examination functions, revamped our handling of tips and complaints, taken steps to break down internal silos and create a culture of collaboration, improved our risk assessment capabilities, begun to recruit more staff with specialized expertise and real world experience, and enhanced safeguards for investors' assets.

Despite these changes, much work remains, and we continue to seek ways to improve our operations and make the SEC more vigilant, agile, and responsive.

Current Challenges

FY 2011 and FY 2012 mark a critical period for the agency. Not only does the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") create significant additional mandates for the SEC, both in the short and long term, but the agency must continue to carry out

its longstanding core responsibilities. These responsibilities — pursuing securities fraud, reviewing public company disclosures and financial statements, inspecting the activities of investment advisers, investment companies, broker-dealers and other registered entities, and maintaining fair and efficient markets — remain essential ingredients to restoring investor confidence and trust in financial institutions and markets following the recent financial crisis.

Over the past decade, the SEC has faced significant challenges in maintaining a staffing level and budget sufficient to carry out its core mission. The SEC experienced three years of frozen or reduced budgets from FY 2005 to 2007 that forced a reduction of 10 percent of the agency's staff. Similarly, the agency's investments in new or enhanced IT systems declined about 50 percent from FY 2005 to 2009.

As a result of increased funding levels in FY 2009 and FY 2010, current SEC staffing levels are just now returning to the level of FY 2005, despite the enormous growth in the size and complexity of the securities markets since then. During the past decade, for example, trading volume has more than doubled, the number of investment advisers has grown by 50 percent, and the assets they manage have increased to $38 trillion. A number of financial firms spend many times more each year on their technology budgets alone than the SEC spends on all of its operations. Six years ago, the level of SEC funding was sufficient to provide 19 examiners for each trillion dollars in assets under management by investment advisers. Today, that figure stands at 12 examiners per trillion dollars.

Today, the SEC has responsibility for approximately 35,000 entities, including oversight of 11,800 investment advisers, 7,500 mutual funds, and more than 5,000 broker-dealers with more than 160,000 branch offices. We also review the disclosures and financial statements of nearly 10,000 reporting companies. The SEC also oversees approximately 500 transfer agents, 15 national securities exchanges, 9 clearing agencies, 10 nationally recognized statistical ratings organizations (NRSROs), as well as the Public Company Accounting Oversight Board (PCAOB), Financial Industry Regulatory Authority (FINRA), Municipal Securities Rulemaking Board (MSRB), and the Securities Investor Protection Corporation (SIPC). In addition, the Enforcement Division has jurisdiction over any person or entity that violates the securities laws, regardless of whether they are associated with one of these 35,000 entities.

In addition to our traditional market oversight and investor protection responsibilities, the enactment of the Dodd-Frank Act has added significant new responsibilities to the SEC's workload. These new responsibilities include a parallel set of responsibilities to oversee the over-the-counter derivatives market, including direct regulation of participants such as security-based swaps dealers, venues such as swap execution facilities, warehouses such as swap data repositories, and clearing agencies set up as long-term central counterparties. In a similar fashion, whereas the agency has long overseen traditional asset managers, under the Dodd-Frank Act the SEC has been mandated with similar responsibilities for hedge fund advisers, including those that trade with highly complex instruments and strategies. Additionally, the Commission has new responsibility for registration of municipal advisors, enhanced supervision of NRSROs, heightened regulation of asset-backed securities, and creation of a new whistleblower program.

In acknowledgement of this significant new workload, the Dodd-Frank Act authorized an increase in the agency's budget from the $1.11 billion appropriated in FY 2010 to $1.3 billion in FY 2011, $1.5 billion in FY 2012, and $2.25 billion by FY 2015.

So far, the SEC has proceeded with the first stages of implementation of the Dodd-Frank Act without additional funding. This largely has involved performing studies, analyses, and the writing of rules. These initial tasks have taken staff time away from other responsibilities, but we have carried them out almost entirely with existing staff. It is the next step of making the new oversight regimes operational that will require significant additional resources.

FY 2012 Budget Request

The SEC is requesting $1.407 billion for FY 2012.[1] This represents an increase of $264 million over the agency's current FY 2011 spending authority, and will support 4,827 positions (4,460 full-time equivalents, or FTE), an increase of 780 positions (612 FTE) over projected FY 2011 levels. The FY 2012 request is designed to provide the SEC with the resources required to achieve multiple, high-priority goals: adequately staffing the agency to fulfill its core mission of protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation; continuing to implement the Dodd-Frank Act; and expanding the agency's information technology (IT) systems and management infrastructure to serve the needs of a more modern and complex organization.

It is important to note that the SEC's FY 2012 funding request will be fully offset by matching collections of fees on securities transactions. Currently, the transaction fees collected by the SEC are approximately two cents per $1,000 of transactions. Under the Dodd-Frank Act, beginning with FY 2012, the SEC is required to adjust fee rates so that the amount collected will match the total amount appropriated for the agency by Congress. Under this mechanism, SEC funding will be deficit-neutral, as any increase or decrease in the SEC's budget would result in a corresponding rise or fall in offsetting fee collections from market participants.

Of the new positions requested for FY 2012, 312 positions (40 percent) will be used to strengthen and support core SEC operations and to continue reforming its operations and fostering stronger protections for investors. The other 468 positions (60 percent) of the new positions requested for FY 2012 are necessary initially to implement the Dodd-Frank Act. The agency also will need to invest in technology to facilitate the registration of additional entities and capture and analyze data on the new markets. The cost of these new positions and technology investments to implement the Dodd-Frank Act will be approximately $123 million. Many of these new positions will be for experts in derivatives, hedge funds, data analytics, credit ratings, and other new or expanded responsibility areas. The new positions will support important new responsibilities including:

- **Derivatives** -- 157 positions focused on the derivatives markets, including 47 staff in the Division of Trading and Markets to develop programs to oversee over-the-counter derivatives, 34 examination staff to inspect for compliance, and 43 enforcement staff.

[1] In accordance with past practice, the budget justification of the agency was submitted by the Chairman of the Commission and was not voted on by the full Commission.

- **Hedge Funds** -- 102 positions focused on compliance with the new rules for private fund advisers, including 45 examination staff, 21 enforcement staff, and 15 assigned to the Divisions of Investment Management and Risk, Strategy, and Financial Innovation.
- **Oversight** -- 50 positions to support implementation of various requirements with respect to investment advisers and broker-dealers (16 positions), review of self-regulatory organization (SRO) rule filings (11 positions), PCAOB oversight (9 positions), asset-backed securities (8 positions), and corporate governance disclosure and procedural matters (6 positions).
- **Whistleblower** -- 43 positions to support the whistleblower program, including expanding intelligence and investigative analyses of tips received from whistleblowers, and conducting resulting investigations.
- **Municipal Securities** -- 35 positions focused on municipal securities, principally to conduct examinations of newly-registered municipal advisors and to build the new Office of Municipal Securities required under the Dodd-Frank Act.
- **Clearing** -- 33 positions focused on the Act's new responsibilities with respect to clearing, including annual reviews of systemically important agencies, including 20 examination staff and 12 staff in the Division of Trading and Markets.
- **Credit Rating Agencies** -- 26 positions focused on NSRSOs, principally for the Office of Credit Ratings to perform the annual examinations required by the Dodd-Frank Act.

In addition to the new positions requested in FY 2012, the SEC also anticipates that an additional 296 positions will be required in FY 2013 for full implementation of the Dodd-Frank Act.

Investing in Information Technology

The SEC's budget request for FY 2012 will support information technology investments of $78 million, an increase of $23 million over FY 2011. This level of funding would support vital new technology initiatives including data management and integration, document management, EDGAR modernization, market data, internal accounting and financial reporting, infrastructure functions, and improved project management. This funding will permit the agency to develop risk analysis tools to assist with triage and analysis of tips, complaints, and referrals and to complete a digital forensics lab that enforcement staff can use to recreate data from computer hard drives and cell phones to capture evidence of sophisticated frauds. The budget request would also permit the hiring of additional staff in the Office of Information Technology, including experienced business analysts and certified project managers to oversee IT projects and staff to address financial statement and information technology deficiencies identified by the Government Accountability Office (GAO).

Addressing Material Weaknesses in Internal Controls

In November 2010, the SEC completed its Performance and Accountability Report, the equivalent of a company's annual report. A GAO audit found that the financial statements and notes included in the report were presented fairly and in conformity with U.S. GAAP. It also, however, identified two material weaknesses in internal controls over financial reporting: one in information systems, and a second in financial reporting and accounting processes. The root

causes of these weaknesses are gaps in the security and functionality of the agency's financial system, resulting from years of underinvesting in financial system technologies.

These material weaknesses are unacceptable. Rather than try and solve each particular deficiency in piecemeal fashion, the agency has committed to investing the time and resources to implement a long-term, comprehensive solution. To avoid the development risks of creating new technology and systems, the SEC is switching to a Shared Service Provider approach, migrating the agency's financial system to the Department of Transportation. Other agencies, including GAO, have migrated to DoT, and they have had very positive results, with clean audits free of material weaknesses. This will be a significant undertaking, which, assuming adequate funding, will culminate in the cutover to the new system in April 2012.

DIVISION OF ENFORCEMENT

Director, Robert Khuzami[2]

A vigorous enforcement program is at the heart of the agency's efforts to promote investor confidence in the integrity of the marketplace. As the SEC's largest division, the Enforcement Division investigates and brings civil charges in federal district court or in administrative proceedings based on violations of the federal securities laws. Successful enforcement actions result in sanctions that protect investors, both now and in the future, such as penalties and the disgorgement of ill-gotten gains that are returned to harmed investors, as well as barring wrongdoers from working in the industry.

Structural Reforms

Over the past two years, the Enforcement Division carried out the most significant structural reforms of the enforcement program since 1972 — reforms designed to maximize resources and enable us to more effectively combat securities fraud. Highlights of this programmatic transformation include:

Specialization. The introduction of five new national specialized investigative units dedicated to high-priority areas of enforcement which consist of: Asset Management (hedge funds and investment advisers), Market Abuse (high-volume and computer-driven trading strategies, large-scale insider trading, and market manipulation schemes), Structured and New Products (various derivative products), Foreign Corrupt Practices Act violations, and Municipal Securities and Public Pensions. The specialized units, as well as various specialization initiatives in our regional offices, are utilizing enhanced training, specialized industry experience and skills, and targeted investigative approaches to better detect links and patterns suggesting wrongdoing — and ultimately to conduct more efficient and effective investigations. In order to conduct effective investigations in our high-priority areas, prior to the Continuing Resolution, each of the specialized units had been in the process of hiring additional professionals with specialized experience such as trading strategies and trading abuse specialists, quantitative analysts, data architects, market structure experts, portfolio managers, private equity analysts, equity traders,

[2] Mr. Khuzami joined the SEC as Director of Enforcement in March 2009. http://www.sec.gov/news/press/2009/2009-31.htm

and individuals with experience in structuring complex financial instruments and rating structured deals. In addition to investigative work, the specialized units are engaged in a number of initiatives with our colleagues in the Office of Compliance Inspections and Examinations (OCIE) and other divisions to develop risk analytics that proactively identify high-risk areas for further examination and investigation.

Management Restructuring. The Division has adopted a flatter, more streamlined organizational structure under which it has reallocated a number of managerial staff to the mission-critical work of conducting front-line investigations. While a layer of management has been eliminated, the Division is maintaining staff-to-manager ratios that allow for close substantive consultation and collaboration, resulting in a management structure that facilitates timeliness, quality, and staff development.

Office of the Managing Executive. A strong operations function is also critical to the success of the Division. To that end, we created the Office of the Managing Executive to apply critical expertise to the operations arena. This office now oversees functions such as IT forensics and litigation support, case management systems, and collections and distributions activities; and broader operational areas like the budget, process improvement and project management, internal controls, and human resources. This office is also leading the division's efforts to create and collect data, including a set of quantitative and qualitative metrics, and to incorporate this data into our regular case review process. The result of creating this "COO-type" function within the Division is that critical operational tasks are now owned by persons with the appropriate expertise, thus leaving more time for the staff to focus on the mission-critical work of conducting investigations and core enforcement activity.

