

**EXAMINING THE SEC'S AGENDA,
OPERATIONS, AND BUDGET**

HEARING
BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED FIFTEENTH CONGRESS
FIRST SESSION

—————
OCTOBER 4, 2017
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Printed for the use of the Committee on Financial Services

Serial No. 115-45



U.S. GOVERNMENT PUBLISHING OFFICE

30-241 PDF

WASHINGTON : 2018

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EXAMINING THE SEC'S AGENDA, OPERATIONS, AND BUDGET

Wednesday, October 4, 2017

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

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

Present: Representatives Hensarling, McHenry, Royce, Posey, Luetkemeyer, Huizenga, Duffy, Stivers, Hultgren, Ross, Pittenger, Wagner, Barr, Rothfus, Messer, Tipton, Williams, Poliquin, Love, Hill, Emmer, Trott, MacArthur, Davidson, Budd, Kustoff, Tenney, Hollingsworth, Waters, Maloney, Velazquez, Sherman, Meeks, Lynch, Scott, Cleaver, Moore, Ellison, Perlmutter, Himes, Foster, Kildee, Delaney, Sinema, Beatty, Vargas, Gottheimer, Gonzalez, and Crist.

Chairman HENSARLING. The committee will come to order.

Without objection, the chair is authorized to declare a recess of the committee at any time. And all members will have 5 legislative days within which to submit extraneous materials to the chair for inclusion in the record.

The hearing is entitled Examining the SEC's Agenda, Operations, and Budget.

I now recognize myself for 3-1/2 minutes to give an opening statement.

This morning, we—the committee will come to order, please.

This morning, we welcome the Securities and Exchange Commission Chairman, Jay Clayton, for his first appearance before our committee. It has been almost a year since an SEC chair appeared before the committee. And I want to take this time to applaud you, Chairman Clayton, for a number of changes that you have made during your brief tenure.

Under the previous administration, the SEC failed to develop a capital formation agenda and did very little to promote it beyond what Congress required in the JOBS Act. This committee is extremely encouraged by the SEC's renewed commitment under your leadership to facilitate capital formation to help small businesses access the capital they need to innovate, grow, and provide economic opportunities for all Americans.

We also appreciate the public comments you have made on the need to reverse the trend of declining initial public offerings, and the SEC's announcement that confidential IPO filings would be

open to all companies, a provision that the House passed as part of the Financial CHOICE Act.

The SEC should also continue to explore ways to simplify its disclosure regime and return to the concept of materiality. The securities laws are not the appropriate avenue to pursue ideological and political agendas that have nothing to do with the SEC's mission, and can only harm economic opportunity and growth.

Under the previous administration, the SEC dropped the ball on the fiduciary rule and allowed the Department of Labor to insert itself into the SEC's jurisdiction. Surely, this must be reversed. And as I continue to watch our national debt clock spinning out of control, it is with deep gratitude, and at least I think for the first time since I have served on this committee and after the SEC's budget has seen an increase of more than 325 percent since the year 2000, the SEC did not seek a budget increase for Fiscal Year 2018.

Congratulations. It is a welcome change for hardworking taxpayers. I do understand the SEC will request more funding in cybersecurity for Fiscal Year 2019 for obvious reasons, and this brings me to my next point.

The committee has serious questions regarding cybersecurity controls at the SEC. The recent announcement that the SEC's Electronic Data Gathering, Analysis, and Retrieval system, known as EDGAR, had not only been hacked in 2016, but that nonpublic information may also have been used to facilitate illicit trading. This is very, very troubling. Even more troubling is that Congress and the public were not informed until September 2017.

Chairman Clayton, we know that this breach did not happen on your watch, but you are the one who has to fix it. Given the recent Equifax breach and this breach, the committee has serious concerns with the rapidly approaching November 15 implementation for the Consolidated Audit Trail.

While the Consolidated Audit Trail serving as a central repository for order and trading activity data, I urge the SEC again to delay its implementation date until the Commission can ensure that the appropriate safeguards and internal controls are in place to protect this data. To echo what your colleague, Commissioner Piwowar, said, the SEC has only one chance to get this right. Please make sure you do, sir.

I now yield 3 minutes to the gentlelady from New York, Mrs. Maloney, ranking member of our Capital Markets Subcommittee.

Mrs. MALONEY. Thank you, Mr. Chairman. And welcome, Chairman Clayton, who is from the great city of New York.

One of our country's greatest assets is our economic strength, including our strong capital markets. Investors from all around the world pour their money into the U.S. markets because they trust that our companies are accurately reporting and are accurately auditing their financial statements and that their rights as investors will be protected. And it is this confidence in our markets that we need to focus on maintaining. It is the SEC's job to oversee our markets, which makes the SEC one of the most important regulators in the world.

Because of the breadth of activities that it regulates, the SEC must constantly evolve and adapt its regulations in order to re-

spond to new innovations and trends in the market. Sometimes this means modernizing a regulatory regime to take account of new risks that are in the market. Other times it means modernizing the SEC's own operations to account for new risks that the regulator itself faces. The SEC's ability to adapt on both fronts has been highlighted by the recent cyber attacks, both at private companies like Equifax and at the SEC itself with the EDGAR attack.

While I am deeply concerned about the EDGAR attack, I have noticed that there has been transparency in response to the breach. This breach did not happen on Chairman Clayton's watch, but he has been proactive, some say not as proactive as he should be, but he has been proactive in disclosing it to the public and ordering a full investigation into the breach.

The EDGAR system plays a central role in our capital markets. It is the main system where companies keep their investors informed about what is going on in the company. So if there is a problem with EDGAR and its reliability is called into question, we need to know about it as soon as possible, and it needs to be fixed immediately.

I look forward to hearing from Chairman Clayton as well as other priorities he may have in addition to EDGAR.

Thank you.

Chairman HENSARLING. The gentlelady yields back.

The chair now recognizes the gentleman from Michigan, Mr. Huizenga, the chairman of the Capital Markets Subcommittee for 1-1/2 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman.

Chairman Clayton, I will try not to echo Chairman Hensarling too much here, but obviously we now know that to protect investors, maintain fair, orderly, and efficient markets, and to facilitate capital formation is the three-part mission of the Securities and Exchange Commission. And as he pointed out, the last administration was more focused on CEO pay ratios and conflict minerals and a number of other things that literally brought nothing to the table. This designated mission may be important, and as Mary Jo White had said, important, but not the focus of the SEC.

Something we have discussed, one of my biggest concerns, is the decline in IPOs, those initial public offerings that really have given fewer investment opportunities for Main Street investors. We have the strongest, deepest most liquid markets here, but we are becoming less and less attractive to growing businesses due to one-size-fits-all kind of securities regulations.

Hardworking families in west Michigan and throughout the country rely on capital markets to save for everything from college to retirement, and we must work to maintain these efficient capital markets so investors have the opportunity to receive the greatest return on their investment. We need to ensure that Mr. and Mrs. 401(k), as you call our Main Street investors, are able to invest in a better future.

Chairman Clayton, I was encouraged by your remarks in July at the Economic Club of New York where you stressed that a key part of your agenda is facilitating capital formation. I applaud you for that. Well, let's work together, sir, to reverse the negative trend of declining IPOs and instead refocus the SEC on capital formation to

expand opportunities for investors, unleash the American spirit, grow our economy, and increase our job creation.

With that, I yield back. Thank you.

Chairman HENSARLING. The gentleman's time has expired.

The chair now recognizes the gentleman from Michigan, the vice ranking member, Mr. Kildee, for 2 minutes.

Mr. KILDEE. Thank you, Mr. Chairman. And welcome, Chairman Clayton.

First, I want to express my concern over potential insider trading by Equifax executives. It is critical that the SEC closely examine these trades to determine, both for itself and the public at large, whether the individuals were taking advantage of knowledge that would not be publicly disclosed for another 6 weeks. I also urge the SEC to clarify to companies when a cybersecurity breach is material that it must be disclosed. Six weeks between discovery and disclosure is simply too long, especially considering the scale of the Equifax breach. The SEC plays a critical role in ensuring the safety and soundness of our financial markets, and it is vital that it fully examine the Equifax breach in order to begin restoring confidence in our markets.

Second, I am interested in your plans regarding disclosure of political contributions by publicly traded companies. I disagreed with your predecessor, Chair White, in her decision not to undertake rulemaking on this issue. The Supreme Court's 2010 decision in *Citizens United v. FEC* opened the floodgates in terms of political spending. And while we now have seen money take an even more outsized role in our democracy, it is all more critical that SEC act. It can't undo the damage that has been done, but it could bring transparency to the glut of money being spent in American politics, money that we can't see.

The SEC already requires corporations to disclose material information that the public would need to know before investing in a company. I believe it should require similar disclosures regarding political contributions, so that citizens can make informed decisions as they participate in the democratic process. It will take transparency to restore confidence in our election process, and I urge the SEC to do its part and undertake rulemaking.

Thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

Today, we welcome the testimony of the Honorable Jay Clayton. This is the first time that Chairman Clayton has appeared before our committee. Chairman Clayton was sworn in as chairman of the U.S. Securities and Exchange Commission on May 4 of this year. Chairman Clayton earned a B.S. in engineering from the University of Pennsylvania, a B.A. and M.A. in economics from the University of Cambridge, and a J.D. from the University of Pennsylvania Law School. Prior to joining the Commission, Mr. Clayton was a partner at Sullivan & Cromwell.

Without objection, the witness's written statement will be made part of the record.

Chairman Clayton, you are now recognized to give an oral presentation of your testimony. Thank you.

**STATEMENT OF HONORABLE JAY CLAYTON, CHAIRMAN, U.S.
SECURITIES AND EXCHANGE COMMISSION**

Mr. CLAYTON. Chairman Hensarling, Congresswoman Maloney, Congressman Huizenga, Congressman Kildee, distinguished members of the committee, thank you for the opportunity to testify before you today about the work of the SEC.

I will start with a second thank you, this one to my fellow commissioners and the 4,600 women and men of the SEC who have been incredibly welcoming to me. I have benefited from my interaction with these individuals.

During my 5 months at the Commission, I have devoted a substantial portion of my efforts to agency operations. As discussed in more detail in my written testimony, I believe there are four areas where additional focus and resources are most needed: One, cybersecurity; two, retail investor protection; three, market integrity, including structure, risk, and resiliency; and, four, capital formation.

My written testimony also discusses in detail the work of the Commission over the past 5 months and various policy initiatives moving forward.

The remainder of my oral testimony will focus on cybersecurity, and I will end with one comment on our regulatory agenda.

I have been concerned by and focused on cybersecurity, both internally and externally, since my first weeks at the Commission. As recent events demonstrate all too well, this is an area where we need to devote significant additional resources and attention. I will turn to the recently disclosed incident from 2016.

In August 2017, I was notified of a possible intrusion into our EDGAR system. In response to this information, I immediately commenced an internal review, which led me to understand that the breach of our EDGAR system in 2016 provided access to non-public information and that the information obtained by the intruders may have been used for illicit trading.

This matter involving our EDGAR system and its ramifications concerned me deeply. I am focused on getting to the bottom of the matter, and importantly, lifting our general cybersecurity efforts moving forward.

I recognize that I am not the only one who is deeply concerned. Rightfully, the 2016 intrusion will cause this committee and others to increase their focus on whether the Commission's approach to cybersecurity appropriately addresses our risk profile. This is all the more reason it was appropriate to disclose the 2016 intrusion to Congress and the American people 2 weeks ago and to update that disclosure this past Monday. These disclosures were appropriate and important, even though a review and investigation are ongoing and may take substantial time to complete.

On Monday, I disclosed that, pursuant to our ongoing investigation, the staff had determined that the EDGAR test filings accessed by third parties contained personal information of two individuals. Staff are reaching out to the two individuals to notify them and to offer identity theft protection and monitoring services. I also noted in the release that should the agency's review uncover additional individuals whose sensitive information may have been accessed,

the staff will contact them and offer identity protection and monitoring as well.

With respect to, one, getting to the bottom of what happened in 2016, two, assessing where we are today, and three, improving our approach to cybersecurity moving forward, I have organized the agency's efforts into five work streams: The independent review of the 2016 intrusion by our Office of Inspector General. Second, the investigation led by the Division of Enforcement into the potential illicit trading, getting to who the hackers were. A focused review and, as necessary or appropriate, uplift of our EDGAR system. Four, a more general assessment and uplift of the agency's cybersecurity risk profile efforts that were initiated shortly after my arrival, including the identification and review of systems, current and planned, that hold market sensitive data or personally identifiable information, including the Consolidated Audit Trail, or CAT. And finally, the agency's own internal review of the EDGAR intrusion.

While there are limits on what I know and can discuss about the 2016 incident due to the status and nature of these reviews and investigations, I believe this is an appropriate framework to approach the key questions of what happened in the past, where we stand, and how we can improve moving forward.

As a result of this incident, some have questioned whether we can appropriately protect sensitive information we receive and whether we should receive additional data to further our mission. I want to say that we are serious about this, but it is not the time for us to pull back from important market oversight initiatives. Our mission is too important to millions of Main Street investors, issuers, and market participants to do so. In short, we must be vigilant and we must do better.

Turning to policy matters, my written testimony discusses our recent regulatory efforts and objectives in detail, including my philosophy on our upcoming Regulatory Flexibility Act agenda. I am pleased that this morning, the Commission announced it will hold an open meeting next Wednesday to consider a rule proposal by the FAST Act to modernize and simplify the disclosure requirements in Regulation S-K in a manner that reduces costs and burdens on companies with no reduction in the disclosure of all required material information. I know that a bipartisan group of members of this committee worked to include this provision in the FAST Act. I thank you for your efforts.

In closing, I would like to thank the committee for its continued support of the SEC, its mission, and its people, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Clayton can be found on page 64 of the appendix.]

Chairman HENSARLING. The chair now recognizes himself for 5 minutes.

Chairman Clayton, I am happy to hear the FAST Act announcement. I will have a couple of cybersecurity questions, time permitting. But I really want to lead off with your concern about the declining IPO markets.

In your opinion, what are some of the chilling effects of regulation on the IPO market? What would you focus this committee's at-

tention on? And why is it so important that we reinvigorate the IPO market?

Mr. CLAYTON. Let me start with your last question, why I think this is so important. The choices available to our retail investors, the people who are saving for their retirement, I believe, are, in fact, diminishing because the number of public companies is diminishing.

The most efficient way for retail investors to invest is in our public capital markets. It is costly for them to invest in private investments. So I want to increase, to the extent possible, the opportunity set for our Main Street investors to invest in the growth of America. That is important.

In terms of why do we have fewer public companies today than we did at different periods in the past, and why is the trend going in a downward direction? There are a couple of things. One thing is that we do have a bit of a one-size-fits-all model, and that means that the regulatory regime that applies to a very, very large company is essentially the same that applies to a medium size or smaller public company. I question whether that continues to be appropriate. I think that the JOBS Act and the scaled disclosure provisions for emerging growth companies demonstrate that a scaled system that is rooted in investor protection, audited financial statements, and disclosure of material information is something we should be looking at.

I also recognize that there are alternative forms of capital available today that were not available 20, 25 years ago, including a fairly robust private equity and venture capital market. But I am looking at that landscape, and I would like to see a greater proportion of companies end up in the public market so that all investors have an opportunity to participate in America's growth.

Chairman HENSARLING. So switching gears, the Consolidated Audit Trail is due to go live in just a little bit more than a month. So given the EDGAR breach, how can you assure this committee that CAT is ready for prime time? Have all cybersecurity concerns been ameliorated?

Mr. CLAYTON. Mr. Chairman, the CAT is being developed by the SROs, the self-regulatory organizations, FINRA and the exchanges, with a contractor. I look at us as having two roles, at the SEC: We have an oversight role in that we oversee those entities, and we are also a beneficiary of the CAT once it is up and running in that we get the data.

With respect to your question about cybersecurity and the SEC, from the time I got to the Commission and got briefed on the CAT, the questions I have been asking are, what information are we taking in? It is sensitive. Do we need it to fulfill our mission, and can we protect it? And I have made it clear that I don't want information unless we need it for our mission.

Chairman HENSARLING. But, Mr. Chairman, have those questions been answered to your satisfaction?

Mr. CLAYTON. To my satisfaction, from the Commission's perspective, the answer has not yet been answered to my satisfaction.

Chairman HENSARLING. And will this go live until those questions are answered to your satisfaction?

Mr. CLAYTON. I want to be clear, but it is a little bit complicated. As far as us taking the information, it is not—we are not going to take it until those questions with respect to the SEC are answered to my satisfaction.

I also have questions about the SROs and the CAT generally and our oversight role. There is a contractual relationship among those parties. I am in dialog with them, but I want to be satisfied that they are doing what they are supposed to do well.

Chairman HENSARLING. Switching gears again, the Financial CHOICE Act, which the House has passed, contains a number of capital formation provisions, including creating venture exchanges, modernizing the definition of accredited investor. What are some of the actions that the SEC is pursuing to make it, again, going public easier and make it more attractive to small businesses and entrepreneurs?

Mr. CLAYTON. So to answer both questions: There is the private investing market, which retail investors and sophisticated investors do participate in. I have asked the Division of Corporation Finance to look across the way we approach crowdfunding, Reg A, Reg D, and ask, is there a consistency that we can bring to this? Removing complexity while maintaining the same investor protection has to benefit those small-and medium-size businesses. That is the bottom line.

Chairman HENSARLING. My time has expired.

The chair now recognizes the gentlelady from New York, Mrs. Maloney, ranking member of our Capital Markets Subcommittee.

Mrs. MALONEY. Chairman Clayton, I think the EDGAR hack has demonstrated that government agencies, and the SEC in particular, are constantly under attack from hackers and criminals, so the SEC really needs to step up its cyber defenses in the wake of this attack. So what are you doing to ensure that the SEC has the most robust cyber defenses possible? Are you creating any new positions, any new policies, any new procedures, any new resources? What are you doing to help protect the agency from the risk of cyber attack?

Mr. CLAYTON. Let me say what we are not doing. We are not waiting until the end of the five workstreams that I outlined to take action. We are focusing immediate attention on the EDGAR uplift.

But with regard more generally to your question, I want to say that I have the support of both Commissioner Piovolaro and Commissioner Stein. We are looking at our incident response plan to see if we can improve it.

With respect to new positions, this is something that I am pleased to say I have the support and I am ready to move forward and say it today, I think the agency could use a chief risk officer, not just for cybersecurity, but for general risk. I have begun the search for a chief risk officer for the agency.

Mrs. MALONEY. Thank you. I want to talk to you about the gap between the—when companies determine that there has been a material change that they need to disclose to the public and when they actually disclose it to the public. And as you know, the current SEC rules give companies 4 days to disclose material changes, and there has been research from Professor Robert Jackson in New

York, Columbia Law School, that shows that executives do actually trade profitably in this 4-day gap. So Senator Van Hollen and I have been working on a bill, which we sent a draft to your office, that would prohibit executives from trading in this 4-day gap.

And do you think this makes sense? What is your response? Should executives be allowed to trade after they have learned about a material change, but before they actually disclose it to the public?

Mr. CLAYTON. Thank you. As I mentioned to Senator Van Hollen and as I mentioned to you, I believe it is good corporate hygiene that, once a determination has been made that there is a material event to disclose, that the company's insider trading policy, which is essentially when are you and are you not allowed to trade, would have a control in there where the senior executives would not be allowed to trade. So as I said before and I agreed, I like this concept.

Mrs. MALONEY. Thank you. I understand that you are examining a pilot program on the access fees charged by exchanges. Many market participants have told me that this pilot program really needs a bucket with zero rebates in order to accurately test the effectiveness of different access fee levels. So my question is, are you going to include a zero rebate bucket in the access speed pilot program?

Mr. CLAYTON. So we have an access speed pilot under consideration. And this question as to what tiers would you have in a pilot program has been on my mind, and I know it has been on the other commissioners' minds, essentially to get the right data so that when we do the pilot, we have the data we need to assess whether the make-or-take model is working appropriately, et cetera. That is a prelude to the answer to your question, which is there has been nothing definitive decided, but a zero rebate or zero fee bucket is something that is under consideration and that I have discussed with the staff.

Mrs. MALONEY. And last, you mentioned in your testimony that you are limited in what you can say about the EDGAR hack due to the IG investigation, but you disclosed it as soon as you found out about it. Now, if only you or the other SEC commissioners had been informed of the EDGAR attack earlier, we might have learned about this much sooner.

So my question is, what is the SEC's policy on notifying the commissioners about cyber incidents when the Office of Information Technology detects any sort of unauthorized intrusion into the SEC systems? Are they supposed to notify their superiors, in this case the SEC's chief operating officer, or is notification only required for really serious hacks? What is the SEC's policy in this disclosure practice?

Mr. CLAYTON. Looking at our past incident response plan, it is something that we will do as part of the review. But your question is a good one. Let me put it in a little bit of context.

As I have said before, we are constantly under attack. Many government agencies are constantly under attack. I can't be notified of every attempt, but there does have to be a mechanism for assessing the significance, not materiality, but the significance of the attack and elevating it to me and the other commissioners.

Chairman HENSARLING. The time of the gentlelady has expired. The chair now recognizes the gentleman from Michigan, Mr. Huizenga, chairman of our Capital Markets Subcommittee.

Mr. HUIZENGA. Thank you, Mr. Chairman. I am going to be moving fast. I only have 5 minutes.

The chairman had touched on Consolidated Audit Trail, the CAT. I have very serious concerns as well. That was part of a letter that we had sent to you last week, and I do—I am a little curious, based on the answers that we have, it seems like it might be a chicken or the egg situation here, whether you are waiting for the SROs to declare that the system isn't ready and the SROs are waiting for SEC to say, hey, wait a minute, we are not ready to take this because of whether it is a breach in EDGAR or other things. So I don't know if—I will give you very briefly, if you want to clarify that at all, or we can just leave it—

Mr. CLAYTON. No. I think they have an obligation to get the CAT system up and running, including an obligation for cybersecurity. With respect to me taking the data once they have it, I am not going to take it until I am comfortable.

Mr. HUIZENGA. So you are waiting to hear whether they can or can't provide you the data in a safe, secure manner? OK. They will be thrilled to hear that, I am sure.

Mr. CLAYTON. This is not the best place to negotiate with them.

Mr. HUIZENGA. Yes, OK. I won't try to get in the middle of that, but we do need to—we do need to address this.

You are going to hear a number of others, my concern of Equifax, the breach of EDGAR. I do want to offer my philosophical support with my Ranking Member Maloney on this 4-day executive trading gap question being addressed, and I look forward to seeing some language on that and working with her.

I do want to quickly move on to MiFID, the markets and financial instruments directive to MiFID II, which is a European Union directive. It is going to require banks to unbundle research payments and charge for research separately from brokerage services. The MiFID rules will require investment research to be paid from either a fund manager's own account or from the client research payment account, which would limit these long recognized use of commissions from trading being used to help pay for research, quote/unquote, soft dollars.

Well, MiFID II regime directly contradicts the U.S. regime, and under the 1934 Securities Act, brokers are prevented from receiving direct payment for research unless they are registered as an investment adviser, which would subject them to a completely entirely new regulatory regime. Clearly, I think we would agree that that would disrupt current models.

September 14 of 2017, the world's largest fund manager, BlackRock, announced that it will pay for external research out of its own pocket, following similar announcements from Vanguard, the world's second largest fund manager, and JPMorgan Asset Management. Many of the asset management industry fear these moves in response to MiFID II are really changing the way the industry does business. And a number of folks up in New York, my friend Kenny, he knows who he is, have expressed grave concern about this, but I am not sure anybody knows really what to do with

this. There have been numerous calls on the SEC to provide some exemptive relief or negotiate with EU to find a workable solution.

Does the SEC intend to provide any formal relief or guidance for U.S. firms to comply with the conflicts between MiFID II and the U.S. regime?

Mr. CLAYTON. The answer is yes, we are trying to do this. The European Union has decided they want to proceed in a fairly specific way, separating payments, research, and commissions, which is, as you correctly outlined, different from the way our markets are structured and we approached it for a while.

In a nutshell, our aim is to allow them to do that in their market, but not either directly or indirectly force the importation of that system. If our broker-dealers and other market participants want to take a different approach from the past, they are free to do so. But we want to provide a structure that allows the current model to continue. We can then assess, as things go on, what the best way forward is.