Office of Market Intelligence. Enforcement established an Office of Market Intelligence to serve as a central office for the handling of tips, complaints and referrals ("TCRs") that come to the attention of the division; coordinate Enforcement's risk assessment activities; and support Enforcement's strategic planning activities. This office will allow the division to have a unified, coherent, coordinated response to the huge volume of TCRs we receive every year, thereby enhancing our ability to open the right investigations, bring solid cases, and effectively protect investors. In addition, we will harvest this information to identify emerging threats to investors and markets, which will in turn inform how we employ our limited enforcement resources in order to optimize investor protection and deterrence.

Moreover, over the past two years, we have completely revamped the way the entire agency handles TCRs, including new policies, procedures and systems, as well as a centralized database so that staff across the agency has this information available to them. In fact, next week, we plan to roll out updates to our TCR system that will improve our ability to obtain information from the public while providing the staff with workflow tools to better correlate, prioritize, assign and track progress of TCRs through to resolution.

Elimination of Unnecessary Process. We improved our law enforcement capabilities and sent a clear signal internally and externally that we value toughness and speed. For example, the Commission delegated to senior staff the authority to initiate formal investigations and issue subpoenas without the prior approval of the Commission. We also have eliminated approvals for

certain routine settlement discussions, Wells notices and the opening of initial matters under investigation. Proper levels of supervision and oversight remain across all of these areas.

Whistleblower Office. The Dodd-Frank Act substantially expands the agency's authority to compensate individuals who provide the SEC with useful information about violations of the federal securities laws. Last November, the Commission proposed rules mapping out the procedure for would-be whistleblowers to provide critical information to the agency. The proposed rules set forth how eligible whistleblowers can qualify for an award through a transparent process that provides them an opportunity to assert their claim to an award. Recently, we announced the selection of a Whistleblower Coordinator to oversee the whistleblower program. We also have fully funded, with the proceeds of penalty amounts, the SEC Investor Protection Fund, which will be used to pay awards to qualifying whistleblowers. Pending the adoption of final rules, Enforcement staff has been reviewing and tracking whistleblower complaints submitted to the Commission.

Cooperation Program. We have added a series of measures to encourage corporate insiders and others to come forward with evidence of wrongdoing. These new cooperation initiatives establish incentives for individuals and companies to fully and truthfully cooperate and assist with SEC investigations and enforcement actions. This program will encourage "insiders" with knowledge of wrongdoing to come forward early, thus allowing us to build stronger cases and shut down fraudulent schemes earlier than would otherwise be possible.

Effective Results

Although statistics alone cannot capture the breadth of the Division's work, since undertaking these reforms, the SEC's enforcement activity has increased significantly. For example, in each of the past two fiscal years, we have filed more enforcement actions than in the previous fiscal year. Our 2010 enforcement actions resulted in approximately $2.85 billion in ordered disgorgement and penalties – over a 176 percent increase from amounts ordered in 2008. In fiscal year 2010 we successfully sought emergency relief from federal courts in the form of temporary restraining orders to halt ongoing misconduct and prevent imminent investor harm in 37 actions; obtained 57 asset freezes to preserve funds for the benefit of investors; and distributed to injured investors nearly $2.0 billion from 42 separate Fair Funds. In addition, our actions halted trading in the securities of 254 issuers that we alleged had inadequate public disclosures – an increase of over 34 percent as compared to fiscal year 2008.

During the past year, the Commission brought significant actions involving issues arising from the financial crisis, including actions against the former CEO and other executives of Countrywide Financial, Citigroup and its former CFO and Head of Investor Relations, Morgan Keegan, Goldman Sachs, State Street Bank, former executives of New Century Financial and IndyMac Bancorp, Brookstreet Securities, and ICP Asset Management and its President. We've obtained multi-million dollar settlements with Tyson Foods, Alcatel-Lucent, Technip, and General Electric for violations of the Foreign Corrupt Practices Act (FCPA). We filed our first case against a state involving municipal securities. We brought accounting fraud cases against Dell, Diebold, and DHB Industries. We brought a significant case charging inappropriate use of confidential customer information by a proprietary trading desk at Merrill Lynch and an action

against AXA Rosenberg in the challenging and rapidly evolving area of computer-based quantitative investment management. We filed a variety of cases to halt Ponzi scheme operators and perpetrators of offering frauds, including those brought in conjunction with the Financial Fraud Enforcement Task Force's Operation Broken Trust sweep. More recently, we brought cases alleging illegal trading on confidential information obtained from technology company employees moonlighting as expert network consultants, illegal trading by major hedge funds based on illegal tips, and a $1.5 billion mortgage securities fraud scheme to defraud the U.S. Treasury's Troubled Asset Relief Program (TARP).

Upcoming Challenges

The Enforcement program continues to face challenges in securing the necessary expertise, human capital and technology resources to fulfill our mission of investor protection. We must be current with market developments. For example, in the market abuse area, we need the expertise and human capital to understand and analyze new trading technologies such as high-frequency and algorithmic trading, data feed latency issues, and large volume trading, as well as systemic insider trading and manipulation schemes. In the asset management area, we must increase our understanding of issues related to valuation of illiquid portfolios, false performance claims, preferential redemptions, and high-risk emerging products. In the municipal securities markets, we must be up-to-date on pension liability disclosures, valuation issues, and tax-arbitrage activities. These examples are just part of a broader array of challenges stemming from the fast-paced change and increasing complexity apparent in the financial products, markets, transactions, and practices that the Division confronts.

Integral to our understanding of these and other areas is an improved ability to analyze large volumes of information, including both structured and unstructured data. As a result of subpoenas and other information-gathering efforts, the Division receives each month approximately three to four terabytes of electronic data. As a comparison, 20 terabytes is often noted as the equivalent to the printed book collection of the US Library of Congress. We need much better tools to consolidate and mine this data, link it together, and combine it with data sources from within and beyond the Commission. This level of analysis would enable staff to more effectively identify risks to investors, trends in the markets, and patterns of activity that may merit further investigation.

CORPORATION FINANCE

Director, Meredith Cross[3]

The Division of Corporation Finance (CF) is responsible for overseeing company disclosure of important information to the investing public. The Division has two primary missions: to see that investors are provided with materially complete and accurate information and to deter fraud and misrepresentation in the offering, trading, voting, and tendering of securities. The Division's primary authority is derived from three statutes: the Securities Act of 1933 ("1933 Act"), the Securities Exchange Act of 1934 ("1934 Act"), and the Sarbanes-Oxley Act of 2002.

[3] Ms. Cross joined the SEC as Director of Corporation Finance in June 2009. http://www.sec.gov/news/press/2009/2009-78.htm

CF's Core Functions

Generally, CF reviews company filings, makes rulemaking recommendations to the Commission, and provides interpretive advice to market participants and the public about the securities laws and corresponding regulations. The Division recently made some targeted changes to its operations, creating a new deputy director for policy and capital markets position, and adding three new offices – the Office of Structured Finance, which will help us address complexities and change in the asset-backed securities market; the Office of Capital Markets Trends, which will evaluate trends in securities offerings and in our capital markets to determine if our rules, regulations, and review approach are adequately addressing them; and finally, a new review group in disclosure operations that will focus on the largest financial institutions. While the Division has established these offices and will transfer some existing staff to them, hiring to fully staff these offices has been deferred until funding has been resolved.

Review of Filings

CF selectively reviews filings of new issuers and public companies reporting under the 1934 Act to both monitor and enhance compliance with disclosure and accounting requirements. The staff members engaged in filing reviews have specialized industry, accounting, and disclosure expertise. Approximately 80 percent of the staff of the Division is assigned to the disclosure review program. The Sarbanes-Oxley Act requires the Division to review the financial statements of all companies reporting under the 1934 Act at least once every three years and more frequently where circumstances warrant. The staff may review more than one disclosure document from the same company in a single fiscal year. For example, the staff is currently conducting "real-time" continuous reviews of filings made by the largest financial institutions.

In the course of a review, the staff may issue comments to a company to elicit better compliance with applicable disclosure requirements. In response to those comments, a company may need to revise its financial statements or amend its disclosure to provide additional or enhanced information, or may undertake to revise its financial statements or other disclosures in future filings. Where appropriate, CF refers matters to the Division of Enforcement.

CF currently plans to enhance the full disclosure program to improve the Division's role in promoting full, fair, and timely disclosure of information for investors. The Division intends to implement these plans in FY 2011 and FY 2012 and will broaden the scope of review and increase its focus on large and financially significant registrants. However, the ability to implement these enhancements turns on whether we are able allocate sufficient resources, balancing all other demands on the Division and our limited staff.

Smaller reporting companies – generally, those with a public float less than $75 million – comprise close to half of the public companies filing with the SEC, yet their aggregate market capitalization is less than one percent of the total market capitalization of all reporting companies that the Division reviews. While these companies, and investors making decisions about them, may particularly benefit from SEC staff review, in light of resource constraints and the relatively small market capitalization of these issuers, the Division plans to evaluate the application of the review program to smaller companies to assess whether the nature of the reviews may be scaled

back, while still satisfying the Sarbanes-Oxley Act mandate to review the financial statements of all public companies at least once every three years.

Interpretive Advice
CF provides advice to market participants and the public through interpretive releases, staff legal and accounting bulletins, updates to the Division's financial reporting manual, no-action and interpretive letters, issuance of compliance and disclosure interpretations on the Division's section of the Commission's Web site, and responses to telephone and e-mail inquiries. In FY 2011 and FY 2012, CF expects its workload in this area may increase beyond that of recent years due to the Commission's adoption and implementation of rules required by the Dodd-Frank Act and, to a lesser extent, rules relating to shareholder director nominations.

Rulewriting
CF also makes rule recommendations to the Commission as needed to improve investor protection, facilitate capital formation, and enhance disclosure. The Division expects to recommend changes to existing rules in a number of areas in FY 2011 and FY 2012, including:

- **Core disclosure requirements.** The Division intends to review and recommend amendments to modify core disclosure requirements, many of which have not been significantly updated in close to 30 years, to ensure that they reflect contemporary business practices and address the needs of modern day investors. The goal is to make sure that the rules elicit useful information, not necessarily more information. In determining what information is useful to today's investors, the Division expects to conduct roundtables and other direct contact with professional and non-professional investors. CF expects this project will be accomplished in phases over several years. As part of this project, CF will work with the Commission's Office of Information Technology to consider how disclosure documents are electronically prepared and submitted to the agency, and how they appear on EDGAR.

- **Small business initiatives.** The Division will consider the recommendations of the Government Business Forum on Small Business Capital Formation and ideas from other sources in developing recommendations for the Commission's consideration to facilitate small business capital formation.

- **Credit rating shopping.** The Division will consider recommending that the Commission adopt rules requiring disclosure of credit rating information, including disclosure relating to credit rating shopping.

- **Improvements to proxy voting and shareholder communications processes.** The Division is reviewing public comment on the Commission's concept release regarding proxy voting and shareholder communications. CF staff will work closely with other SEC divisions and offices with regard to possible recommendations to the Commission for proposed rule amendments to address areas that may be in need of improvement.

- **Rules concerning beneficial ownership reporting.** CF continues to evaluate developments with respect to beneficial ownership reporting by investors and is

considering recommendations for the Commission concerning changes in the disclosure obligations of investors relating to the use of derivative instruments and short positions, as well as the timing of the reporting requirements.

Enforcement Liaison
The Division regularly provides technical assistance to the Division of Enforcement on enforcement matters. In 2010 fiscal year, CF responded to over 1575 inquiries from that Division, and we have as of the end of February, addressed at least 817 such inquiries this year. In fiscal year 2010, we referred 309 matters to Enforcement and as of the end of February we have sent 148 matters to Enforcement so far this fiscal year.