Mr. HUIZENGA. OK. As we all know, that time is flying by. In our remaining few seconds here, market structure, equity market structure, we started a series of hearings on Capital Markets Subcommittee, and really trying to look at the 1975 amendments of the Securities and Exchange Act. A number of things, Reg NMS and others.

Do you believe that it is important that both we and you at the SEC perform a holistic review of equity market structure? And should the focus be on regulation NMS or should it be a much broader review?

Mr. CLAYTON. Yes, I believe it is important. I think a focus on Reg NMS principally makes sense. But you have to ask yourself the broader question: Are we driving efficiency in our markets? And do we have sufficient liquidity? And are the people who are providing that liquidity being appropriately compensated, under-compensated, overcompensated? Is it real liquidity? Those are the kind of broad questions we ought to be asking.

Mr. HUIZENGA. All right. I appreciate that.

My time has expired.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. And welcome, Mr. Clayton.

Chairman Clayton, in the JOBS Act, we increased investor threshold for registering as a public reporting company from 500 to 2,000 investors, with no more than 500 non-accredited investors. In implementing the rules relating to these increased thresholds, the SEC changed the definition of accredited investors as it is applied to those thresholds requiring firms to have a reasonable belief as to each investor's accredited investor status annually, rather than only at the time of the initial investment. Some firms have interpreted this as a requirement by the Commission that firms annually ask their investors to recertify that they remain accredited investors.

Among other things, this change leaves any firm taking advantage of the JOBS Act threshold with great uncertainty as to wheth-

er that firm will remain private in the future, undermining the intent of the JOBS Act.

Can you please explain how this additional requirement benefits the investor, if it at all benefits them?

Mr. CLAYTON. Well, I think your question is a good one. Again, not every rule that we make is a perfect rule. This is a rule that we have to look at—it had a good intent, which was, “Hey, let’s just make sure that our status is where it should be.” It has had an effect of, “You know what, we are not even going to go there because it is too much trouble.” So this is a rule that we should look at.

Ms. VELAZQUEZ. So my next question is can this requirement be change a of the Commission or do you believe this change requires a legislative fix?

Mr. CLAYTON. Let me answer it this way: I think we should look at it. If we think it should be changed and we can’t change it, we will come back to you and ask for help.

Ms. VELAZQUEZ. All right. Thank you.

Chairman Clayton, more of America’s small businesses are accessing capital from financial technology or fintech companies. Some commentators have suggested that a current online marketplace for small business loans falls between the cracks for Federal regulators, including the SEC. What do you see as the SEC’s role in regulating this space?

Mr. CLAYTON. So I am going to give you a general answer about fintech and developments, and then I will try and specifically answer your question about loans and my interaction with the banking regulators.

And I like innovation in the marketplace. I like what we are seeing with distributed ledger technology, I like these things. But as we have seen, including with an enforcement action we brought yesterday, sometimes new things are a new avenue for old frauds. And we are very mindful of that in the initial coin offering space.

Now, with respect to the online platforms I am not a—I’m not a person who likes to jump on other people’s jurisdictions, but I do think that we should be in dialog with the banking regulators on this and share with them our thoughts from the security space.

Ms. VELAZQUEZ. OK. Thank you.

Mr. Chairman, I yield back.

Chairman HENSARLING. The gentlelady yields back.

The chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, chairman of our Financial Institutions Subcommittee.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. And welcome, Mr. Clayton. You are a breath of fresh air, trust me.

We were discussing this morning the breach, and I would like for you to give me a timeline, if you wouldn’t mind, just take a few moments here, so we all know exactly what happened, when it happened, what you knew, when you knew it, if you don’t mind, just briefly.

Mr. CLAYTON. I will do what I can. I will give you my timeline, which is, in August of this year, I was notified that there may be a problem with EDGAR. I asked, “OK, what is the problem? What is the extent of it?” Immediately got to the bottom of it. It is not

easy to get to the bottom of these things. We are talking about something that was in 2016. You have to pull the servers, try and—it has been a long time since I have been a computer guy, but it takes a lot of work to compare what they looked like at one period to what they looked like another period.

When it became apparent that we had a significant problem, I decided it needed to be disclosed. So we disclosed that. And I will say, our work is very much still ongoing as to the extent to which this intrusion took place, the information that was accessed, and then the next step of how was that information possibly used in the marketplace.

With respect to 2016—what happened in 2016? I am going to—I am going to wait for more information from our internal investigation about when the intrusion was noticed, how it was patched, and as Congressman Maloney and others have said what was the escalation process and was it followed? Those questions I think I have to wait on.

Mr. LUETKEMEYER. OK. In your testimony a while ago, you said that the breach basically had some nonpublic information that was used for illicit trading or could have been.

Mr. CLAYTON. Uh-huh.

Mr. LUETKEMEYER. To me, that begs the question are our markets safe? Are they being manipulated? Investors must be able to trust the system before they can or should be willing to participate in it. This falls right in your bailiwick of the trust of the public with regards to the systems that we have in place.

Number 1, I guess, what kind of information was there, and did it affect trading? And what are you doing to look down the road as a result of this breach here to suggest to the different trading platforms how they can protect the data and make sure that those are not implicated or impacted or breached themselves?

Mr. CLAYTON. First, you are absolutely right, this is serious because it does impact the integrity of our markets. This kind of information, nonpublic information that is stored either at the SEC or other places is a target of nefarious actors, because it is valuable to them because they can trade ahead of the rest of the market. So question one is do we need it? In this case, we are talking about test filings, and I expect, but don't know the details, the filings that were probably the—let me say this. Filings that were of value were in advance of earnings releases, in all likelihood, or another market event, and that they happened to include information the night before the release or something like that. But that is the type of question in the overall review that we should be asking ourselves, do we need that information where there is a latency between the time we get it and the time it becomes public? And if we do need it, then we have to pay particular attention to it.

Mr. LUETKEMEYER. During the course of the process here—I chair the Financial Institutions Subcommittee here and work data is right square in the middle of what we are doing. Tomorrow, we are going to have Equifax in here. In a couple of weeks, we are going to have another hearing in our committee with regards to data breaches and data security. And some of the things we are looking at are the protocols for notification and new forms of perhaps IDs that people use to be able to access. I saw in your testi-

mony here, you had 50 million times a day the EDGAR system is accessed for individuals who do it in a positive way to look at data that is there. We need to let that disclosure information still be available, but how do you protect it?

I saw that there is biometric stuff. I saw this morning where the administration is talking about doing away with Social Security number IDs. Do you have some thoughts on what you would like to suggest to us with regards to identification monikers as well as notification protocols?

Mr. CLAYTON. Well, let me try and stay in my space. And I have asked the folks at the Commission, if we are taking things like personally identifiable information, Social Security numbers, date of birth, do we really need to be taking that? And if we do need to be taking it, should we be taking it in a different or disaggregated form from the other market information we are taking? Those kind of threshold questions are ones we should be asking.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the ranking member, the gentlelady from California, Ms. Waters.

Ms. WATERS. Thank you very much, Chairman Jay Clayton.

Chairman Hensarling, thank you for holding this hearing. And I would like to thank Vice Ranking Member Kildee for managing today.

Mr. Chairman, 2 weeks ago, you announced that, in

August 2017, you learned that a 2016 breach of the SEC's electronic system for public company filings, quote, "May have provided the basis for illicit gains through trading," end quote. This announcement came right on the heels of Equifax's announcement of a data breach that exposed sensitive personal information of 145 million American consumers. These incidents are deeply disturbing as they indicate critical vulnerabilities in our financial system. The dangers presented by these vulnerabilities are even more potent, given the recent efforts by foreign actors to destabilize the United States through cyber attacks on Wall Street, U.S.-based information technology companies, and even our national election processes.

Could you tell us whether the SEC's investigation, as far as you know, has uncovered the involvement of any foreign actors in the 2016 hack? To what extent are you coordinating with the Department of Homeland Security to identify and guard against significant cyber threats from state and nonstate actors?

Mr. CLAYTON. Thank you. I agree with you about the seriousness of this issue that we had, the Equifax issue, and issues generally. With respect to the investigation of, I will call it, our incident, and the hackers, perpetrators, I don't want to—I don't want to comment with any specificity because there is an ongoing investigation, and I have been advised, and I agree with this advice, that getting into details may hamper that investigation. We are looking at who the actors are, trying to identify how long they were there, and with the ultimate goal of bringing them to justice.

Ms. WATERS. So given all of this, the GAO identified 26 deficiencies in the SEC's control over its key financial systems and information, including failure to properly prevent unauthorized access to sensitive financial data.

What steps has the SEC taken to address the deficiencies identified in the GAO's report and better protect nonpublic market information from exploitation by cyber criminals?

Mr. CLAYTON. We have had two recent GAO audits, which I think you reference there. My understanding of where we stand on those is that there were 15 recommendations, and we have implemented 12 in one report, and I can get you more details. But I think adding it up, of the 26, I think we have implemented over 20 at this stage. So it needs to go through the process with the GAO for the GAO to be satisfied that our implementation is what they would expect.

Ms. WATERS. Do you feel you have the resources available to you to make these corrections? The SEC has been underfunded, seriously underfunded. And many of us have fought very hard to try and give you, our cop on the block, the resources that you need to do the work that you have to do to protect our investors, et cetera. Do you feel you have the resources necessary to correct these financial systems that the GAO has identified need so much work?

Mr. CLAYTON. So I have made an assessment now in the first 5 months that I have been there. And for Fiscal Year 2019, we were flat this year. I think that was appropriate, given that I am new. But going forward, I am asking for a 7 percent increase, a substantial portion of that going to cybersecurity. I would say the next thing behind cybersecurity is market integrity, making sure—and those two are related, cybersecurity and market integrity. And then I would like to put more money into retail fraud. But the short answer to your question is we need more money for cybersecurity.

Ms. WATERS. All right. So you are talking about flat funding for 2018?

Mr. CLAYTON. Yes, that was what we had for 2018.

Ms. WATERS. Well, with flat funding, how are you going to be able to move forward to do what needs to be done to ensure that you can protect all of this vital information that is exposed?

Mr. CLAYTON. That is a really good question, a question I ask myself. I had what I will say is a pool of reserve, 20 positions, new positions, and a bit of money for our contingencies. Well, I now know what those contingencies are. I authorized the hiring of six additional people for cybersecurity and putting some additional money into it.

Ms. WATERS. So you have a reserve that you will be using probably for 2018, given the flat funding?

Mr. CLAYTON. I am using what—I will use a nontechnical term: I am using what wiggle room I had for cybersecurity.

Ms. WATERS. I am trying to get you to say what you need so the chairman will hear you.

Chairman HENSARLING. The time of the gentelady has expired.

The chair now recognizes the gentleman from Wisconsin, Mr. Duffy, chairman of our Housing and Insurance Subcommittee.

Mr. DUFFY. Thank you, Mr. Chairman.

Chairman Clayton, welcome to the committee. I just want to get some clarification on the EDGAR hack. This took place some point in 2016. Is that fair to say?

Mr. CLAYTON. Yes, that is.

Mr. DUFFY. And Homeland Security was notified of this in 2016. Is that right?

Mr. CLAYTON. I believe that to be correct, yes.

Mr. DUFFY. And do you know if any of the commissioners or Chair White were notified at the same time that Homeland Security was notified?

Mr. CLAYTON. I have no indication that they were notified.

Mr. DUFFY. So we have a hack, someone at the SEC knows that it has taken place, they notify Homeland Security, but don't notify the chair or the commissioners? Does that give you some pause?

Mr. CLAYTON. That is a question that should be answered as part of our investigation.

Mr. DUFFY. Better yet, when did you become the chair of the SEC?

Mr. CLAYTON. May of this year.

Mr. DUFFY. May of this year. And when did you find out about this hack?

Mr. CLAYTON. In August.

Mr. DUFFY. Does that give you some pause?

Mr. CLAYTON. Yes.

Mr. DUFFY. There is some conversation about a deep state. That the chair, the head of the organization on day one wouldn't have been apprised of this is concerning to me, and hopefully—I know you just got there—hopefully, you will take a look at this in the chain of command and ask the questions who should be making decisions at the SEC? Frankly, I would say it would be you and the commissioners, not the deep state. Fair enough?

Mr. CLAYTON. Fair enough.