International Coordination
The globalization of securities markets requires CF to work with its foreign counterparts on an ongoing basis. The active participation of CF staff with technical expertise in international working groups – of, among others, the International Organization of Securities Commissions, the Financial Stability Board, and the Organization for Economic Co-operation and Development – is essential to the fulfillment of the Commission's international responsibilities. Such participation also promotes consistency between international standards and Commission policy and the interests of the United States. In addition to working with international groups, there are also a number of bi-lateral relationships, such as with European regulators, which are increasingly important in today's global environment. The international work of CF also includes collaborating with other Federal agencies, such as the Federal Reserve Board and the Department of the Treasury, by providing them with technical assistance on matters related to international coordination of financial regulation.

Dodd-Frank Rulewriting

In addition to the rulemaking initiatives discussed above, CF staff is responsible for preparing rules to implement a significant number of Dodd-Frank Act requirements. CF has reassigned a number of attorneys from throughout the Division, including disclosure operations, to work on these rules. CF expects that these projects will be conducted throughout FY 2011 and FY 2012.

Dodd-Frank rules for which CF is responsible include, among others, the following:

Asset-Backed Securities. Asset-backed securities (ABS) rules in a number of areas, including, among others:

- **Representations and Warranties.** On January 20, 2011, the Commission adopted final rules to implement Section 943 of the Dodd-Frank Act, which requires the Commission to adopt rules regarding representations and warranties in ABS.

- **Issuer Review of Underlying Assets.** On January 20, 2011, the Commission adopted final rules to implement Section 945 of the Dodd-Frank Act. Section 945 requires the Commission to issue rules requiring an asset-backed issuer in a 1933 Act registered transaction to perform a review of the assets underlying the ABS, and disclose the nature of such review.

- **Risk Retention.** CF staff is working closely with other regulators to jointly develop recommendations to implement the risk retention rules required by Section 941 of the Dodd-Frank Act. These rules will address the appropriate amount, form, and duration of required risk retention for ABS securitizers, and the definition of qualified residential mortgages.

Corporate Governance and Executive Compensation. Corporate governance and executive compensation provisions of the Dodd-Frank Act including, among others:

- **"Say-on-Pay" and "Golden Parachute."** In January 2011, the Commission adopted rules to implement the provisions of the Dodd-Frank Act that require public companies subject to the federal proxy rules to provide their shareholders with:
  - an advisory vote on executive compensation, generally known as "say-on-pay" votes, as well as with an advisory vote on the desired frequency of say-on-pay votes.
  - an advisory vote on compensation arrangements and understandings in connection with merger transactions, known as "golden parachute" arrangements.

- **Compensation Committees and Compensation Consultants.** The Commission is required by Section 952 of the Dodd-Frank Act to mandate new listing standards relating to the independence of compensation committees and to establish new disclosure requirements and conflict of interest standards that boards must observe when retaining compensation consultants.

- **Recovery of Erroneously Awarded Compensation.** Section 954 of the Dodd-Frank Act requires the Commission to adopt rules mandating new listing standards relating to specified executive compensation "clawback" policies.

- **Pay versus Performance and Pay Ratios.** Under Section 953 of the Dodd-Frank Act, the Commission must adopt rules requiring new disclosures about the relationship between executive compensation and company performance, and the ratio between the median of the annual total compensation of an issuer's employees and the annual total compensation of the issuer's chief executive officer.

- **Employee and Director Hedging.** Section 955 of the Dodd-Frank Act requires the Commission to adopt rules requiring disclosure by issuers of their policies relating to certain employee and director hedging activities.

Specialized Disclosures. Title XV of the Dodd-Frank Act contains specialized disclosure provisions related to conflict minerals, coal or other mine safety, and payments by resource extraction issuers to foreign or U.S. government entities. The Commission published the rule proposals relating to these three provisions in December 2010. The comment periods were scheduled to close on January 31, 2011, but the Commission extended the comment periods for all three rule proposals for 30 days, to March 2, 2011 after receiving several requests for an extension of the time for public comment.

Exempt Offerings.

- **Accredited Investor.** Section 413(a) of the Dodd-Frank Act requires the definition of "accredited investor" in the Commission's 1933 Act rules to exclude the value of a person's primary residence for purposes of determining accredited investor status on the basis of having net worth in excess of $1 million. The Commission proposed rule amendments on January 25, 2011 that would implement this provision, and would clarify the treatment of any indebtedness secured by the residence in the net worth calculation.

- **"Felons and Other 'Bad Actors'".** Under Section 926 of the Act, the Commission is required to adopt rules that disqualify securities offerings involving certain "felons and other 'bad actors'" from relying on the safe harbor from 1933 Act registration provided by Rule 506 of Regulation D.

Upcoming Challenges

While CF has developed review practices and procedures to satisfy the Sarbanes-Oxley Act mandate to review the financial statements of all reporting companies at least once every three years, this requirement, coupled with limited resources, constrains the Division's ability to devote sufficient resources to the review of companies that represent the largest portion of U.S. market capitalization. The Division's limited staff is responsible for reviewing the disclosures of approximately 10,000 reporting companies under this review mandate, and also for reviewing registration statements and other transactional filings made under the 1933 Act and 1934 Act, such as filings related to capital raising and business combinations. The challenges of staffing the review program are even greater in light of the Division's new responsibilities under the Dodd-Frank Act. As noted, CF is currently evaluating its review program with the goal of increasing its focus on large and financially significant registrants and assessing whether additional efficiencies might be gained with regard to its reviews of smaller reporting companies, consistent with its obligations under the Sarbanes-Oxley Act. CF has already made targeted changes to its operations, including the formation of three new offices in order to better fulfill our mission of investor protection. The ability to realize these benefits will be compromised, however, if we are unable to fully staff them and/or are unable to hire staff with the necessary expertise in structured products or in the capital markets.

TRADING AND MARKETS

Director, Robert Cook[4]

The Division of Trading and Markets (TM) is responsible for establishing and maintaining standards for fair, orderly, and efficient markets. While TM's workload continues to be dominated by a diverse range of core functions that are vital for protecting investors and markets, the scope of its responsibilities has expanded tremendously under the Dodd-Frank Act.

[4] Mr. Cook joined the SEC as the Director of Trading and Markets in January 2010. http://www.sec.gov/news/press/2009/2009-242.htm

TM's Core Functions

Oversight of Securities Markets

TM devotes substantial resources to regulating the securities markets, including 15 securities exchanges (equities and options), 3 electronic communication networks (ECNs), over 60 active alternative trading systems, and over 200 internalizing broker-dealers. Our ongoing oversight responsibilities include:

- Reviewing new exchange registrations, an extensive process that requires analysis of, among other complex issues, the impact of a new exchange on the protection of investors, the public interest, and the national market system. TM currently estimates receiving applications for four to eight new exchanges through FY 2012.
- Processing proposed SRO rule changes, which address issues ranging from new fee structures to changes in trading rules to revamped governance structures. TM received over 2,000 rule filings in 2010, nearly double the number of filings received only five years ago.[5]
- Reviewing new financial products, ranging from now-common index exchange traded funds (ETFs) to physical commodity trusts to more esoteric products.
- Initiating changes to market rules to keep pace with market developments.

The Division also leads Commission efforts to respond to significant market events, such as the severe market disruption of May 6, 2010. In addition to spearheading the Commission's inquiry into that day's events, coordinating an independent joint SEC-CFTC advisory committee focusing on those events, and publishing two joint reports with the staff of the CFTC, the Division led the implementation of key regulatory responses, including: (1) a uniform circuit breaker pilot program designed to halt trading in a disorderly market; (2) pilot exchange rules designed to improve the process of breaking "clearly erroneous" trades; and (3) exchange rules to enhance quotation standards for market makers.

Key Challenges. The Division's mission has become ever more challenging with the exponential growth in the size and complexity of the U.S. securities markets.

- *Rapidly changing markets.* Markets today are vastly different from markets even five years ago: there are more trades occurring in smaller average sizes on an increasing number of trading venues. For example, the total volume of trading in exchange-listed stocks grew 107 percent in the last six years, reaching an average daily volume of 8.5 billion shares in 2010. In 2005, there were 2.9 million average daily trades in NYSE-listed stocks, and 79 percent of the volume in such stocks was executed on the NYSE. In 2010, average daily trades in these stocks had increased by 486 percent, to 17 million, but the NYSE's percentage had fallen to roughly 22 percent by January 2011. The remaining volume had shifted to a number of diverse trading venues. Options markets have experienced similar dynamic growth as total contract volume of trading in equity options grew 264 percent in the last six years. Volume in equity options also is dispersed across an increasing number of options exchanges, as evidenced by the dispersed market share

[5] This number includes filings by the exchanges and other SROs, such as clearing agencies, FINRA, and the MSRB.

for 2010 total contract volume, where 5 out of 9 options exchanges each had between a 10 percent and 25 percent market share.

- *Expanding information and surveillance gaps.* This tremendous increase in volume generates significant amounts of trading information. However, the Division's ability to obtain relevant information in a timely manner – and to use it to monitor markets effectively or to respond rapidly to crises such as May 6 – is limited by the lack of any standardized, automated system to collect data in real time or close to real time across the various trading venues, products, and market participants. For example, to obtain individual trader information the Commission must make a series of time-consuming manual requests. The Commission's tools for collecting data and overseeing markets do not even incorporate readily available technology currently used by those the Commission regulates.

Core Initiatives. In FY 2011 and FY 2012, the Division plans to focus on several key initiatives to improve market oversight:

- *Advancing a comprehensive review of equity market structure.* In January 2010, the SEC published a concept release on equity market structure in order to solicit public input on several of the key issues highlighted by the explosive growth in trading volume: (1) the quality of performance of the current market structure; (2) high frequency trading; and (3) undisplayed liquidity in all its forms. In addition to considering the more than 200 comment letters that the Commission received, the Division organized a Commission-hosted public roundtable on market structure in June 2010. The Division plans to continue to advance this discussion and consider appropriate rulemaking responses in the coming months.
- *Enhancing market surveillance.* In spring 2010, the Commission published for comment TM proposals to require large trader reporting and to mandate the development and implementation of a consolidated audit trail system. The Division plans to continue work on these proposals and other mechanisms to enhance market surveillance in FY 2011 and FY 2012.
- *Addressing, as appropriate, significant market developments.* The Division plans to continue to identify and, as appropriate, formulate rules to respond to, significant equities and options market developments in FY 2011 and FY 2012, which will include the evolution of the single-stock circuit breaker into "limit-up/limit-down" functionality and the review of proposed exchange mergers or other business combinations.

Oversight of Clearing Agencies and Transfer Agents

The Division currently participates in the oversight of 9 active clearing agencies that are examined by the Commission, and anticipates that a number of additional clearing agencies may become subject to Commission oversight in FY 2011 and FY 2012. The Division has significant ongoing oversight responsibilities with respect to clearing agencies, and our ability to develop and sustain our oversight functions depends on adequate staffing and resources. These responsibilities include:

- Reviewing new clearing agency registration applications and rule changes, a complex process that involves addressing key systems, operations, and risk management issues;

- Engaging in rulemaking, including adopting new prudential standards; and
- Monitoring risk-related issues as part of a recently developed Clearing Agency Monitoring group, which has been created to monitor and evaluate clearing agency risk management and operational systems.

In addition, the Division is responsible for rules relating to approximately 500 registered transfer agents. The Division is evaluating whether to make extensive recommendations to the Commission to modernize transfer agent regulation.

Oversight of Broker-Dealers, FINRA and SIPC

Broker-Dealers. The Division oversees regulations governing over 5,000 registered broker-dealers, including by:

- Establishing or approving rules governing broker-dealer activities, including rules pertaining to capital adequacy, the protection of customer assets, anti-money laundering, sales practices and record-keeping.
- Supervising on an ongoing basis the financial activities and risk-management controls of certain "risk-supervised broker-dealers," and reviewing filings of other broker-dealers with respect to their material affiliates.