Mr. DUFFY. I want to quickly move to economic growth. So there has been a lot of conversation about the lackluster economic growth that we have had since the crisis or over the Obama years of 1.8 percent. We just hit 3.1 percent growth this last quarter. I hear President Trump, our former colleague and committee member, Mick Mulvaney, has talked about this frequently: What we can do to put people back to work, what we can do to address our deficit clock, if we can actually just grow our economy. And that is wrapped around a conversation of tax reform. We hear a lot of conversation about regulatory reform in government.

What space does the SEC have in helping grow the American economy, address our debt, put people back to work? Do you have any space to play in economic growth?

Mr. CLAYTON. I think we—well, let me say this: I share the view, your view, I think it is the view of most people in this room, that the difference between 3-1/2 percent growth and 2-1/2 percent growth is huge, over any meaningful period of time. As a citizen, growth in jobs is what I want to see. So I definitely bring that perspective to the SEC in terms of growth and jobs. Capital formation is essential to it. As is confidence in our markets.

So I am looking, and the men and women of the SEC are looking, how can we facilitate, how can we break down barriers to capital formation without in any way affecting the integrity of our markets? And that is, I know it is front of mind for our division of corporation finance, it is in front of my mind, and we are going to continue to look for opportunities.

Mr. DUFFY. And for my constituents in central and northern Wisconsin, your work on improving capital formation, that has an impact on jobs, doesn't it? That has an impact on economic growth? Is that fair to say?

Mr. CLAYTON. It is fair to say.

Mr. DUFFY. OK. I want to quickly pivot to corporate governance. We have been spending some time looking at proxy advisory firms. We basically have two that own the market. There is a lack of transparency. There is a lack of competition. I am wondering if this is a space that you have had an opportunity to look at and whether you see whether there is a need for at least some reform in this space?

Mr. CLAYTON. It is a space that I have had an opportunity to look at. It is a space that the Commission is looking at. These firms provide a service that has value. They amalgamate data so that 1,000 investment managers don't have to do it and provide that data.

Mr. DUFFY. Is that a service to the company that hires them or is this a service to the ideology of the firm that owns them?

Mr. CLAYTON. Good question. Good question. Because they are the aggregator of data and the entities that people look to for that data, they have significant influence in the way they present that data. That is just the way life works. I am aware of that. I am looking at it, and I think it is something that we should all look at, because—particularly with the increase in indexing and passive money that—

Mr. DUFFY. If I could just—

Mr. CLAYTON. —Further increases their influence.

Mr. DUFFY. My time is almost up. When we hear stories about a firm getting a negative recommendation, and right on the heels of that coming out, lo and behold, an offer comes to buy the consulting services of the firm that just gave you a negative recommendation, and they claim there is a firewall between the two. But I watch enough Mafia movies where people come in and go, yes, we were going to protect you. Pay up. This is a space that is ripe for the SEC to look at and this committee as well.

Mr. Chairman, I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The chair now recognizes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

Good morning, Chairman Clayton. Last week, I sent you a letter regarding legislation that I am helping to lead, which is H.R. 3555. I hope you got the letter. It is entitled the Exchange Regulation—Regulatory Improvement Act, and it is by my colleague, Republican colleague from Georgia, Mr. Loudermilk, and myself.

Now, our bill simply clarifies the definition of the word facility of an exchange so that companies like the New York Stock Exchange are not hamstrung when trying to diversify the lines of business that they provide to their members and to investors.

I want to make it clear also that our bill in no way limits the Securities and Exchange Commission's regulatory powers, nor does it impede their ability to do their job. But our bill does not carve anything out from the Securities and Exchange's regulatory jurisdiction. The SEC has full authority today and tomorrow, should our

bill become law, to continue to go after the bad actors and to oversee the filings of market data, collocation, lifting standards, and other business changes filed with the SEC today. All we are trying to do is to allow the necessary breathing room for the New York Stock Exchange and companies like that to be able to operate in a more fluid situation.

Your thoughts on that. And were you able to get my letter and read it?

Mr. CLAYTON. I am aware of—I am aware of your letter and I am aware of the issue, which is, in our regulatory approach to the New York Stock Exchange or similar facilities, are we, the SEC, going beyond our bread and butter and getting into regulating businesses that are away from, or tangential to, the operations of those facilities? And it is a good question. It is a good question. We shouldn't be stretching in a way that impedes innovation, so we should be asking ourselves that question.

Mr. SCOTT. Right. Well, we look forward to working with you and sharing your input as we move this legislation forward. By Mr. Loudermilk and myself.

Now, I want to go to another bill. Ms. Gwen Moore and myself are working on a bipartisan bill with Republican Keith Rothfus entitled or numbered House Resolution 2319, and it addresses a concern that we have about your rule that went into effect a year ago. It was the amendment to the rule governing money market funds.

Now, as you know, Chairman, rule 2a-7 of the Investment Company Act requires certain funds available to institutional investors to switch from a usable, very usable net asset value, which we call NAV, to allow it to fluctuate or float, but others don't get that benefit. And I know the SEC went through a very rigorous rulemaking process on this rule. But sometimes, sometimes, very few times but sometimes, our regulators get it wrong, and I think this is an example of that.

Now, your predecessor, chairman of the SEC, argued that the benefits of a floating NAV would exceed the costs and issuers of commercial paper and municipal debt. But evidence is showing that this isn't the case, because since the SEC has finalized the rule in 2015, we have seen a massive flight from prime and tax exempt money funds, because the costs of a floating NAV are so high.

So we have this bipartisan effort, and what are your thoughts on that?

Mr. CLAYTON. I am aware of the shift in assets from municipal and commercial assets to government assets in the institutional money market space as a result of our rule. It was anticipated. There are other considerations here, but I am looking at it.

Mr. SCOTT. Good.

Mr. CLAYTON. Our Division of Economic and Risk Analysis is looking at it. And so I think it is too early to say we were wrong, too early to say we were 100 percent right.

Mr. SCOTT. I welcome your thoughts.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentlelady from Missouri, Mrs. Wagner, chairman of our Oversight and Investigations Subcommittee.

Mrs. WAGNER. Thank you, Mr. Chairman.

And thank you, Chairman Clayton. Before I get into my line of questioning, I did want to mention the latest news concerning the hack on the EDGAR corporate filing system. As chairman of the Oversight and Investigations Committee, I would ask that you continue to communicate with our staff concerning this issue, as it is of obviously great interest to all of us. And I thank you for the time you have spent with them at this point.

Now, as you know, I have spent the better part of the last 4 years fighting for low- and middle-income investors who are losing their access to investment advice under the Department of Labor's misguided fiduciary rule. A recent U.S. Chamber of Commerce survey noted 13.4 million consumer accounts will lose access to products under the Department of Labor rule. America is in the midst of a savings crisis, and we want to make things easier, not harder for them.

Just last week, I introduced the Protecting Advice for Small Savers Act, the PASS Act of 2017, which will create a standard for broker-dealers that will eliminate I hope any confusion. My bill, among other things, will repeal the Department of Labor rule, create a best interest standard for broker-dealers and all the services they provide, and require them to disclose compensation and any conflict of interest that exists. Most importantly, it will allow these broker-dealers to do what they must do, which is act in the best interest of their clients.

Mr. Chairman, I believe the PASS Act of 2017 would certainly provide clarity for the investor. If you are sitting across from a broker-dealer and maybe you have two different accounts with them, it is important that you have the same standard. Unfortunately, that isn't the current practice, and that is causing both confusion and harm.

Can you comment, sir, on how important it is to fix this, to move from this bifurcated regulatory regime created under the Department of Labor rule, sir?

Mr. CLAYTON. Yes. So we have talked about one of the things that I initially focused on in getting into the job, cybersecurity.

Mrs. WAGNER. Right.

Mr. CLAYTON. One of the other initial focuses was this: I want to thank Secretary Acosta for reaching out to us and saying, hey, this is something that we should try and work on together. And we have been. And a lot of the themes that you outlined are the themes that I have, one of which is choice. Investors should have a choice, what type of account they want, what type of relationship.

Mrs. WAGNER. And you stated that the choice is diminishing, in fact, in your earlier testimony.

Mr. CLAYTON. And asset choice, what assets they want to invest in. There should be clarity. I recognize that there is not the kind of clarity that there should be in the marketplace today. We should bring clarity.

There ought to be consistency with us and the Department of Labor. We can't have asymmetric standards. You can't put one hat on when you are talking about 50 percent of your assets and another hat on when you are talking about another 50 percent. It makes no sense.

And then we have to cooperate. They have a mandate; we have a mandate. They are not the same, but we can cooperate and get there, I believe. I am for all of those things. Now, the devil's in the details and we are working on it.

Mrs. WAGNER. Do you agree this is something we need to make sure is completely transparent for that investor?

Mr. CLAYTON. Yes.

Mrs. WAGNER. Wonderful. In July of this year the State of Nevada implemented its own fiduciary standard. Are you concerned about the potential impact a patchwork of State laws will have on the provision of retirement advice?

Mr. CLAYTON. I am.

Mrs. WAGNER. My staff and I have been reviewing the comments submitted to the SEC as part of the review. There are a lot of very personal stories that concern me, mostly how the rule will result in decreased services. As you know, the Dodd-Frank Act gave the SEC the authority to establish regulations in this space.

Can you tell me, Chairman Clayton, what your next step is and when will the SEC be acting?

Mr. CLAYTON. The next step in anything like this would be a rule proposal. We are working on such a proposal. We want to work with the Department of Labor. If this were easy, it would already be fixed. We have a lot to do, but I am confident that we are going to put forward something that addresses those four issues and that has a standard that protects investors and that they understand.

Mrs. WAGNER. We are all interested in the best interest standard. We want to make sure that there is access, that there is choice, and that it is affordable for those low-and middle-income investors. I have maintained all along the past 5 years, this is about Main Street, not about Wall Street. This is about taking care of those that should be saving for the future in the middle of this savings crisis.

So I thank you, Chairman Clayton, I look forward to working with you, and my time has expired.

Chairman HENSARLING. The time of the gentlelady has expired.

The chair now recognizes the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you. Hello, Mr. Chairman.

Mr. CLAYTON. Hi.

Mr. MEEKS. Good to see you. Good to have you here. And I first want to start off by thanking you for replying to a letter that I sent to you earlier on. And I am sure if you recall my letter dealing with diversity is very important to me.

So let me just—and I assume that we are in the same spot that you do consider that board diversity, with regards to gender and ethnicity, et cetera, on our public companies is tremendously important to disclose, and so that the public knows who is on these boards. And it also helps I think the culture within some of these companies. Are we together on that?

Mr. CLAYTON. We are together on diversity adding value in decisionmaking bodies and organizations. I believe in it, and I think it is important in our public companies. It is important to me at the SEC.

Mr. MEEKS. So the companies should disclose. To the degree I know that the board diversity rule, your predecessor was talking about how we needed to improve it and that was on the agenda. And that is why I wrote the letter to you, because I was concerned when I heard that you were removing that improvement from the agenda dealing with board diversity.

So I am very concerned about that, because if something is not working I think that we should fix it, correct?

Mr. CLAYTON. So we have a rule in place that says that to the extent companies have a policy regarding diversity, they are to discuss it and how they approach it.

I have asked our Division of Corporation Finance to look at that, to look at the work they have done in the past and to see if we are getting the type of disclosure that we would expect companies to provide in this area. How do you think about putting together a mix of directors that is going to best serve the shareholders, keeping in mind various characteristics of diversity. And that is—

Mr. MEEKS. So disclosing if those boards on these public corporations, then shouldn't they be disclosing the diversity that they have on their boards, whether or not and what criteria, if any, that they are setting forth for women, for ethnic minorities, for disabled, for—that is information.

I know, for example, it is important to a State like mine where my comptroller is saying that if you are going to get the pension funds of all of New York, which are diverse, we want to make sure that those companies have diverse boards. Therefore, they should be—and I thought the diversity rule that it has to be disclosed or should be disclosed, the diversity on these boards.

And I will just add I just saw a report that said that basically big companies say they favor diversity, but they refuse to prove it. In other words, only 40 percent of the companies are talking about where the diversity is, which tells me that there is a lot of room for improvement. And so I would have to turn to the SEC to see how do we improve the rule on diversity disclosure, since it does not appear to be working currently?

Mr. CLAYTON. And some people say that for improvement, we should have a grid that has different categories with respect to diversity, and that that should be disclosed in the company's proxy statement as opposed to the current narrative disclosure of how companies approach it. Is that Mr. Stringer who you are referring to?

Mr. MEEKS. Yes.

Mr. CLAYTON. Yes. And I am aware of his shareholder engagement in this area, and I believe in shareholder engagement in areas of this type. I am not at the point where I think a grid is appropriate. I get concerned about that kind of prescribed disclosure. But I am monitoring this issue.

Mr. MEEKS. So what do you think should be done, based upon what we have seen from some reports thus far that does not seem to be working other than just monitoring or after you monitor and you confirm what we see in these reports, then what actively do you think you can do, as chair of the SEC, to make this rule a stronger rule or to make sure that it is complied with?

Mr. CLAYTON. I think exactly what I said. I have the Division of Corporation Finance looking at this, looking at whether companies—when a company gets together, when the nominating committee of a company gets together and says, hey, what should we have on our board, what type of skills, what type of perspectives should we have on our board, I would like to see a discussion of that that includes—

Mr. MEEKS. I don't mean to cut you off, but I have 12 seconds. I just want to say this: I think that when you look at levels of skills, everybody, whether you are a woman, you are going to have a level of skills; ethnic minority, you are going to have a level of skills.

The question is, you can have two people that have the same, and if you don't consider diversity at all you can just have one group, period, and just say that they have the level of skills, and you have not considered diversity.

Mr. CLAYTON. I agree with you. I agree with you.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Kentucky, Mr. Barr, the chairman of our Monetary Policy and Trade Subcommittee.

Mr. BARR. Chairman Clayton, welcome to the committee and thank you for your service.

As you know, the SEC has adopted a rule that will require all mutual funds that invest in stocks and bonds to file monthly reports detailing all the securities in their portfolio. The compliance date for this rule is fast approaching. The fund industry expressed deep concerns during the rulemaking that the SEC was not in a position to assure that the data would be kept secure, and it emphasized that the data in the hands of a hacker could be used to trade in a way that could hurt millions of fund investors. For example, criminals might trade ahead of funds, based on what they observe in the data, or replicate proprietary portfolio strategies.

When the SEC adopted the rule, I am told it issued a 500-plus-page release and only two paragraphs of which mentioned the industry's information security concerns. In short, the SEC said that it is none of your business, we have it covered. Obviously, that is not, in fact, the case, given recent revelations. Of course, I will note that the EDGAR hack did not occur on your watch.

But my question, Chairman Clayton, is this: Shouldn't the SEC delay this monthly reporting of fund portfolio data until it is far more certain that the SEC will be able to keep it secure?

Mr. CLAYTON. So that provides an example of the type of question that we are asking, which is, are we taking in data that does, indeed, have significant market sensitivity. And I will take what the fund industry is saying at face value there, which is that this data, although it may be a month old, is something that would provide someone who had access to it an advantage if somebody had a large position that they know they needed to get rid of. We can go into details. That is exactly the type of question we are asking.

Mr. BARR. Thank you.

Mr. CLAYTON. Can we protect it? We need to know. And if we can't, do we delay our receipt? Do we have people hold it so if we

really need it we can get access to it? Those are all the kind of questions we should be asking.

Mr. BARR. Thank you. I thank you for taking that under consideration.

I also would applaud you in your written testimony and your verbal testimony talking about disclosure effectiveness and the need to reduce costs and burdens on companies. And I noted your concern about IPO activity, diminished IPO activity, and why companies are not going public.

Let me share with you one example of why that may be the case and a good example of the need to modernize and simplify disclosure requirements. And the perfect example is section 1503 of the Dodd-Frank Act. That is the mine safety disclosure requirement.

Under 1503 of Dodd-Frank, a publicly traded mine operator is required to report on a quarterly or annual basis various violations alleged—alleged—by MSHA in citations and orders. When MSHA issues any of these citations or orders, it is important to recognize that the mine operator is required to disclose, regardless of whether or not it agrees with MSHA's allegations. In the meantime, the mine operator has the ability to dispute MSHA's findings with informal conferencing with MSHA and formally before the Federal Mine Safety and Health Review Commission.

In fact, one co-operator in Kentucky told me that over 30 percent or over a third of all of these MSHA violations are challenged, and many of them are successfully challenged. And that process takes time. It takes about 4 to 6 months from the date of the citation being issued before it can be assigned to an administrative law judge, and during that process many citations and orders are modified. But by the time this occurs, a publicly traded mine operator may have already been required to include the citation or order in the quarterly or annual filing.

Now, here is the problem: The problem is that not only many times these disclosures are not material to the investor; they are affirmatively misleading to the investor, because of the timing of when they have to file. Talking to attorneys who practice in this MSHA area and have looked at the statute, they believe that the SEC has regulatory discretion to stay the filing requirements.

And I would urge the SEC to take a look at this, because, of course, this can significantly undermine the public's confidence and investment in the mining industry. And I would just urge you as you talk about why companies are not going public, this is exhibit A. This should be the example of exhibit A.

And I would ask for your response and whether or not the SEC would be willing to review that?

Mr. CLAYTON. So it is not an area where I practiced, so I don't have the type of familiarity with it that you referenced. But as a more general matter, I have talked about the aggregate effects of incremental requirements, that each one on its own has a purpose, and you can see why people would ask for it. But overall, it creates quite a burden.

And one of the metrics I like to ask people who run public companies is, how many days a quarter do you spend on compliance and reporting as a result of our rules and the market's reaction to our rules? And I will tell you what bothers me is that it is a signifi-

cant multiple of the amount of time private company managers who are good spent.

Mr. BARR. Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Illinois, Mr. Foster.

Mr. FOSTER. Thank you, Mr. Chairman, and Chair Clayton.

And I would like to start out by saying that I too represent one of the tragically underrepresented minorities in Congress, that is to say scientists, and how pleased I am to see an engineer in public service. So thank you for that.

Now, Chair Clayton, the SEC has been looking into initial coin offerings, including taking recent action against two of them. I have been speaking with various people in the ICO space and I am interested in your thoughts on where this is all going and whether the ICOs are more likely to evolve into some sort of innovative tool for capital formation or simply an attempt to circumvent security laws while providing inadequate disclosures.

Specifically, some of these ICOs involve purchasing something tangible, like say cloud storage, that would not traditionally be treated as a security, but however the purchaser can then sell it and there is a secondary market. And so there is undoubtedly room for speculators to hope to profit as the value of this token appreciates.

And adding to this complexity, very often sometimes the token holder offers, as part of the exchange, his or her available computing power as part of the bargain, which would seem to me to mean that the token holder is not relying solely on the efforts of others, which is one of the traditional definitions of securities.

Does the Howey test actually work in this case, and where do you see this going?

Mr. CLAYTON. We have tests that look backward, because that is what we know, what happened in the past. I will be very—the way I look at these types of arrangements, where you take someone's money and instead of handing them a stock certificate you hand them a piece of computer code and then you take the money and you invest it in a venture, I don't see that much of a distinction between those two, whether you get a stock certificate or whether you get a piece of computer code.

But what I am optimistic about is we have a settlement and transfer system, and I think one of the things that is very appealing but also can be an engine for fraud about these initial coin offerings is the ability to transfer, to trade is greatly enhanced, because you are just exchanging computer code across the spectrum rather than getting a stock certificate, signing it over, things like that.

So that is an answer. The answer to your question is, it depends. I want to give people who are investing just like a stock certificate the same protection from those kind of things, but I do want to facilitate a more rapid ability to exchange.

Mr. FOSTER. OK.

Mr. CLAYTON. That is my point.

Mr. FOSTER. At the point you see legislative clarity needed on this stuff, don't hesitate to contact us, because Congress does not

always do well in staying abreast to technological developments as we should.

Mr. CLAYTON. Thank you very much.

Mr. FOSTER. Now, you have also expressed concern about the declining fraction of companies that are publicly held, and which is something that concerns me greatly. I was wondering what fraction of that might simply be due to the fact that we are having wealth pile up at the top in our country and that wealthy people tend to invest in private equity, direct investments in companies, whereas retail investors sort of come from the middle class.

And so have you made an attempt to separate that? Because the narrative that we have that there is something wrong with the public markets might be a symptom of the larger problem that the wealthier just having more.

Mr. CLAYTON. It is a dynamic system, and I think that there are elements of all of this. One thing that we have in this country, which I don't want to lose, is a broad participation in our capital markets. We are actually having—we are putting more responsibility on individuals to save for their retirement. The amount of funds in self-directed retirement accounts or quasi-self-directed has tripled in the last three and a half decades. I want to keep that.

So there are lots of drivers. Ones you mentioned too probably are having an effect. But we need to have an efficient way—given what we have decided to do in terms of retirement savings, we need to have an efficient way for the average American to participate in the marketplace.

Mr. FOSTER. All right. Thank you. Just the last question, I have been really concerned about these reports of sexual harassment in Silicon Valley. You have seen really egregious things being done that for sure involve misallocation of the investors' capital for reasons that are not economic.

And I was wondering, aside from just the fundamental immorality of this, at what point is the problem of investors being not treated properly something the SEC might get involved in?

Mr. CLAYTON. I actually had not thought about us getting involved in that. I will think about that.

Mr. FOSTER. Another thing to think about. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from North Carolina, Mr. McHenry, vice chairman of the committee.

Mr. MCHENRY. Thank you so much, Mr. Chairman.

Mr. Clayton, thank you for being here. And I actually want to follow up on Mr. Foster's question about initial coin offerings. Your investigative finding from July 25th I found encouraging. The SEC had a finding in order to establish a rationale for initial coin offerings, or ICOs.

Can you walk me through your thinking on that finding? Because I know it was a major decision for you to enter into a new space and try to regulate and point to good actors that are in the ICO space.

Mr. CLAYTON. Sure. There is a process and a substance element to it. The process element was, instead of starting with enforcement actions, we decided to start by level-setting with this report and saying, hey, here is how to behave well and here are some

things that trouble us. So the intent of that was to notify people in this space there is a way to do this right and there are some things that—then there are some things that trouble us. And if you do it right, we are all for it; and if you do it wrong you are going to have some explaining to do. That is it in a nutshell how we went about it.

Mr. MCHENRY. I have been involved in crowdfunding, and it looks to me that ICOs are an avenue that are basically trying that level set, to enable the flow of capital and enable different opportunities via technology. So what are you doing to help entrepreneurs ensure that they are pursuing ICOs correctly?

Mr. CLAYTON. Well, that was part of the report, to first ask yourself if it is a security. In most cases where you are funding something, it is. And then go through, whether it is crowdfunding procedures, Reg A procedures, whatever exemption works for you, go through that exemption; or if an exemption doesn't work you are going to have to consider registration, which is probably not a practical avenue at this moment.

I think it does highlight that this area of funding smaller businesses, through crowdfunding or other means, technology can really help it. It can help us do our job too.

Mr. MCHENRY. So do you foresee the need for congressional action to ensure that secondary trading of coin, cryptocurrencies are enabled, or do you believe you have law on your side to properly do that?

Mr. CLAYTON. The fair answer is, I don't know enough about how they are going to trade yet to know if we can do it with what we have or whether we need your help.

Mr. MCHENRY. OK. But it is a first step. We are only 3 months in for the SEC's findings.

Mr. CLAYTON. Yes.

Mr. MCHENRY. With time, I hope we can get more data on that.

So let me shift to a separate issue that I know you care about as much as I do, which is this discussion about the rise of the rest. How do you help—what we do know is 80 percent of startup capital goes to three States. There are 47 other States that have great ideas, but the flow of capital is not there. It is not commensurate with the set of ideas and opportunities around there. And I know this is something you care about, as we have discussed.

What can we do for medium size and small businesses in the rest of the country? What can we do as policymakers and what can you do at the SEC to make sure that is possible?

Mr. CLAYTON. I think first recognizing that this is the landscape. I have to say I was surprised that the three States get the lion's share. We had some folks in the other day. We have been talking to people about this, small and medium size businesses, not intermediaries, but people who have these businesses.

I learned something new, which is the Midwest is the world's fourth or fifth largest economy, depending on how you measure it, but it has very little venture capital, has lots of great companies, lots of well-educated people, a big economy, but very little venture capital. And that should tell us something.