FINRA Oversight and Coordination. The Division oversees FINRA by reviewing and processing its rule filings. TM also works closely with FINRA on various issues, including monitoring and responding to emerging regulatory issues relating to broker-dealers.

SIPC Oversight. The Division supervises SIPC (in conjunction with OCIE) and monitors the liquidation of broker-dealers under the Securities Investor Protection Act of 1970 in order to help ensure that customers of failed firms are compensated to the fullest extent allowed by the law.

Oversight of Credit Rating Agencies

TM currently writes rules applicable to the 10 credit rating agencies registered with the Commission as nationally recognized statistical rating organizations (NRSROs), reviews applications from potential new registrants and, in conjunction with OCIE, monitors their activities.

Oversight of Municipal Securities Market Participants and MSRB

The Division currently administers the rules of the Commission with respect to the practices of municipal securities brokers and dealers and municipal advisors. It also reviews MSRB rulefilings, coordinates with the MSRB in rulemaking and enforcement actions, and, together with the Division of Corporation Finance, advises the Commission on policy matters relating to the municipal bond market.[6]

[6] The Dodd-Frank Act envisions that certain of the credit rating agency and municipal securities functions currently being carried out by TM will eventually be folded into separate offices. In addition to the Whistleblower Office mentioned earlier, the Dodd-Frank Act requires the Commission to create four new offices within the Commission, specifically, the Office of Credit Ratings, Office of the Investor Advocate, Office of Minority and Women Inclusion,

Oversight of Trading Practices
The Division develops rules and other initiatives that respond to the constant evolution in trading practices among market participants. Among other efforts, the Division leads and administers Commission initiatives with respect to: (1) secondary market activities related to the IPO market; (2) the regulation of research analysts, (3) short sale regulations; (4) securities lending; (5) over-the-counter (OTC) equities market activities; and (6) certain measures to prevent manipulative practices.

Continuity of Markets and Operations / Cyber Security
TM is responsible for supervising the capacity and resilience of our largely electronic exchanges and responding to potential disruptions to market continuity, whether due to systems outages, geopolitical uncertainty, malicious systems intrusions, or other causes. In addition, the Division performs cyclical reviews of exchanges, ECNs, and clearing agencies to ensure they are acting in accordance with the Commission's Automation Review Policies (ARP) and have adequate systems in place to deal with technology disruptions. In 2010, TM conducted 12 such ARP reviews. In FY 2011 and FY 2012, the Division plans to enhance its ARP reviews, with a particular focus on whether registered entities have appropriate cyber security measures. The Division is also preparing recommendations for the Commission to further strengthen the ARP standards.

Enforcement Liaison
The Division regularly provides technical assistance to the Division of Enforcement on enforcement matters. In 2010, TM responded to over 950 inquiries from that Division, and we are on track to address roughly 1,200 inquiries this year.

Investor / Market Participant Guidance
The Division also responds to calls, emails, correspondence and other communications from industry, counsel, the public, congressional staff, foreign sources and others. Last year, the Division handled roughly 15,000 such communications and since last March has processed over 1,000 tips, complaints, referrals, and regulated entity notices. The Division also issues written interpretive guidance and no-action and exemptive relief to market participants.

International Coordination
The globalization of securities markets requires TM to coordinate its regulatory activities with its foreign counterparts on an ongoing basis. The active participation of TM staff with technical expertise in international working groups – of, among others, the International Organization of Securities Commissions, the Financial Action Task Force, the Joint Forum and the Financial Stability Board – is essential to the fulfillment of the Commission's responsibilities. Such participation also helps ensure that international standards are consistent with Commission policy and in the interests of the United States.

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and Office of Municipal Securities. As each of these offices is statutorily required to report directly to the Chairman, the creation of these offices is subject to approval by the Commission's appropriations subcommittees to reprogram funds for this purpose. Until reprogramming approval is received, the initial functions of the offices are being performed on a limited basis by other divisions and offices.

Dodd-Frank-Related Challenges

Many of these core functions have been substantially expanded by the mandates of the Dodd-Frank Act, including functions related to exchanges, clearing agencies, NRSROs, and municipal markets. In addition, TM has been charged with developing the registration and regulatory regime for entities that participate in the security-based OTC derivatives market. All told, the Division is responsible for over 25 separate rulemaking initiatives with adoption deadlines of one year or less under the Dodd-Frank Act. Many of these rulemakings are the first step in new ongoing supervisory and regulatory functions for TM that will extend into FY 2012 and beyond.

Regulation of OTC Derivatives

New Categories of Registrants. The Division will be responsible for the registration and other rules for four entirely new categories of entities: security-based swap execution facilities (SEFs) (an estimated 20 new registrants in FY 2011 and FY 2012); security-based swap data repositories (SDRs) (an estimated three new registrants in FY 2011 and FY 2012); security-based swap dealers (an estimated 50 new registrants in FY 2011 and FY 2012); and major security-based swap participants (an estimated fewer than 10 in FY 2011and 2012).

New Rules under Title VII. Title VII of the Dodd-Frank Act establishes a new oversight regime for the OTC derivatives market and requires the Commission to write rules that address, among other things: business conduct, capital, and margin requirements for market intermediaries; the operation of trade execution facilities and data repositories; mandatory clearing requirements; and public transparency for price and trade information. The Division has already prepared ten rulemaking proposals in this area that the Commission has published for comment, namely, proposed rules regarding:

- Anti-fraud and anti-manipulation measures regarding security-based swaps;
- Reporting and real-time public dissemination of trade information for security-based swaps;
- Obligations of security-based swap data repositories;
- Mandatory clearing of security-based swaps;
- Exceptions to the mandatory clearing requirement for hedging by end users;
- Standards for the operation and governance of clearing agencies;
- Registration and regulation of security-based swap execution facilities;
- Definitions of swap and security-based swap dealers, and major swap and security-based swap participants, done jointly with the CFTC;
- Trade acknowledgements for security-based swaps; and
- Conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.

The Commission also adopted interim final rules regarding the reporting of outstanding security-based swaps entered into prior to the date of enactment of the Dodd-Frank Act. The Division is continuing to develop a number of other proposed rules required by Title VII.

Ongoing Regulatory Responsibilities. Going forward, the Division's regulatory responsibilities will be significantly expanded by the addition of the new categories of registered entities, the required regulatory reporting and public dissemination of security-based swap data, and the mandatory clearing of security-based swaps. In particular, the Division will need to: (1) register the new entities on a rolling basis, coordinating where appropriate with OCIE and other divisions, (2) monitor market developments and promulgate new rules and guidance where needed, and (3) respond to numerous interpretive requests in connection with the requirements applicable to the new registrants. Unlike broker-dealers – for which FINRA performs many front-line supervisory functions – the Dodd-Frank Act does not provide for an SRO performing any of these new regulatory responsibilities.

Expanded Responsibilities Related to Credit Ratings

Rulemaking/Studies. The Division is responsible for 12 separate rules related to NRSROs that are mandated by the Dodd-Frank Act. The SEC must address, among other things, internal controls and procedures, conflicts of interest, credit rating methodologies, transparency, ratings performance, analyst training, credit rating symbology, and disclosures accompanying the publication of credit ratings. In addition, as required by the Act, the Division has reviewed and identified references to ratings in TM administered rules, with a view to eliminating these references. The Division plans to recommend rule proposals to the Commission on these matters in the near future. The Division is also working on three studies required by the Dodd-Frank Act relating to the independence of NRSROs, the standardization of credit ratings, and the process for rating certain structured finance products.

Exam Coordination. The Division is also working with OCIE to assist in the annual examination of each NRSRO, as mandated by the Dodd-Frank Act.

Registration and Regulation of Municipal Advisors

Under the Dodd-Frank Act, the Division also is responsible for implementing a new registration regime for municipal advisors. Last September, the Commission adopted an interim final rule establishing a temporary registration regime for municipal advisors; over 850 have since done so. In December, the Commission proposed a rule to create a permanent registration process, which will require ongoing maintenance and guidance from the Division. The Division has also led the Commission's oversight of changes to the MSRB governance structure that were mandated by the Dodd-Frank Act.

Enhanced Clearing Agency Oversight

Title VIII of the Act provides for enhanced oversight of financial market utilities (FMUs), including clearing agencies registered with the Commission, and payment, clearing or settlement activities that are designated as systemically important. As required by Title VIII, the Division is working closely with the Federal Reserve Board and CFTC to develop a common framework to

supervise FMUs that the Financial Stability Oversight Council (FSOC) designates as systemically important, which will evolve into an ongoing function into FY 2012 and beyond.

Accelerated SRO Rule Filing Timeframes
The Dodd-Frank Act imposed new procedural requirements with respect to the Commission's processing of SRO rule filings, which have substantially increased the Division's workload. For example:

- The Division must expedite its initial review of all filings, because it is now required to send an SRO's proposal to the Federal Register for publication in just over two weeks after receipt – about a third less time than before.
- Where SEC approval is required, the Commission must now take final action on an SRO's proposal within defined timeframes, or the proposed rule will be "deemed to have been approved", regardless of any public comment or whether the Commission has determined that the proposal is consistent with the federal securities laws.

Other Dodd-Frank Responsibilities
TM is responsible for implementing many additional aspects of the Dodd-Frank Act, a number of which will expand the Division's ongoing regulatory functions.

Rulemakings. The Division is currently leading the Commission's implementation of the following mandatory rulemaking provisions:

- Section 619 of the Dodd-Frank Act, commonly referred to as the Volcker Rule, which restricts certain proprietary trading activities of broker-dealers;
- Section 621 of the Act, which places restrictions on certain conflicts of interest arising in connection with certain activities involving asset-backed securities;
- Section 956 of the Act, which required joint rulemaking with other financial regulators concerning certain incentive-based compensation arrangements at broker-dealers and investment advisers; and
- Section 982 of the Act, under which the Commission will update the audit requirements for broker-dealers.

The Division also will be responsible for considering and, as appropriate, recommending proposals to the Commission to implement additional provisions of the Dodd-Frank Act, such as Section 921, which grants the Commission authority to limit or eliminate mandatory pre-dispute arbitration agreements.

Interagency Coordination. In addition to the supervision of FMUs described above, the Division is significantly engaged in additional new interagency projects mandated by the Dodd-Frank Act, including the designation of systemically important non-bank financial entities and the design of mechanisms for the orderly liquidation of broker-dealers under new liquidation authority afforded FSOC and the Federal Deposit Insurance Corporation (FDIC). This coordination, which involves complex, interagency regulatory issues, is expected to continue into FY 2012 and beyond.

OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS

Director, Carlo di Florio[7]

A vigorous examination program reduces opportunities for wrongdoing and fraud, and also provides early warning about emerging trends and potential risks in our Nation's capital markets. The Office of Compliance Inspections and Examinations (OCIE) conducts the SEC's National Examination Program. The results of OCIE's examinations are utilized by the Commission to inform rule-making initiatives, to identify and monitor risks, to improve industry practices and to pursue misconduct.

The National Exam Program examines investment advisers, investment companies, broker-dealers, transfer agents, credit rating agencies, exchanges and other SROs such as clearing agencies, FINRA, and the MSRB. In addition to new regulation affecting these registrants, the Dodd-Frank Act introduces new regulation of hedge funds and derivatives and municipal advisers, which will significantly increase our examination responsibilities.

To address these new requirements, OCIE has developed a more risk-based approach to the examination program that will enable us to use our resources more effectively. This approach is necessary, given that the exam program is only able to cover a very small portion of the individuals and entities that register with the Commission, and the disparity between resources and responsibilities is growing as a result of the new requirements of the Dodd-Frank Act. In order to operate a risk-based examination program that effectively identifies and carefully reviews the major risks, we will need more examiners, industry expertise and further technological resources.