Mr. MCHENRY. So that initial finding, now we have to work through steps in order to enable this, right? So the surprising thing to you was the lack of capital?

Mr. CLAYTON. Yes. Well, and a lack of that type of capital and the type of expertise in the venture market to put that capital to work, because there must be people who have businesses that are worthy of funding.

Mr. MCHENRY. My time has expired, but I would love to follow up with you more on those ways that we can enable policy so that the other 47 States benefit.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentlelady from Ohio, Mrs. Beatty.

Mrs. BEATTY. Thank you, Mr. Chairman, and thank you, Ranking Member, and thank you to our witness today, Mr. Secretary.

We have had a lot of questions posed to you about the Consolidated Audit Trail. So I have a question. Is it necessary for the CAT to collect social security information of the individuals and, if so, what value of that information is it to the SEC?

Mr. CLAYTON. Your question is a question that I have as well. What value do we get from the PII? Now, I am sure there is some value. I will give you an example. If we have an insider trading investigation and we want to be able to say, oh, here is this person and they know that person, identifying who the people are and where they live and how they might work together is something of value to us. And we have actually made great strides in connecting insider trading rings that you would never know on the face of them through data. That said, it is when do we need to get it? Do we need it all the time? Those are very good questions around things like people's social security numbers.

Mrs. BEATTY. OK. We may circle back a little more on that.

I ask the following question to every Secretary that comes here, your predecessor, because I think when you run an operation as large as your operation, it is important for some of us to focus on the people side of it as well as the process, the security side.

So for me in section 342 of the Dodd-Frank with the OMWI Act, it is very important to me, as a female and as a black woman, small business owner, that we have diversity in our agencies, because I think it makes a difference. So I took the liberty of looking at some statistics that I want to share with you now that you are the chairman of the SEC and you head an agency that has that actual mandate under Dodd-Frank.

So when you think about of the 500 companies that make up the Fortune 500, only four of them have African-American CEOs. That is less than 1 percent. So I am going to ask you on three questions, do you think that is problematic?

The second one, of the 500 companies that make up the Fortune 500, there are only 32 female CEOs. That is roughly 6 percent. Do you think that is problematic?

Even at your old law firm, Sullivan & Cromwell, of the 174 partners, there were 32 women and only 3 were African American.

I guess my point of this exercise is to make sure that I point out it is not just a problem for you; it is a problem for all of the directors. That is important to the constituents that I represent, because

I think—and you mentioned it on page 18 of your testimony, that you had value in having a diverse work force.

So I want to know how you are going to continue that, improve that, so maybe when you come back and your expert team might have some females sitting behind you or people of color.

Mr. CLAYTON. I do have some behind me.

Mrs. BEATTY. Let's get them on the front row the next time.

Mr. CLAYTON. We will. I want to thank you for this question. So we have that OMWI report that you know about. I read it in connection with my preparation. And then when I got to the Commission I met with Pam Gibbs right away, who is our chief OMWI officer.

So here is the bottom line on our report: We are doing pretty well across the Commission except in one area, leadership. And so when I talk to Pam and when I look to fill leadership positions, this has been front of mind. And we have been in a regular dialog about improving that aspect of diversity at the Commission.

Mrs. BEATTY. In my few seconds left, let me thank you for that, because I appreciate your honesty, I appreciate your effort. And you have also met with her more than one time. So I want to say thank you for that, because that is not always the case here. And I appreciate you saying that we don't—recognizing that it is important that we have women and minorities on the team, but to put them in leadership is important.

I even beat up on our chairman. We didn't have a female as the chairwoman of any of our committees, and now we have one. So I am not asking you anything that I don't ask here.

So the next time you come, I will be looking forward to having females and minorities in leadership.

And I yield back.

Chairman HENSARLING. The time of the gentlelady has expired.

The chair now recognizes the gentleman from California, Mr. Royce, chairman of the Foreign Affairs Committee.

Mr. ROYCE. Thank you, Mr. Chairman.

And thank you very much, Chairman Clayton. At the outset in your remarks, Mr. Chairman, let me just say I appreciate your comments that we need to give Mr. and Mrs. 401(k) access to the capital formation of growing companies. I thought you put that well. The current downward trend, as you explained for companies, has fewer and fewer going public, and that has the potential to benefit the few over the many. I strongly share your sentiment that all investors should have the opportunity to participate in America's growth, and I think we stand ready to help you achieve that goal.

I think when we talk about the massive Equifax breach and the attack on the SEC itself, this is not the first nor will it be the last attack, but consumers, consumers as well as investors deserve to know when cyber attacks put their money at real risk. And in your recent speech that you gave before the Economic Club of New York, you emphasized that disclosure requirements extend to cybersecurity issues. Your words were: Public companies have a clear obligation to disclose material information about cyber risks and about cyber events, and that you expect them to take this requirement seriously.

So I would ask are there plans for the SEC to look at current disclosure requirements for cybersecurity risks, or do you believe the materiality standard that we currently have is sufficient? What is your view on that?

Mr. CLAYTON. Thank you for recognizing there are different constituencies that need to know, consumers and investors, and those two aren't separate but that is a good way to look at it.

In terms of what is my view on this, for me, materiality is the touchstone. I have seen overly prescriptive rules not have the effect that they should. And in this area, though, I think it is pretty clear that your cyber risk profile, hey, where do I have sensitive material? Where would a denial of service attack affect my company? Where would it affect consumers? That is a materiality judgment that I think is fairly easy to make, and I expect companies to be thinking about it in the same way they think about other key elements of their business.

Mr. ROYCE. Let me get through a couple other questions here to you. So I am pleased also on your reference here on efforts to hire a chief risk officer to oversee cybersecurity efforts at the SEC. Now, over at the State Department, I have led the effort through the bipartisan cyber diplomacy act to establish a high-level Ambassador there for cyberspace to help counter foreign threats to the internet.

My question is fairly straightforward here. Do you need our help to get this done, in terms of your ambition here of filling that slot, or can you do this on your own? Do we need any legislative language? And also, as a follow-on, how will you define the responsibilities of this new CRO that you will bring on board?

Mr. CLAYTON. So to try to take them in order, I think a CRO, as we have seen in the private marketplace, we are not a corporation, but in terms of just it is good organizational hygiene to have somebody who looks across the organization at the risk profile of the organization.

We have a lot of different divisions at the Commission, and I can't expect somebody in one division to be constantly thinking about risks in another, but I should have somebody who is thinking about risks across those divisions. So that is the role. And the risk that kind of goes across the divisions, at least across several of them, that is most acute at the moment is cyber risk and our use of data. Do I need your help at this point? No, but if I need help I am not going to be afraid to ask for it.

Mr. ROYCE. OK. And then I would like to follow up on Mr. Duffy's comment on proxy advisory firms. I understand your comment that the firms do provide a service that has value, but I would like you to look at this another way.

Wouldn't you agree that the value of the information would benefit from competition in the market, because right now I just asked are investors being best served when only two firms dominate that entire market? Is there more we can do to increase competition?

Mr. CLAYTON. It is a valid point. It is a valid point. It is an interesting organizational dynamic question, because somebody has to compile the data, but once one or two people do it, how do you foster competition across more of them?

Mr. ROYCE. Maybe we can continue that dialog.
Thank you, Mr. Chairman.

Mr. CLAYTON. We can continue that dialog, yes.

Chairman HENSARLING. The time of the gentleman has expired. The chair now recognizes the gentleman from Minnesota, Mr. Ellison.

Mr. ELLISON. Welcome to the committee, Mr. Clayton. I am going to kind of pick up on where Chairman Royce left off. This issue of market concentration has been on my mind a lot. And I am glad that you are focused on this question of IPOs and startups and I think this is an important question, but I would like to get your take on how increasing market concentration has impacted a whole range of things in our economy.

If you look up on the screen, if you look at Facebook, you can see they acquired 50 companies since 2005, Google 200, Amazon 65, Apple 80. That is just in the tech area. We could get charts up there in beer, in chicken, in you name it, we pretty much can do it, in pharmacies. And I wonder, like if I am a startup person, I have opened up a new business, I am trying to consider either taking my company public or why wouldn't I just sell to a big company like that, because then I could avoid a lot of fees and stuff like that and maybe get more money.

And I am curious to know, from your standpoint, is that part of the explanation for why we don't have the IPOs? Then in addition does that explain why you see what I consider to be recklessness and a lack of care with companies like Wells Fargo, that they just don't have to be as careful because they just don't have the competition. Maybe even Equifax would be a little bit more careful. If they just didn't have two other competitors in the market to worry about, they might put more energy/resources into protecting our data. What are some of your thoughts on how market concentration is impacting our economy?

Mr. CLAYTON. So first question on—and with your data here.

Mr. ELLISON. Yes.

Mr. CLAYTON. I agree with you that—and as I said, the lack of companies going public troubles me, because I want broader participation. I agree with you that when—not me, but when someone is sitting there saying, hey, am I going to go public, am I going to continue to take private money, or am I going to sell, the path of least resistance and maximum return can be to sell. And that is more true in some industries than others, but it does lead to these companies not raising money in the capital markets and a concentration. And look, it is smart for these companies to acquire smaller companies. They acquire talent.

There are a lot of market forces that affect there, but I think your point is a valid one as to one of the factors driving a reduction in the number of small-and medium-size startup opportunities for people to invest in.

As far as your broader question on concentration of let's just call it power in the marketplace and does it have effects, that is outside of our bailiwick as securities regulators, but it is certainly a valid question.

Mr. ELLISON. And we often don't get the chance to talk to the agency lead who would be exactly on point but I do think the SEC has a role to play in terms of fostering competition. In keeping with what Mr. Royce just asked you, what are your views on how the

SEC can help foster a greater amount of competition in the market when you look at like all these industries. They have three players in them, two players, four players. I can go on and on.

Mr. CLAYTON. I will give you the cliché that I use, but I think it is not just a cliché. I say when we have one-size-fits-all regulation, we end up with just one size.

Mr. ELLISON. Well, good point. I don't know if I agree with that point, but I will say this: We stopped doing aggressive antitrust enforcement in the eighties. And we used to be really into it, Republicans and Democrats. Now we have just said—one of the things I read in your bio is that you used to do mergers and acquisitions. Perhaps you might be the best qualified among a lot of other people to really say now that you are on the other side of the divide we might want to start taking this problem a lot more seriously about declining competition.

Mr. CLAYTON. An area that I can step into and say that I am worried about declining competition is in the provision of financial services. I don't want to see our regulations drive us toward a limited number of players in financial service provision.

Mr. ELLISON. Well, I agree with that. And that is why I think that we have had a lot of debate in this committee over a SIFI designation. My thought, if you don't want to be a SIFI, get smaller.

Anyway, I hope that we can continue this conversation. I am worried about even you mentioned risk. When you are so big you don't have to worry about risk then you do not do—anyway, I am out of time. Thank you.

Mr. CLAYTON. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The chair now recognizes the gentleman from Illinois, Mr. Hultgren.

Mr. HULTGREN. Thank you, Chairman.

Chair Clayton, thank you for being here. Good to have you here and appreciate your important work at the SEC. I am interested initially in discussing and getting your opinion on the implementation of the Consolidated Audit Trail in light of recent discovered breaches in the EDGAR database at the SEC.

Two days ago, in an op-ed by Hal Scott and John Gulliver of Harvard Law School ran in the Wall Street Journal made a number of points for why the proposed data collection went far beyond its intention for unraveling market events, such as the flash crash. Specifically, they note, and I will quote from their op-ed: "An SEC cost-benefit analysis for the CAT did not meaningfully weigh the risk and potential cost of a cybersecurity breach against the benefit from the improved ability to discover the cause of a flash crash or identify a market manipulator," end quote.

I wonder first, do you believe the operators of the CAT, Thesys, is taking the appropriate steps to secure the information that will be stored within the CAT, and what role does SEC have in overseeing this?

Mr. CLAYTON. OK. So Professor Scott's editorial, I think it is fair to quote from it because no one likes criticism, but it was a fairly based set of questions that we should be asking ourselves.

And to your specific question about oversight of security, the first line of oversight of security is with the SROs, who under our plan

are charged with overseeing Thesys, the vendor who is producing the CAT. And I do intend to press them on whether the current security procedures that are in place are appropriate, and to do it in the kind of detail that Professor Scott raised in his editorial, which was, what is the data you are taking in, and is the security apparatus appropriate for that data?