Recent Reforms

Over the past year, OCIE has undertaken a broad self-assessment of its strategy, structure, people, processes and technology. This has resulted in a comprehensive improvement plan to break down silos and promote a high-performance culture. Below is an outline of key program improvement initiatives.

Strategy – Strengthening Our Mission and Risk-Focusing our National Exam Program. OCIE is implementing many reforms toward an integrated National Exam Program ensuring consistency, effectiveness and efficiency. The cornerstone is a national governance model and enhanced risk-focused exam strategy to better allocate and leverage limited resources to their highest and best use. Four key objectives support our overall mission to protect investors, maintain market integrity and facilitate capital formation:

- **Improve industry compliance** with the securities laws as well as industry risk management and compliance practices through exams and communication with industry.

[7] Mr. di Florio joined the SEC as the Director of OCIE in January 2010. http://www.sec.gov/news/press/2010/2010-1.htm

- **Identify and prevent fraud** through risk-targeted exams and better coordination with the Division of Enforcement in identifying, investigating and preventing fraud.
- **Monitor new and emerging risks** to investor protection and market integrity through joint initiatives with our policy divisions and the Division of Risk, Strategy and Financial Innovation. This includes the development of new risk assessment and surveillance models and risk analytics so we can target the highest risk firms, practices and trends.
- **Inform policy** as the eyes and ears of the SEC in the field, through structured involvement in the rule-making process, and with dedicated policy support teams on key initiatives.

Structure – Strengthening Expertise in Critical Risk Areas. OCIE is implementing significant structural enhancements to support the National Exam Program and a risk-focused exam strategy. This restructuring will strengthen expertise and facilitate teamwork, while driving greater consistency, effectiveness and accountability. For example:

- We have a new national governance model that includes regional leadership in key strategic planning, policy setting and performance management decisions.
- We have a new Risk Analysis and Surveillance Unit to enhance our ability to identify the highest risk firms we should be examining and the highest risk issues to focus on in our exams of those firms.
- We have launched new Specialization Working Groups dedicated to enhancing our ability to identify, understand and proactively examine new and complex industry developments, in areas such as structured products, valuation, high-frequency trading and municipal securities.
- We are also looking at how best to staff exams with examiners whose skills sets most effectively address the specific risks in an exam profile. This includes deploying joint IA/BD teams to address issues regarding dual broker-dealer and investment adviser registrants.

While these structural improvements are comprehensive, they are also designed to achieve specific outcomes. For instance, these changes will facilitate better teamwork and collaboration with the policy divisions and also speed alerts, information hand offs, and transitions from OCIE exam staff to the Enforcement Division.

People – Recruiting Specialists, Improving Training and Strengthening Culture. In the past year, before the Continuing Resolution necessitated that we suspend recruiting, OCIE was able to recruit people with new skill sets that are critical to supervising our modern capital markets. We have also been building a leading practice training program, introducing mentoring, and building a culture of high-performance, teamwork and accountability. Here are some specific examples:

- We have recruited a limited number of new Senior Specialized Examiners to strengthen our expertise and skills sets in key risk areas, including complex products, risk management, business areas and quantitative analytics.

- We are working to implement a new Certified Examiner Training program that establishes consistent baseline technical training and certification standards across the country.
- We are strengthening management skills and practices through new management and leadership training programs.
- We are launching a mentoring program to support the professional development of our examiners and leverage the expertise and experience of our most seasoned examiners.

Process – Streamlining Processes to Drive Consistency, Effectiveness and Efficiency. We have re-engineered our exam process end-to-end. This has enabled us to target more risk-focused examinations, enhance pre-exam preparation, improve multidisciplinary staffing, and increase field supervision. We have become more risk-focused in allocating resources effectively and efficiently. In addition, we have introduced new mechanisms to drive consistency and accountability across our National Exam Program. Here are some examples:

- A National Exam Manual that sets forth updated policies and procedures governing examinations nationwide.
- A standardized National Exam Workbook to drive consistency in the exam process nationwide.
- OCIE's first Chief Compliance Officer to enhance and monitor compliance with our own policies and procedures, as we expect of our registrants.
- Regular meetings between home office and regional offices to coordinate and monitor performance and compliance.
- Increased use of supervisors in the field and involvement of senior staff on exams.

Technology – Automating the Exam Process to Keep Pace with New Developments. We are focusing our technology strategy on moving from a manual to an automated exam process where possible. This includes automating risk assessment and surveillance; exam preparation; all key activities associated with exam execution, such as trade analysis; work paper management and data analytics and reporting. Other technology initiatives include:

- We created a Technology Committee to oversee our technology resources and strategy.
- We have a dedicated Senior Technology Officer who is developing a comprehensive technology strategy, technology architecture and implementation plan to automate and strengthen our exam program.
- We are piloting new risk assessment and trade analysis technologies that will make the program more efficient and effective in identifying risks and wrongdoing throughout the capital markets.

Governance, Enterprise Risk Management and Internal Controls. The financial crisis revealed just how dramatically risk management failures can harm investors, jeopardize market integrity and hinder capital formation. It also revealed the need for better oversight of risk at the board

and senior management levels, and the need for stronger independence, standing and authority among a firm's internal risk management, control and compliance functions. As a result, we are focusing in our exams on the overall governance and risk management framework of a firm so we can assess the firm's system of checks and balances.

Challenges Facing the Exam Program

Our new risk-based approach is driven in part by the simple fact that our current examination resources can only cover an even smaller portion of the registrants that we are responsible for examining. Only nine percent of registered advisers were examined in FY 2010 and approximately one-third of advisers registered with the SEC have never been examined. With respect to broker-dealers, the examination program currently only conducts internal control examinations of the 30 largest firms on a three- or four-year cycle. Additionally, out of more than 160,000 broker-dealer branch offices, less than one percent are examined annually.

Moreover, increases in the regulatory population and new complex products and lines of business complicate examination oversight. Examinations have grown more complex with the increased use of new complex products, including derivatives and ETFs; the growth of technology to facilitate such activities as high-frequency trading; and with the growth of "families" of financial service firms with integrated operations that include both broker-dealer and investment adviser affiliates.

The Dodd-Frank Act shifted the responsibility for examining many smaller advisers to the states. However, the Act expanded the SEC's responsibilities by adding to its jurisdiction municipal advisors, as well as a large number of complex entities, such as five new categories of securities-based swap participants as well as hedge fund and other private fund advisers. The net of all these changes in the registrant population is that, at the beginning of FY 2012, the SEC anticipates that it will oversee nearly 9,000 advisers with close to $40 trillion of assets under management, 850 groups of registered funds, including third party administrators, more than 5,000 broker-dealers with more than 160,000 branch offices, at least 15 national securities exchanges, and approximately 500 transfer agents. OCIE, together with other Commission divisions and offices, will also oversee, in addition to the 9 active clearing agencies currently examined, a number of additional clearing agencies; the PCAOB; MSRB; FINRA and potentially thousands of municipal advisor entities and individuals. Overall, absent any increase in resources, to a greater extent than is the case today, the expected size of the SEC regulated community in FY 2012 will dwarf the size of the current examination program (currently slightly less than 900 staff nationwide).

Notwithstanding our efforts to make the National Examination Program more effective and efficient, more resources are required for the program to adequately fulfill its mission to protect investors and ensure market integrity. With the addition of approximately 200 FTE positions sought in the 2012 budget, we will be able to conduct more examinations and improve our overall coverage of the industry, as well as better fulfill our new responsibilities under the Dodd-Frank Act. We also should be able to improve our risk analysis approach so that those examinations will be more likely to focus on the areas in greatest need of attention.

INVESTMENT MANAGEMENT

Director, Eileen Rominger[8]

The Division of Investment Management (IM) assists the Commission in executing its responsibility for investor protection and for promoting capital formation through oversight and regulation of America's $38 trillion investment management industry. A primary function of IM is to administer the Investment Company Act of 1940 and the Investment Advisers Act of 1940 and develop regulatory policy for investment advisers, mutual funds and other investment companies. In order to perform this function, IM works in conjunction with the SEC's Office of Compliance Inspections and Examinations (OCIE), which conducts surveillance and on-site inspections.

IM's Core Mission

Money Market Fund Rulemaking, Oversight, and Surveillance

Important reforms the Commission adopted in the regulation of money market funds became effective in FY2010 and FY 2011. Included in these amendments was a requirement for money market funds to report their portfolio holdings to the Commission on a monthly basis. The Commission thus has begun more extensive oversight and surveillance of money market funds based on this data. In the coming year, IM plans to continue and expand initiatives to improve its monitoring of money market funds and ability to analyze trends in money market funds' portfolio exposures, liquidity levels and average maturities.

Also, IM is considering recommending additional reforms aimed at further improving the regulatory regime for money market funds and lessening their susceptibility to runs. Last year, the President's Working Group on Financial Markets (of which the SEC Chairman was a member) published a report examining various options for additional money market fund reforms. The Division's staff contributed substantial assistance and resources to this effort and continues to consult with their counterparts in the other agencies that comprise the Financial Stability Oversight Counsel (FSOC). The Commission requested comment on the options discussed in this report and will consider the comments received in evaluating additional regulatory reform.

Other Rulemaking

In the past year, IM has been engaged in preparing rule proposals and adoptions on a number of important initiatives to protect investors. These include:

- *Rule 12b-1.* The Commission proposed to rescind rule 12b-1, the rule that permits funds to make payments from fund assets for expenses incurred in the distribution of fund share, and replace it with a new rule and regulatory framework governing asset-based distribution fees. IM is currently reviewing the more than 2,000 comments the Commission received on the proposal and will evaluate whether to recommend that the Commission adopt 12b-1 reforms.

[8] Ms. Rominger joined the SEC as the Director of Investment Management in February 2011. http://www.sec.gov/news/press/2011/2011-14.htm

- *Target Date Funds.* The Commission proposed changes to rules regarding fund names and marketing materials with respect to target date funds. A target date fund is typically intended for investors whose retirement date is at or around the fund's stated target date. American workers increasingly rely on target date funds for their retirement needs. After consideration of public comments, the Division will evaluate whether to recommend that the Commission adopt rule changes to address target date funds.

- *Investment Adviser Brochures.* In July of last year, the Commission adopted final rules that substantially overhauled the primary disclosure document registered investment advisers must provide their clients and prospective clients. Form ADV, Part 2 – commonly referred to as the "brochure" – includes information on an adviser's qualifications, investment strategies, business practices, and disciplinary information. The new brochures, which will be posted to the Commission's web site as advisers file them, will have expanded content and an improved narrative plain English format.

- *Pay to play.* The Commission adopted in June of last year a new rule to address so-called "pay to play" practices in which investment advisers make campaign contributions to elected officials in order to influence the award of contracts to manage public pension plan assets and other government investment accounts. The rule, adopted in response to a growing number of reports of such activities across the country, is intended to combat pay to play arrangements at the state and local government level in which advisers are chosen based on their campaign contributions to political officials rather than on merit.

Interpretive Advice and Exemptive Relief
In addition to its role in Commission rulemaking, IM provides formal and informal legal guidance in the form of interpretive and no-action letters, exemptive relief, interpretive releases, memoranda, and other letters and materials. In FY 2010, the staff closed 921 matters involving formal and informal legal guidance.

Review of Filings
IM reviews filings of investments companies that register under the Investment Company Act of 1940 and register their securities under the Securities Act of 1933 to both monitor and enhance compliance with disclosure and accounting requirements. The filings reviewed include initial registration statements, post-effective amendments thereto, and proxy statements. Under Commission rules, some filings containing non-material changes or disclosure that is substantially similar to a prior filing may not be subject to staff review or subject to a limited review. Pursuant to requirements under the Sarbanes-Oxley Act of 2002, the Division reviews the annual reports of all investment companies no less frequently than once every three years.