Mr. HULTGREN. That is our hope that this is obviously vital information that is there and potentially susceptible, and so we are just concerned about that. I also am concerned about some of the timing. NMS' plan for the CAT calls for specs to be produced by May 2018 detailing how personal identifiable information should be shared and protected. However, the SROs, as we were talking about, are scheduled to report data beginning November 15th, which is just 5 weeks from now, hard to believe.

How can we expect Thesys to construct a test to secure a database, a test that secures a database within such a short period of time? And then wouldn't it be more appropriate for the SEC and the NMS plan to consider PII before this information is collected and shared by the SEC and SROs?

Mr. CLAYTON. Yes and yes. And in that question of do we have the right security in light of the data and its usefulness to us, we should be particularly focused on PII and what is its value. Does it have enough value that we should be taking it; and if it does, to what extent and what security are we going to place on it?

Those are all questions that the SROs should be asking Thesys and I should be looking at from an oversight perspective, and then if we eventually take that data in we should be looking at.

Mr. HULTGREN. My sense is that your voice is very important in this of clarifying what really is necessary and what isn't necessary for the SROs to collect. And especially, I think that gets back to this cost-benefit analysis of absolutely, we want to do everything we can to identify bad actors or problems in the market, but at the same time we realize this information really is personal and important and we want to protect it. Again, that is the point of my question.

Let me move on, because I have just have a minute left. I sent you a letter earlier this year regarding amendments to FINRA Rule 4210. I want to thank you for your quick response and for the attention your agency and FINRA have given to the issue for small and middle market dealers that my letter highlighted. I would also like to commend you on your initiative to assemble a fixed income advisory committee at the SEC.

To my prior point, I believe it would be helpful to make sure that small and middle market dealers have a strong voice before the Commission. These dealers are often overlooked, unfortunately, with policymakers and as new rules come up and new regulations and things. And I think it is a great opportunity to help prevent that.

So I wanted just to see can you give the committee a sense of when the advisory committee will officially begin its work, and what are the primary topics for which you hope they can lend expertise to the Commission, and, again, any thoughts you have on having smaller or middle market dealers have a voice in that.

Mr. CLAYTON. So on the committee itself, as soon as possible. I am working through this with Commissioner Piwowar and Commissioner Stein. We are doing it in a very collaborative way.

With respect to representation on the committee, to your narrow question, yes, this is not going to be all the big boys.

Mr. HULTGREN. Good.

Mr. CLAYTON. It is going to have—

Mr. HULTGREN. That is important. I have a lot more questions. We will follow up in writing if that is OK.

Thank you, Mr. Chairman, I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Missouri, Mr. Cleaver, ranking member of the Housing and Insurance Subcommittee.

Mr. CLEAVER. Thank you, Mr. Chairman, for being here. Presently security laws will allow good-acting companies, companies that follow the law to receive less oversight and more relaxed disclosure requirements. And on the other hand, current security laws would say that if you are found guilty of felonies or even misdemeanors or if your company just stepped on antifraud provisions that based on those laws you are supposed to be automatically disqualified.

I am assuming you do understand that that is not how it works, because we have repeat offenders who don't suffer when they violate these security laws. I can call the names of some of the companies. I am not anxious to do that, but I will if you wanted me to do so.

But do you have any—assuming that I am correct in my assessment, which I am, what would you do to deter that kind of behavior essentially forgiving the bad behavior and allowing companies that are repeatedly violating securities laws to function like they are a moral company?

Mr. CLAYTON. So this is the area of bars, and whether it is bars from the industry altogether or bars from particular activities. And I will just tell you how I look at it. I break it down into two areas.

One is individuals. Having given us, the Securities and Exchange Commission, the power to bar individuals I think is very important. And I actually—I expect our enforcement division to use that power aggressively, because if you have individuals—it is a privilege to work in this industry. You do well if you work in this industry. And if you are an individual bad actor, you should be out of the industry. And I think I have made that clear to our enforcement division.

Mr. CLEAVER. Well, are you—

Mr. CLAYTON. Then there are companies.

Mr. CLEAVER. Yes.

Mr. CLAYTON. Companies are more complicated, because you can have a relatively junior person, in terms of the hierarchy, who is a bad actor who you are getting rid of. And I do have a hard time making shareholders pay substantially for that type of activity.

Now, to be clear, if you have activity at the top of the house that is bad activity or there is endemic activity, I do believe in bars. And so I am just giving you a flavor. That is how I look at it. And different people can look at it a different way, but that is how—

and I also like—I want to empower the enforcement division with the power to pursue those bars, because it makes them more effective.

Mr. CLEAVER. I appreciate that. Sometimes these repeat offenders are not dealt with, in my estimation. In fact I think about this a lot. You rob a neighborhood convenience store, and you are going to be ostracized and criminalized. You rob America, and you are decriminalized and monetized. And it is just one of those things that in the middle of the night I get a headache.

And the years that I have been on this committee, 13 years, we have had people come in here who have done some bad stuff, and they get punished with a \$60 million separation amount of money. That is their punishment. And the world, the people out in the world see this and they don't understand. It makes people angry. It is one of the things that I think angers—I wish we had more time, but my time is out. You do understand I think where I am going.

Mr. CLAYTON. I do. And I want you to know we formed a new unit in our enforcement division, a retail fraud unit that is focused on this. And one of the things they are very focused on is recidivists. We need the people out, we need those people out of the industry.

Chairman HENSARLING. The time of the gentleman has expired.

The chair wishes to inform all members that after calling on one more member the chair will call a short 10-minute recess.

The chair now recognizes the gentleman from Florida, Mr. Ross.

Mr. ROSS. Thank you, Chair.

Chairman, thank you for being here as well. And thank you for not increasing your budget request this year. That is rather refreshing to see that more can be done with less and really challenge the efficiencies of the skills and resources that are under your tutelage there at the SEC.

One of the things I have been concerned about for a long time, and you spoke about this a little bit, capital formation. And it is specifically the ability of smaller companies to access benefits from the capital markets. Compared to larger capitalization ranges, small cap equities face unique challenges in both capturing the attention of analysts and attracting institutional investors.

As a result, many potentially high-growth companies often face a deficit in independent investment research and a lack of liquidity after going public. Again, you discussed the one size fits all.

Some CEOs have branded this phenomenon as the valley of death. Unfortunately, it has become clear that this issue is causing many promising companies, our startups, the ones that you spoke about that aren't happening, to stay private longer or elect to sell to larger companies rather than accessing the capital markets to foster job creation.

Are there any steps the SEC can take to help reduce the barriers faced by small cap equities after they go public?

Mr. CLAYTON. I hope the answer is yes. One of the motivators of the tick size pilot that we have been looking at is if we adjust the tick size, are we going to get—how do I say it—better trading, increased liquidity, and perhaps attract more research? If you do those things, it makes it more attractive to become a medium-size

public company to start with. That is one of the questions we are asking ourselves with the tick size pilot.

There are other things that I am—

Mr. ROSS. And I guess where I am going with this is that our European friends have a different approach to this, and specifically with MiFID, the Markets in Financial Instruments Directive II, that will, of course, require that they unbundle their research and have to—it is going to adversely impact the consensus values. It is going to adversely impact earnings. It is going to impact a lot in the markets, in fact, devaluing domestically.

Are there measures that the SEC is taking to address this?

Mr. CLAYTON. Yes. There are a lot of commentators who believe that the unbundling is going to have an adverse impact at the small and medium size—

Mr. ROSS. They can't afford it. They are going to eventually have to register as an investment adviser and—

Mr. CLAYTON. Yes.

Mr. ROSS. And it is going to trickle down to Mr. and Mrs. 401(k).

Mr. CLAYTON. This is exactly why I don't want that model to be imported.

Mr. ROSS. But it is going into effect in January?

Mr. CLAYTON. It is going into effect in Europe in January. And I want our approach to their efforts to ensure that the U.S. markets don't have to import that model.

Mr. ROSS. And what can we do to help you in that regard?

Mr. CLAYTON. There is a patchwork that we are putting together of exemptive relief. But we can't do this alone. We have to have our European colleagues recognize that we will recognize the way they are approaching the market, but recognize the way we are approaching the market should stay the same way, because capital flows back and forth.

Mr. ROSS. Right.

Mr. CLAYTON. So we can't just draw a line down the middle of the Atlantic and say, you do it your way, we will do it ours. We have to—

Mr. ROSS. Some transition, yes.

Asset managers, they are totally different than the bank entities, yet they are being identified by FSOC as potentially being SIFIs and yet they are under the authority of the SEC.

It would seem to me that there are obvious differences, there is a difference in risk, there is a difference in capital. Would you not agree that the SEC is more than competent to regulate the asset managers, as it has been doing without FSOC's interference with SIFIs?

Mr. CLAYTON. I agree that this is our space.

Mr. ROSS. And even being your space, I would hope also that if any asset managers were of such a significantly important financial institution that you would allow them the opportunity to be recognized early on to have an opportunity to correct that and to stay in the market without having to adversely impact the markets, because they were taken by surprise, not knowing what their classification is?

Mr. CLAYTON. I think that is a reasonable perspective on this issue.

Mr. ROSS. I appreciate that.
Chairman, I will I yield back.

Chairman HENSARLING. The gentleman yields back. The committee now stands in recess for 10 minutes.

[Recess.]

Chairman HENSARLING. The committee will come to order.

The chair now recognizes the gentleman from Colorado, Mr. Perlmutter.

Mr. PERLMUTTER. Thank you, Mr. Chair.

Mr. Commissioner, thank you for being here. I just have a couple questions and sort of basic stuff. I first want to start with these ICOs, these initial coin offering things. It reminds me of the old days with penny stocks. It can be a different medium every time. And I just—you are in a position where you have to balance formation and ease of liquidity with the potential for fraud and theft and loss.

So just kind of your basic philosophy on this stuff now that you are chair of the Commission.

Mr. CLAYTON. So I agree with you. This is—here we have a new thing that has some good, but it is a new avenue for fraud. And that was getting the 21(a) report out saying, hey, here is the good way to do it, here is the bad way to do it. That is sort of the guidance for people in the marketplace, but then we have the bad actors. And I am very—well, I am cautiously optimistic about the Enforcement Division's approach to this. They know that this is a ripe area for pump and dump.

Mr. PERLMUTTER. Right.

Mr. CLAYTON. Right? Pump and dump—it is actually even easier here than it is in the penny stock area, because it is all electronic, it is all anonymous. It is harder to catch the bad guys at the end of the day. And I recognize that, and from a philosophical and policy point of view, if we are not doing a decent job on educating people that that is what can happen, and then when the bad guys act, getting at them, it is going to be a lot harder for us to get the benefits of this kind of technological advancement. So that is how I look at it.

Mr. PERLMUTTER. OK. And I agree with you. You are going to just always be balancing this sort of stuff.

So I serve on the new subcommittee that we formed on terrorism and illicit finance where a lot of our concerns deal with cryptocurrencies and electronic kinds of transactions, but more financing of bad guys, but potentially the SEC's going to have to keep their eyes on all of this.

The second question I have is sort of going to an Equifax or a Sony or a Yahoo or EDGAR or whatever, a hack occurs, but let's put it in the private sector. And you talked about materiality, a reportable event. Given—you potentially have insider trading and you potentially have bad guy trading. So how quickly do you expect somebody to report this kind of hack upon their discovery of it?

Mr. CLAYTON. I have done this for a while in terms of disclosure. You can't put a day, a specific day timeframe on this. But what we can ask people to do is to constantly assess: am I at the point where I know that this is something that investors making investment decisions should know, and what can I tell them? It is not

an easy thing to do, but my experience is the sooner you can reach a conclusion on that and get it out, the better.

And you can see with our own work here. You don't always know all the facts that you would want to know at the time you have to make the disclosure, but erring on the side of earlier rather than later is the way to go.

Mr. PERLMUTTER. Right. And I would suggest to you, you are moving from the attorney who has had to deal with this and advise clients to the regulator who says you should have done this earlier.

Mr. CLAYTON. Uh-huh, uh-huh.

Mr. PERLMUTTER. Or you didn't have enough information, we are going to cut you some slack. But it is a different mindset that you have to have.