International Coordination
Funds and the advisers that operate them, including private funds and private fund advisers, frequently operate on a global basis. The active participation of IM staff with technical expertise in international working groups is essential to the fulfillment of the Commission's international responsibilities. For example, IM staff recently participated in work of the International Organization of Securities Commissions designed to help regulators assess the systemic risk

posed by hedge funds and other private funds on a global basis by collecting consistent and comparable information. Such participation also helps promote international standards that are consistent with Commission policy.

Enforcement Liaison
The Division regularly provides formal and informal legal and policy guidance to the Division of Enforcement on enforcement matters. In 2010, IM reviewed over 500 enforcement-related matters from the Division of Enforcement, and expects to review approximately the same number of enforcement-related matters in 2011. In addition, IM conducts reviews of disciplinary disclosures in new or amended Forms ADV filed by registered investment advisers. The Division also responds to IM-related tips, complaints and referrals and has assisted in the Commission's development of a Commission-wide TCR system.

Implementing Provisions of the Dodd-Frank Act

Currently, IM is focusing its rulemaking program on implementing the provisions of the Dodd-Frank Act as they relate to investment companies and advisers, and, as rules are adopted, much of the work will shift to the Division's disclosure, interpretive advice and exemptive relief programs. These include:

Investment Adviser Regulation. The Dodd-Frank Act changed the universe of regulated entities for which the Commission is responsible by increasing the statutory threshold for SEC registration by investment advisers to $100 million in assets under management; requiring advisers to hedge funds and other private funds to register with the Commission (the staff anticipates this will add approximately 750 new private fund advisers to the registrant pool); and requiring reporting by certain investment advisers that are exempt from registration. While the number of registered advisers is anticipated to shrink overall by 28 percent, the total assets managed by advisers registered with the Commission are expected to rise.

In November, the Commission proposed new rules and rule amendments, including amendments to Form ADV, to implement the provisions of the Act described above. Concurrently, the Commission proposed rules to implement new exemptions from registration created by the Dodd-Frank Act for advisers to certain private funds and for certain foreign private advisers. The new rules would define "venture capital fund," provide for an exemption for advisers with less than $150 million in private fund assets under management in the United States, and clarify the meaning of certain terms included in the foreign private adviser exemption. The comment period for both proposals ended on January 24, 2011. After review of the comments received by the Commission on these proposals, the staff plans to recommend in FY 2011 that the Commission adopt rules and rule amendments implementing these Dodd-Frank Act provisions.

Earlier in FY 2011, the Commission proposed an exclusion from the definition of investment adviser for certain family office investment advisers as directed by the Dodd-Frank Act. The staff also is reviewing the comments received and preparing a rule adoption for Commission consideration on this matter.

Systemic Risk Reporting. In January, the Commission proposed reporting requirements for private fund investment advisers to assist FSOC in monitoring for potential systemic risk, in

accordance with the Dodd-Frank Act. Following consideration of the comments received, the staff in FY 2011 expects to prepare a rule adoption for Commission consideration. For purposes of monitoring this information and the new information received from money market funds, the Division hopes to hire additional staff with the expertise necessary to analyze, answer inquiries, and develop reports with respect to this systemic risk information.

CROSS-DIVISIONAL STUDIES

In addition, we have undertaken a number of cross-divisional studies required by the Dodd-Frank Act, including:

Investment Adviser/Broker Dealer Fiduciary Study. In January 2011, SEC staff completed a study required by Section 913 of the Dodd-Frank Act that, among other things, evaluated the effectiveness of existing legal or regulatory standards of care for broker dealers and investment advisers when providing personalized investment advice about securities to retail customers.[9] The study also evaluated whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the applicable standards of care for brokers, dealers, and investment advisers that should be addressed. SEC staff recommended that the Commission adopt rules, consistent with Congress' grant of authority in the Dodd-Frank Act, which would apply a uniform fiduciary standard of conduct to both broker-dealers and investment advisers when providing personalized investment advice about securities to retail investors. As provided for in the Dodd-Frank Act, this fiduciary standard would be no less stringent than the standard that currently applies to investment advisers under the Investment Advisers Act. SEC staff also recommended that the Commission consider whether certain regulations applicable to broker-dealers and investment advisers should be harmonized to add meaningful investor protection. The staff expects to recommend to the Commission proposed rules as may be appropriate based on the study's recommendations.

Study on Enhancing Investment Adviser Examinations. In January 2011, IM staff, with assistance from other divisions and offices, completed a study required by Section 914 of the Dodd-Frank Act that reviewed the need for enhanced examination and enforcement resources for investment advisers that are registered with the Commission.[10] The study describes the decrease in the number and frequency of examinations of registered investment advisers over the past several years and explores how the number and frequency of examinations are likely to change as a result of, among other things, the Dodd-Frank Act's amendments to the Advisers Act's registration provisions. The study notes that the Commission likely will not have sufficient capacity in the near or long term to conduct examinations of registered investment advisers with adequate frequency, and that the Commission's examination program requires a source of funding that is adequate to permit the Commission to meet the new challenges it faces and

[9] Commissioners Casey and Paredes did not support release of the study as published and issued a separate statement in conjunction with publication of this study. The study is available at http://www.sec.gov/news/studies/2011/913studyfinal.pdf; The statement by Commissioners Casey and Paredes is available at http://www.sec.gov/news/speech/2011/spch012211klctap.htm.

[10] Commissioner Walter issued a separate statement in conjunction with publication of this study. The study is available at http://www.sec.gov/news/studies/2011/914studyfinal.pdf; The statement by Commissioner Walter is available at http://www.sec.gov/news/speech/2011/spch011911ebw.pdf.

sufficiently stable to prevent adviser examination resources from periodically being outstripped by growth in the number of registered investment advisers. The study highlights three options to strengthen the Commission's investment adviser examination program: (1) imposing user fees on SEC-registered investment advisers to fund their examinations; (2) authorizing one or more self-regulatory organizations that assess fees on their members to examine, subject to SEC oversight, all SEC-registered investment advisers; or (3) authorizing FINRA to examine a subset of advisers – i.e., dually registered investment advisers and broker-dealers – for compliance with the Advisers Act.

Financial Literacy Study. The Dodd-Frank Act requires the SEC to conduct a study and draft a report, due in FY 2012, which assesses the existing financial literacy of retail investors, and identifies methods to improve disclosures made to investors and the most useful information investors need to make informed investment decisions. The Act specifically identifies mutual fund investments and point of sale disclosures to be covered by particular aspects of the study. This study is being led by the Commission's Office of Investor Education and Advocacy.

Conclusion

While the SEC has made substantial progress in reforming its operations and increasing its efficiency, our efforts are ongoing. Our budget request reflects this need to further improve our internal operations, and also provides the resources needed to accomplish our core mission, implement the responsibilities given to us under the Dodd-Frank Act, and undertake badly needed new technology initiatives. Investors and our markets deserve nothing less. We look forward to continuing to work closely with Congress as this legislative session continues, and we are happy to answer any questions you may have.

Questions from Chairman Scott Garrett
for the Hearing Record
From the March 10, 2011 Hearing before the
United States House of Representatives Committee on Financial Services
Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises

on

Budget and Management of the U.S. Securities and Exchange Commission

1. As you know, Section 929X of the Dodd-Frank Act requires the Securities and Exchange Commission ("SEC") to write rules providing for public disclosure of "aggregate" short sales. For good reason, Congress opted for aggregate versus individual disclosures to avoid divulging individual proprietary trading strategies while providing useful comprehensive information. Despite clear language in the statute and report language, it is my understanding that some SEC staff may be spending time considering how to change this mandate for aggregate information into a public, "individual" reporting requirement. Is this true? If it is, given your agency's limited resources, and given that Congress considered this and specifically directed public disclosure of "aggregate" rather than "individual" short sales, can you help us understand the rationale for spending staff time in this way?

Answer: As you know, Section 13(f) of the Securities Exchange Act of 1934 sets forth certain public reporting requirements applicable to certain institutional investment managers, including requirements, generally, to report for each security covered by the Section that the institutional investment manager held, the name of the issuer and the title, class, CUSIP number, number of shares or principal amount, and aggregate fair market value of each such security.

Section 929X(a) of the Dodd-Frank Act amends Section 13(f) to insert the following: "(2) the Commission shall prescribe rules providing for the public disclosure of the name of the issuer and the title, class, CUSIP number, aggregate amount of the number of short sales of each security, and any additional information determined by the Commission following the end of the reporting period. At a minimum, such public disclosure shall occur every month."

Section 929X(a) does not have a specific deadline for the required rulemaking. Currently, SEC Staff is focusing its limited time and resources on other provisions of the Dodd-Frank Act with specific statutory deadlines.[1] However, we welcome public comment and consultation relating to this statute.

Any proposed rulemaking by the Commission under Section 929X(a) would be subject to public notice and comment prior to formal adoption by the Commission. Already, however, the Commission has received a number of comment letters addressing short sale disclosure related

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[1] *See* "Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act — Upcoming Activity" at http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml.

requirements under the Dodd-Frank Act, including the requirements of Section 929X(a),[2] with one commenter specifically addressing the question of individual versus aggregate reporting under Section 929X.[3] In addition, the Staff met with representatives of an industry trade association at their request to discuss concerns about the question of individual versus aggregate reporting under Section 929X.[4] As the staff works to prepare a recommendation for Commission consideration of the rules required by Section 929X(a), we will carefully consider these concerns, all comments received, and the legislative history of the Dodd-Frank Act.

2. "[A]lthough Chinese companies are allowed to list on U.S. exchanges through reverse mergers and to raise money from American investors, the SEC is not able to actually regulate and oversee any company in China. ... Is this true?"

A. Domestic and foreign companies with securities listed on U.S. exchanges are subject to the registration and reporting requirements of the federal securities laws, regardless of the primary place of business. In addition, domestic and foreign companies that publicly offer securities in the U.S. are subject to the federal securities laws, even if the securities are not listed on an exchange. While the majority of foreign-based issuers are engaged in legitimate business operations, others may take advantage of the remoteness of their operations to engage in fraud.

The number of issuers with their principal place of business in the People's Republic of China (the PRC) has undergone a marked increase in recent years, including those PRC-based companies that became domestic issuers[5] through reverse mergers.[6] The SEC's Division of Enforcement has pursued securities violations by PRC-based issuers for a number of years, including investigating and filing its first accounting fraud case against a PRC-based issuer in early 2006.[7] As will be described in more detail below, since then, the SEC has brought a

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[2] *See, e.g.*, Letter from Peter Chepucavage, Plexus Consulting Group, dated Aug. 3, 2010; letter from William Wuepper dated Aug. 10, 2010; letter from Ed Schweitzer dated Sept. 8, 2010; letter from Richard H. Baker, President and CEO, Managed Funds Association, dated Sept. 22, 2010 ("MFA (Sept. 2010)"); letter from Richard H. Baker, President and CEO, Managed Funds Association, dated Feb. 7, 2011 ("MFA (Feb. 2011)"). Comment letters submitted to the SEC regarding short sale disclosure related requirements of the Dodd-Frank Act are available at http://www.sec.gov/comments/df-title-ix/short-sale-disclosure/short-sale-disclosure.shtml.

[3] *See* letter from MFA (Sept. 2010); letter from MFA (Feb. 2011).

[4] *See* Memorandum from the Division of Trading and Markets regarding a January 5, 2011 meeting with representatives from the Managed Funds Association available at http://www.sec.gov/comments/df-title-ix/short-sale-disclosure/short-sale-disclosure.shtml#meetings. *See also* letter from MFA (Sept. 2010); letter from MFA (Feb. 2011).

[5] The term "domestic issuer" used in this letter includes issuers organized in the U.S. or that do not qualify to report as foreign issuers because of the nature of their U.S. contacts.

[6] *Public Company Accounting Oversight Board, Activity Summary and Audit Implications for Reverse Mergers Involving Companies from the China Region: January 1, 2007 through March 31, 2010*, Research Note # 2011-P1 (March 14, 2011) http://pcaobus.org/Research/Documents/Chinese_Reverse_Merger_Research_Note.pdf The PCAOB's research note identified 159 reverse mergers by companies principally based in the PRC between 1/1/07 and 3/31/10.

[7] *See Securities and Exchange Commission v. NetEase.com, Inc.* (action against company and two former officers), (Feb. 2006), Lit. Rel. 19578 (http://www.sec.gov/litigation/litreleases/lr19578.htm).

number of cases, including market manipulations;[8] accounting and disclosure violations;[9] actions against auditors and accountants;[10] trading suspensions;[11] and administrative proceedings to revoke companies' registration statements.[12]

"[D]ue to non-publicized rules that the SEC follows under its internal legal workflow regime, the SEC is prohibited from even calling or emailing any person or entity within China's borders. Is this true?"

There are certain difficulties associated with investigations of securities laws violations that touch on foreign jurisdictions. The SEC routinely notifies our regulatory counterparts, including the China Securities Regulatory Commission (CSRC), that obtaining voluntary and direct access to witnesses and information is important to our enforcement investigations. In many jurisdictions, the SEC can directly access witnesses and information to further its investigations. However, some jurisdictions, such as the PRC, view such direct efforts as a possible violation of sovereignty and/or national interest, which may be expressed informally (as is done by the CSRC) or embodied in law or agreement. In such cases, we generally work with the

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[8] *See, e.g., SEC v. China Energy Savings Technology, Inc.* (action against company and multiple defendants) (Dec. 2006), Lit. Rel. 19931 (http://www.sec.gov/news/press/2006/2006-200.htm); *SEC v. Berger, et al.*, Lit Rel. 21833, (Feb. 2011) http://www.sec.gov/litigation/litreleases/2011/lr21833.htm .

[9] *See, e.g., SEC. v. China Holdings, Inc. et al.* (action against company and CEO) (Oct. 2009), Lit. Rel. 21272 (http://www.sec.gov/litigation/litreleases/2009/lr21272.htm); *In the Matter of China Yuchai International, Limited*, (action against company) (June 2010), Rel. No. 34-62235 (http://www.sec.gov/litigation/admin/2010/34-62235.pdf).

[10] *See, e.g., In the Matter of Moore Stephens Wurth Frazer & Torbet LLP, et al.*, (Dec. 2010), Rel. No. 33-9166 (http://www.sec.gov/litigation/admin/2010/33-9166.pdf).

[11] *See, e.g., Heli Electronics Corp.* (http://www.sec.gov/litigation/suspensions/2011/34-64101.pdf) ; *China Changjiang Mining & New Energy Co.* (http://www.sec.gov/litigation/suspensions/2011/34-64164.pdf); and RINO International Corporation (http://www.sec.gov/litigation/suspensions/2011/34-64291.pdf) .

[12] *See, e.g., China 9D Construction Group,* Admin. Proc. No. 3-14215 (March 24, 2011) (Single respondent) (Revoked by default) (http://www.sec.gov/litigation/admin/2011/34-63817.pdf), *Carrier1 International S.A., et al.*, Admin. Proc. No. 3-14257 (March 24, 2011) (Respondent – China Expert Technology, Inc.) (Revoked by default) (http://www.sec.gov/litigation/admin/2011/34-63911.pdf), *Score One, Inc., et al.*, Admin. Proc. No. 3-14251 (March 8, 2011) (Respondent – Score One, Inc.) (Revoked by default) (http://www.sec.gov/litigation/admin/2011/34-63889.pdf), *China Digital Media Corporation,* Admin. Proc. No. 3-14250 (February 11, 2011) (Single respondent) (Revoked by consent) (http://www.sec.gov/litigation/admin/2011/34-63888.pdf), *Tabatha V, Inc., et al.*, Admin. Proc. No. 3-14126 (February 10, 2011) (Respondent –Tabatha V, Inc.) (Revoked by default) (http://www.sec.gov/litigation/admin/2011/34-63884.pdf), *Apex Capital Group, Inc., et al.*, Admin. Proc. No. 3-14151 (January 13, 2011) (Respondents – Apex Capital Group, Inc. and Asia Fiber Holdings Ltd.) (Revoked by default) (http://www.sec.gov/litigation/admin/2011/34-63713.pdf), *VIPC Communications, Inc., et al.*, Admin. Proc. No. 3-14127 (January 12, 2011) (Respondent –Vizario, Inc.) (Revoked by default) (http://www.sec.gov/litigation/admin/2011/34-63702.pdf), *Tabatha V, Inc., et al.*, Admin. Proc. No. 3-14126 (December 6, 2010) (Respondent – Tagalder Global Investment, Inc.) (Revoked by default) (http://www.sec.gov/litigation/admin/2010/34-63433.pdf).

jurisdiction's home regulator to pursue our enforcement aims, and we continue to press for direct access where foreign law would not prevent it.

"How can U.S. investors feel comforted that someone is responsible for protecting American investors in these companies?""[T]here are press reports and other discussion regarding Chinese reverse mergers being an area rife with fraud. To what extent does the SEC have concerns in this area? Without getting into specifics, is the SEC conducting investigations into banks, auditors and other 'gatekeepers' for companies that raise red flags for fraud and that are gaining access to American investors and markets?"

Early last summer, the SEC launched a pro-active risk-based inquiry into U.S. audit firms that have a significant number of domestic issuer clients with primarily foreign operations, including in the PRC. In connection with the inquiry, the Division of Enforcement contacted several U.S. audit firms requesting information concerning the firms' audit practices and compliance with U.S. auditing standards in connection with foreign-based reverse merger companies, including in the PRC. After Enforcement's inquiries, and since March 2011 alone, more than twenty-four PRC-based companies have filed Forms 8-K disclosing auditor resignations, accounting problems, or both. Many of these Forms 8-K disclose issues regarding cash and accounts receivables concerns and the auditors' difficulties in confirming these amounts.

As a result of information learned in our risk-based review and other on-going investigations, within the last five weeks the SEC moved to protect U.S. investors by suspending trading in at least three PRC-based reverse merger entities: (1) Heli Electronics Corp. (HELI); (2) China Changjiang Mining & New Energy Co (CHJI); and (3) RINO International Corporation (RINO):

- On March 21, 2011, the Commission suspended trading in HELI because questions had arisen regarding the accuracy and completeness of information contained in HELI's public filings concerning, among other things, the company's cash balances and accounts receivable. HELI also failed to disclose that its independent auditor had resigned due to accounting irregularities.

- On April 1, 2011, the Commission suspended trading in CHJI because questions had arisen regarding the accuracy and completeness of information contained in CHJI's public filings concerning, among other things, the company's financial statements for 2009 and 2010. CHJI also failed to disclose that it filed its most recent Form 10-Q without the required review of interim financial statements by an independent public accountant and that the company's independent auditor had resigned, withdrawn its audit opinion issued April 16, 2010 relating to the audit of the company's consolidated financial statements as of December 21, 2009, and informed the company that the financial statements for quarters ended March 31, June 30, and September 30, 2010 could no longer be relied upon.

- On April 11, 2011, the Commission suspended trading in RINO because questions had arisen regarding the accuracy and completeness of information contained in RINO's public filings since, among other things, the company had failed to disclose that the

> outside law firm and forensic accountants hired by the company's audit committee to investigate allegations of financial fraud at the company had resigned after reporting the results of their investigation to management and the board, and that the chairman and independent directors have also resigned. In addition, questions had arisen regarding the size of RINO's operations and number of employees, the existence of certain material customer contracts, and the existence of two separate and materially different sets of corporate books and accounts.

In addition to trading suspensions, in the last several months alone, we also have revoked the securities registration of at least eight PRC-based companies that became domestic issuers through reverse mergers. In each instance, the Commission moved to revoke the securities registration because of a failure to make required periodic filings – filings that should contain information of critical importance to U.S. investors.[13] Importantly, once we have revoked the registration, no broker-dealer or national security exchange can execute a trade in the stock unless the company files to re-register the stock.

In addition to trading suspensions and registration revocations, the Commission filed an enforcement action in December 2010 against U.S. audit firm Moore Stephens Wurth Frazer & Torbet LLP (MSWFT) for improper professional conduct in connection with their audit work for PRC reverse merger company China Energy Savings Technology, Inc.[14] In that case, the Commission censured MSWFT, required the disgorgement of all audit fees plus prejudgment interest, and denied the engagement partner the privilege of appearing or practicing before the Commission as an accountant with a right to apply for reinstatement after two years. The Commission also ordered MSWFT to retain an Independent Consultant to review MSWFT's audit practices and make recommendations reasonably designed to ensure that all audits conducted by MSWFT comply with Commission regulations and with PCAOB standards and rules. MSWFT is barred from accepting any new issuer audit clients with operations in the PRC, Hong Kong, and Taiwan until it has provided the SEC with a certificate of compliance with the Independent Consultant's recommendations.

In April 2009, the U.S. District Court for the Eastern District of New York found all defendants in our previously-filed emergency action against China Energy Savings Technology, Inc., undisclosed control person Chiu Wing Chin, and China Energy's CEO, secretary, and vice president, liable for fraud, ordering them to pay more than a $34 million in disgorgement, prejudgment interest and civil penalties, and imposing officer-and-director bars against the individual defendants.[15] The SEC filed its underlying emergency fraud action against China Energy in December 2006, alleging that the defendants engaged in an illegal "pump and dump"

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[13] *Id.*

[14] *See, e.g., In the Matter of Moore Stephens Wurth Frazer & Torbet LLP, et al.*, (Dec. 2010), Rel. No. 33-9166 (http://www.sec.gov/litigation/admin/2010/33-9166.pdf).

[15] *See* Lit. Rel. 21621 (Aug. 2010) (http://www.sec.gov/litigation/litreleases/2010/lr21621.htm)

and market manipulation of the company's stock, and freezing $3.9 million in assets in the U.S.[16] In September 2009, the SEC also sued the company's U.S.-based stock promoter for his role in the fraud, ultimately obtaining a $2.5 million judgment against him last summer.[17]

In October 2009, the Commission filed civil fraud charges in the U.S. District Court for the District of Columbia against China Holdings, Inc. (CHHL) and Julianna Lu, who is described in CHHL's public filings as the company's "Chief Executive Officer, Principal Financial Officer, Principal Accounting Officer, Treasurer and Chairwoman of the Board of Directors."[18] Our complaint alleges that from April 15, 2008 through April 17, 2009, CHHL and Lu made material misrepresentations in nine public filings, including a Form 8-K and two Forms 8-K/A which fraudulently misrepresented that CHHL dismissed its then-current auditor (who had in fact resigned), and that CHHL and the auditor had no disagreements over matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedures. Our litigation against CHHL and Lu is ongoing.

In June 2010, the Commission filed an enforcement action against China Yuchai International Ltd. in connection with China Yuchai's violations of books and records and internal controls provisions of the federal securities laws arising out of China Yuchai's material overstatement of net income for the year ended December 31, 2005.[19] The overstatement was caused by an erroneous material adjusting journal entry made at China Yuchai's majority-owned subsidiary, Guangxi Yuchai Machinery Company Limited.

In the China Yuchai matter, the Commission experienced significant difficulty and delay in our attempts to obtain workpapers from foreign auditors. The passage of Section 929J of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which amends Section 106 of the Sarbanes-Oxley Act of 2002 (SOX), clarifies the application of SOX Section 106 to the production of foreign audit documentation by (i) expanding the scope of audit documentation to be produced and (ii) simplifying service of process through the appointment of a U.S. agent. We expect that this provision of the Dodd-Frank Act will enhance the Enforcement staff's ability to obtain evidence needed to swiftly advance their ongoing investigations of domestic issuers based in the PRC, and elsewhere.

In addition to the Division of Enforcement's efforts in this area, the SEC's Division of Corporation Finance works to monitor and enhance compliance with the applicable disclosure and accounting requirements through its filing review process. The staff selectively reviews filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934 and when appropriate, issues comments on a company's filings. It is important to note that the staff does

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[16] *SEC v. China Energy Savings Technology, Inc.* (Dec. 2006), Lit. Rel. 19931 (http://www.sec.gov/news/press/2006/2006-200.htm).

[17] *See* Lit. Rel. 21621 (Aug. 2010) (http://www.sec.gov/litigation/litreleases/2010/lr21621.htm)

[18] *See SEC v. China Holdings, Inc., Julianna Lu* (http://www.sec.gov/litigation/litreleases/2009/lr21272.htm)

[19] *In the Matter of China Yuchai International, Limited*, (action against company) (June 2010), Rel. No. 34-62235 (http://www.sec.gov/litigation/admin/2010/34-62235.pdf

not evaluate the merits of any transaction and the review process is not a guarantee that the disclosure is complete and accurate – responsibility for complete and accurate disclosure lies with the company and others involved in the preparation of a company's filings. The staff is not limited in its ability to ask issuers questions in the comment process. While most issuers respond to the staff's comments, in some instances they do not. Where issuers do not respond, the staff will evaluate whether further inquiries or action is necessary to obtain a response.

Foreign-based issuers that enter the U.S. markets by means of reverse merger, including those from the PRC, are subject to this selective filing review process. As part of this process, the staff may review such an issuer's annual report, a Form 8-K reporting a reverse merger, or a registration statement filed subsequent to a reverse merger. In this regard, the staff's focus has been on overall compliance with the mandated disclosure requirements as well as a specific focus on each issuer's ability to prepare financial statements in accordance with U.S. GAAP. As appropriate, the staff has questioned issuers conducting all of their operations outside of the U.S. about how they have prepared their financial statements and assessed their internal control over financial reporting (ICFR). This process may result in expanded disclosure in the issuer's filings.

The SEC's Office of Chief Accountant is working closely with the Division of Enforcement, the Division of Corporation Finance, and the PCAOB to identify problematic audit practices and auditor conduct in connection with reverse merger companies registered with the SEC, a significant percentage of which are from the PRC. The Office of Chief Accountant also processes submissions under Section 10A of the Exchange Act relating to auditor discovery of potential illegal acts by issuers, including ensuring that the information contained in those submissions is brought to the attention of the relevant personnel within the agency.

In parallel with our risk-based review efforts, the SEC's Office of Investor Education and Advocacy is working to alert individual investors about certain risks associated with investing in foreign-based domestic issuers formed through reverse mergers. To that end, we are in the process of drafting an investor alert identifying those risks for individual investors. The investor alert, which will be finalized and published in the very near term, will be disseminated through www.sec.gov, the SEC's official website; www.Investor.gov, the SEC's website directed at individual investors; and Twitter.

In addition to our own work, the SEC is actively coordinating with other regulators, including the SROs, PCAOB, and other authorities, to address these concerns. The PCAOB has issued audit practice alerts and research notes concerning PRC-based reverse merger companies.[20] The PCAOB also recently announced a settled disciplinary action against an audit firm and two of its associated persons for, among other things, improper audits of two companies with their principal place of business or operations in the PRC. The firm's registration with the PCAOB

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[20] *Public Company Accounting Oversight Board, Activity Summary and Audit Implications for Reverse Mergers Involving Companies from the China Region: January 1, 2007 through March 31, 2010*, Research Note # 2011-P1 (March 14, 2011) http://pcaobus.org/Research/Documents/Chinese_Reverse_Merger_Research_Note.pdf ; PCAOB Staff Audit Practice Alert No. 6, *Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants from Outside the Firm*, (July 12, 2010) http://pcaobus.org/Standards/QandA/2010-07-12_APA_6.pdf .

was revoked, and the individuals were barred from being associated persons of a registered public accounting firm.[21] Moreover, the SROs recently halted trading in almost a dozen stocks.[22] In addition, NASDAQ is filing with the SEC a proposed rule change to adopt additional listing requirements for a company that has become public through a reverse merger.[23]

Our risk-based review of U.S. audit firms with a significant number of foreign-based domestic issuer clients continues. We have a team of attorneys and accountants from across the agency thinking pro-actively and working hard to address these issues in a way that does not unduly inhibit capital formation by legitimate PRC and other foreign-based domestic issuers – capital formation that is critically important as we seek to recover from the financial crisis.

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21 *See In re Chisholm, Bierwolf, Nilson & Morrill, LLC, Todd D. Chisholm, CPA, and Troy F. Nilson, CPA*, Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions, PCAOB Rel. 105-2011-003 (Apr. 8, 2011) (revoking permanently the registration of the firm, barring Chisholm permanently, and barring Nilson for at least 5 years).

22 NASDAQ Current Trading Halts, http://www.nasdaqtrader.com/trader.aspx?id=TradeHalts

23 *See* http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2011/SR-NASDAQ-2011-056.pdf

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

R. BRUCE JOSTEN
EXECUTIVE VICE PRESIDENT
GOVERNMENT AFFAIRS

1615 H STREET, N.W.
WASHINGTON, D.C. 20062-2000
202/463-5310

March 10, 2011

The Honorable Scott Garrett
Chairman
Subcommittee on Capital Markets and
Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Subcommittee on Capital Markets and
Government Sponsored Enterprises
Committee on Financial Services
U. S. House of Representatives
Washington, DC 20515

Dear Chairman Garrett and Ranking Member Waters:

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses and organizations of every size, sector and region, believes that effective regulators are needed to insure the safety and soundness of the financial markets.

As the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises holds a hearing entitled "Oversight of the Securities and Exchange Commission's Operations, Activities, Challenges and FY 2012 Budget Request," the Chamber would like to draw your attention to a report, Examining the Efficiency and Effectiveness of the U.S. Securities and Exchange Commission (SEC). This report was released by the Chamber on February 11, 2009 and makes 23 recommendations to improve the core operations of the SEC to improve the agency's regulatory oversight.

While some improvements have been made to the management and operations of the SEC, much remains to be done. Effective financial regulatory reform cannot take place until the regulators themselves are better managed and have the tools and expertise needed to understand the markets that they regulate. Among the recommendations that are needed to create a more effective agency include:

- The SEC should create a Chief Operating Officer (COO) position with sufficient authority to oversee daily operations throughout the SEC.

- The SEC should establish a coordinating council, chaired by the COO, to resolve issues or disagreements involving more than one division or office.

- The SEC should expand the breadth of its staff expertise. Legal and accounting expertise should be complemented with staff experts in capital markets operations and the business operations of regulated entities as well as financial economics.

- The Division of Trading and Markets and the Division of Investment Management should be realigned into a Division of Investor Protection and Retail Financial Services Regulation and a Division of Market Oversight and Operations.

- The SEC should create an accelerated conditional approval process for new investment products or services.

The Chamber looks forward to working with the Subcommittee on this issue and others to ensure the vibrancy of the American capital markets.

Sincerely,

R. Bruce Josten

cc: The Members of the House Committee on Financial Services

March 8, 2011

The Honorable Ruben Hinojosa
United States House of Representatives
Attn: Greg Davis
2262 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Hinojosa:

On behalf of the Financial Planning Coalition (The Coalition), we write to strongly urge adequate funding for the activities of the Securities and Exchange Commission (SEC), which safeguard consumer financial protections that are badly needed in the financial sector. The Coalition is made up of the Certified Financial Planners Board of Standards, Inc. (CFP Board), the Financial Planning Association (FPA), and the National Association of Personal Financial Advisors (NAPFA). These organizations represent about 75,000 financial professionals across the country, including industry leaders, educators, authors, and professionals committed to serving the best interests of consumers.

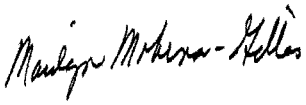
The United States capital markets have long been the envy of the world. But for many, the recent financial crisis shook investors' faith in US markets. Ensuring that the capital markets are well-regulated – including oversight by adequately funded regulators – is essential to restoring the confidence that will help lead the nation's economic recovery.

We fully appreciate the challenge facing Congress in trying to manage the federal deficit and the debt burden. However, we note that the SEC is funded entirely through fees assessed to those who the SEC regulates; taxpayers do not bear the burden of funding the SEC. In short, SEC funding has no effect on the deficit. Due to current funding reductions, the SEC Enforcement Division is cutting back on investigations, important vacancies are going unfilled, and technology upgrades needed to deal with the daily influx of information have been cancelled. At the same time, the size and complexity of SEC oversight responsibilities are significantly outpacing SEC funding.

Simply put, to effectively oversee markets and market participants, the SEC needs Congress to authorize the additional funding needed to adequately meet its increasing responsibility and improve its oversight function. However, because the government is still operating under a continuing resolution, these anticipated increases have not occurred and there is continued pressure in the ongoing budget discussions to reduce the SEC's budget.

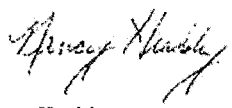
The SEC adjusts its fees several times a year to ensure that it receives the amount appropriated by Congress to cover its costs to supervise and regulate the securities market. A modest increase in appropriated fees would not hinder the creation of capital and would not place a burden on taxpayers. In contrast, level or reduced appropriations would jeopardize the agency's ability to adequately police the securities markets and leave investors vulnerable to unscrupulous individuals engaged in financial scams and fraud. In the wake of the recent financial collapse and fraudulent Madoff episode, it is more important than ever to give the SEC the resources and tools it needs to protect investors, particularly our most vulnerable seniors, properly police the markets, and help restore investor confidence to our system.

Sincerely,



Marilyn Mohrman-Gillis
Managing Director, Public Policy
Certified Financial Planner Board of Standards

Dan Barry
Managing Director of Government Relations & Public Policy
Financial Planning Association



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NASAA

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March 8, 2011

The Honorable Scott Garrett
Chairman
Capital Markets and Government-Sponsored
Enterprises Subcommittee
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Capital Markets and Government-Sponsored
Enterprises Subcommittee
Washington, DC 20515

RE: SEC Budget

Dear Chairman Garrett and Ranking Member Waters:

On behalf of the North American Securities Administrators Association (NASAA), [1] I want to express our support of adequate funding for the Securities and Exchange Commission (SEC) to fully implement its responsibilities mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Securities regulation is a complementary regime of both state and federal securities laws, and we work closely with our national counterparts to uncover and prosecute violators of those laws. Traditionally, state securities regulators have pursued the perpetrators at the local level who are trying to defraud the "mom and pop" investors in your states. That allows the SEC to focus on the larger, more complex national market manipulation type cases.

While the SEC has been criticized for its past lax enforcement and for not pursuing the Madoff Ponzi scheme earlier, under the leadership of Chairman Mary Schapiro[2] the agency has a renewed determination to return to our joint mission of protecting the public from investment fraud.

We urge Congress to provide the SEC with the resources they need to enhance their technology and take on the examination of investment advisers, hedge funds advisers and credit rating

1 The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

2 Chairman Schapiro previously served as a Commissioner of the SEC from December 1988 to October 1994. She was appointed by President Ronald Reagan in 1988; reappointed by President George H.W. Bush in 1989; named Acting Chairman by President Bill Clinton in 1993; and appointed Chairman of the CFTC by President Clinton in 1994, where she served until 1996.

agencies, which is required under the Dodd-Frank Act. As Chairman Schapiro stated, "the 2012 funding is entirely offset by transactions fees such that the SEC budget will not add to the deficit."

Thank you for your thoughtful consideration of this matter, which is vital to restoring investor confidence and integrity to the marketplace. Please don't hesitate to contact me or NASAA's Director of Policy, Deborah House, if we can be of assistance to you.

Yours,

David S. Massey
North Carolina Deputy Securities Administrator
NASAA President