Mr. CLAYTON. Absolutely. And I have been pretty clear, going back to July, before we disclosed the incident we have discussed, that I would like to see better and more prompt disclosure. I thought it was good to get that message out.

Mr. PERLMUTTER. OK. Mr. Chair, I yield back.

Chairman HENSARLING. The gentleman yields back.

The chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Mr. Chairman, for hosting this important briefing. And thank you, Chairman Clayton, for being with us today and for providing your perspective on so many important issues relative to the SEC.

My interest today, Chairman Clayton, is to address the pending sale of the Chicago Stock Exchange to a Chinese government-affiliated firm. And I would thank you for your recent thoughtful decision to freeze this transaction.

As you are aware, for the past year and a half, I have lead a congressional effort to block this transaction over our significant national security concerns. In addition to national security, we are also concerned that the SEC may have trouble monitoring the post transaction ownership of the exchange with a Chinese foothold in this market, that there might be significant Chinese government dominance over its business operations and decisionmaking, enabling a company to be listed that would not otherwise have previously been acceptable.

With this in mind, would you please describe the actions and thought process that led to the Commission placing a hold on this transaction?

Mr. CLAYTON. I am happy to discuss the procedural aspects of where we stand. And where we stand is Commissioner Stein, Commissioner Piwowar, and I will have to decide this issue, because it is now before the Commission. So I am not going to—I am not going to comment on the merits in light of that deliberative process. But from a process point of view, this was a matter that had originally been delegated to the staff. We delegate lots of matters to the staff.

Mr. PITTENGER. Sure.

Mr. CLAYTON. The staff went through its review process and produced a recommendation. That recommendation is now being reviewed by the Commission. We have provided a time period for additional submissions of information. Those submissions of informa-

tion are coming in. And I—it is a group effort with my other commissioners. I feel like we are working collaboratively very well in all areas. I expect we will work well in this area. But speaking for myself, I want to bring this matter to a resolution sooner rather than later.

Mr. PITTENGER. Yes, sir. Do you have a timeframe for adjudicatory decision?

Mr. CLAYTON. I don't have a specific timeframe, but I don't expect this to be—I don't expect to be talking about this particular aspect of it next time I see you.

Mr. PITTENGER. Thank you, sir.

As you know, the transaction did receive the CFIUS approval under the previous administration. In light of your decision to freeze the transaction, would you qualify this at this point as a national security oversight by CFIUS and the previous administration?

Mr. CLAYTON. The question—there is a lot of ground that I have to cover.

Mr. PITTENGER. Sure.

Mr. CLAYTON. National security is not really one that they have given me responsibility for.

Mr. PITTENGER. Well, there are basis for—

Mr. CLAYTON. I need to take advice on national security.

Mr. PITTENGER. Yes, sir, I understand that.

Let's move on then. Earlier this year, acting Chairman Piwovar stated: It is difficult to conceive of a circumstance with counsel in favor of enforcing the due diligence requirements to the conflict mineral rule.

Do you agree with acting Chairman Piwovar's reviews, and what is in the status of the SEC work on modifying the conflict minerals disclosure rule?

Mr. CLAYTON. So just taking a step back on the conflict minerals rule. This was the subject of substantial court process involving the First Amendment, a finding that parts of the rule did, in fact, violate the First Amendment. The district court has now sent all of that effectively—I am using layman's terms rather than lawyer's terms—has sent that back to the Commission to assess whether where we stand today, which is the rule is partially in effect, is appropriate in light of that decision. And one of the questions is, is our current no-action stance on the due diligence appropriate, and we are looking at it.

Mr. PITTENGER. Yes, sir. Thank you for that.

Just going back briefly to the Chicago Stock Exchange issue, do you consider the Chinese foothold in our markets and being able to list a semiconductor company, perhaps some other business that would no longer—otherwise, we would not have accepted, do you believe that that is a concern?

Mr. CLAYTON. Look, I am—let me—I don't want to talk about specific instances because that is not appropriate. But what I can say is the United States has generally been in favor of fair and open global capital markets.

Mr. PITTENGER. Yes, sir.

Mr. CLAYTON. It is fair and open. And one of the things I have to do in my job is assess whether we have fairness across jurisdictions.

Mr. PITTENGER. OK. I understand. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The chair now recognizes the gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

And I want to thank the witness, so welcome, Mr. Clayton. I would like to revisit the issue of the Equifax hack and breach and possible insider trading. I think to talk about this, the timeline is important, and that is on or about July 29 of this year, 2017, Equifax discovered that their computer systems had been hacked, and that the Social Security numbers and personal identifiable information for about 143 Americans was stolen, including their Social Security numbers. Sometime later, but before the hack had become public information, the three top executives for Equifax sold about \$2 million worth of stock. And because they were clever enough to conduct this trade before the information was made public, and while it was inside information, they avoided a 35 percent drop in the share price.

Now, I understand that you were asked some questions about this over in the Senate, and you were asked if there was an investigation of these three individuals and the trades that they had made before the news of the hack and of the breach had been made public. And you were reluctant to answer that question. Could you answer that today?

Mr. CLAYTON. I would provide the same answer to you that I did in the Senate and that I do with anything with respect to the matter. We at the Commission have a longstanding policy of not commenting on whether we have an investigation ongoing or any details of an investigation.

Mr. LYNCH. Let me ask you this, when—

Mr. CLAYTON. And it has served us well. I am sorry.

Mr. LYNCH. When we had the EDGAR situation, you came right out.

Mr. CLAYTON. That was us.

Mr. LYNCH. Yes, it was you.

Mr. CLAYTON. Yes. And I made an exception for that because I thought it was important, and it is ours.

Mr. LYNCH. The only thing—look—so this is 143 Americans. This is everybody.

Mr. CLAYTON. Uh-huh.

Mr. LYNCH. This is everybody.

Mr. CLAYTON. What I can say—what I can say, and I—we are mindful of the significance of cybersecurity issues, we are mindful of the significance of insider trading, and we are very mindful that the American people, they want to know that—they want to know that we are doing what they would want us—

Mr. LYNCH. I want to know that too. I am on this committee. I have to tell you, and I will follow up on Mr. Cleaver's questions, so we have bad actor restrictions, and your commission regularly and customarily is giving exemptions and waivers to people who repeatedly violate the law. So that is why it makes me ask the ques-

tion, are you investigating the three executives from Equifax? If I didn't have doubt, I wouldn't ask this question.

Mr. CLAYTON. I am confident—let me answer your question in a general way that I hope gives you comfort, and that is that if we were to find that an executive of a U.S. public company committed insider trading, I am certain that we would ban them.

Mr. LYNCH. Well, they are saying they did. Equifax is saying that they were hacked on the 29th, and that some time before they announced it to the public and the stock went down 35 percent, they are saying they sold \$2 million. So the elements are there.

Mr. CLAYTON. I want to go back to Congresswoman Maloney's question—

Mr. LYNCH. Yes.

Mr. CLAYTON. —About having a control in place so that issues like this are avoided in the future, and that is if a company determines that it has a material event that it should disclose. I do believe it is good corporate hygiene for section 16 insiders—set of executives—to not be permitted to trade by their insider trading policy. I do believe that.

Mr. LYNCH. Well, I will let that go for now. I will wait for further action. But in the meantime, I do want to just amplify what Mr. Cleaver was getting at. When these folks are repeatedly found to have violated the law, it doesn't help our confidence in the SEC to have you regularly and routinely give them waivers from the bad actor legislation that we in Congress have passed.

I yield back, Mr. Chairman. Thank you.

Mr. HUIZENGA [presiding]. The gentleman's time has expired.

The chair recognizes the gentleman from Pennsylvania, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Chairman, I want to talk a little bit about the issue with the capital markets we have and the liquidity of them and depth. In your testimony, you state U.S. capital markets have long been the deepest, most dynamic, and most liquid in the world. I am wondering about the connection between depth and liquidity, particularly when we consider the decreasing number of public companies and fewer IPOs that we have been seeing. It was interesting, Representative Ellison showed a chart looking at delistings of public companies going back into the 1970's, and how the line went up and down with respect to mergers and acquisitions.

The mergers and acquisitions have been around a long time, and delisting has happened as a result of that. But what is new here is lack of new companies coming in. We have seen a similar dynamic going on in the community bank space with all the consolidations going on and very few charters coming on. I think the SEC has said it cost \$2.5 million to go public in ongoing costs of \$1.5 million for public companies. And you have talked about how fewer public companies are affecting Mr. and Mrs. 401(k).

Do fewer public companies mean a shallower market?

Mr. CLAYTON. Well, do they mean that the portfolio you can choose from is smaller?

Mr. ROTHFUS. Yes. So if you have—say you used to have 5,000 public companies, now it is 2,500. Fewer options for diversifying, concentration?

Mr. CLAYTON. Yes. Yes. And now, people are starting to look at this, academics, market participants, they are starting to look at if you have a shrinking number of companies and you have continuing need for investing for your retirement—are we—is that somehow having an effect on the marketplace that we should be concerned about? Now, that is sort of—

Mr. ROTHFUS. Well, it seems it might also have an effect on liquidity too.

Mr. CLAYTON. It does. It does.

Mr. ROTHFUS. Any time you shrink the number of purchasers or the number of sellers, I think it is going to impact liquidity. Would you agree with that?

Mr. CLAYTON. Yes. I—one of—I outlined in my four priorities, one of them was market integrity, including structure and risk. This is one of the things that I think I need to better understand, we need to better understand, is how our market's changing and is it having an effect on liquidity.

Mr. ROTHFUS. The chairman started off the question about the fewer IPOs. I think you responded, one of the problems has been one-size-fits-all regulations, and you spoke favorably of scalability. You also mentioned the funding options that weren't there decades ago that are now there as options.

And I wonder if it would be of benefit for the SEC to take a look at some of the regulations we have had over the 20 years. In a July 12 speech, you said: The Commission should review its rules retrospectively. We should listen to investors and others about where rules are or are not functioning as intended. We cannot be shy about being introspective and self-critical.

Can you explain how you plan for the SEC to retrospectively review regulations it promulgates as well as regulations that are already on the books to ensure that they are still effective? Take a look at Sarbox, take a look at the capital formation provisions within Dodd-Frank and ask are the costs outweighing the benefits of what these were intending? Can you shed a little light on that?

Mr. CLAYTON. Well, I think the FAST Act and what you will see from our proposal is that kind of thinking. Are there ways to make it much—hopefully, much less expensive or burdensome to provide material information, without in any way diminishing investor protection? Yes, we should be looking across the spectrum of our rules. And what I said in that speech is the effects our rules have—because sometimes we make a rule and we think it is going to cost X to implement it and, lo and behold, it is three X.

Mr. ROTHFUS. Right.

Mr. CLAYTON. And those are the particular circumstances where we should be looking, because we made some assumptions, we did it in a reasonable way, but it turns out, looking forward, it costs more money, and we need to think about that. The numbers you cited on the costs of IPOs, to be perfectly honest, I think they are light.

Mr. ROTHFUS. OK. The FASB issued their final current expected credit loss, or CECL, standard rule in June 2016. This rule would change longstanding accounting rules by requiring financial institutions to reserve for the expected life of loan credit loss when the loan is first issued.

Do you plan for the SEC to conduct its own review of this rule with you as chairman?

Mr. CLAYTON. So I understand some of the concerns, particularly from what I will say is our regional and community banks around the CECL rule and the potential impact on capital. I know that they are talking to the banking regulators about that, but I am mindful of keeping an eye on where this—where the practical results of this accounting change—

Mr. ROTHFUS. Thank you, Chair. I yield back.

Mr. HUIZENGA. The gentleman's time has expired.

The chair recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Now, Mr. Chairman, first a couple of accounting issues to find that those are scintillating and draw much more attention to the committee in this video.

First, for over 100 years, accountants have defined and audited income and expense, but investors care about other numbers: same store sales, backlog. And I hope that you would lead the SEC in moving toward a situation where either your designee, the Financial Accounting Standards Board, or the SEC itself, defines the terms that are important to investors in various industries and requires that they be audited. Right now, I am investing based on same store sales, but Nordstrom has one definition, Target has another, and I don't trust either's numbers because neither one is audited.

Research and development by private companies is what we expect to lead the 21st century. We in Congress spend tens of billions of dollars to encourage it. The FASB, using the power you have given them, requires the immediate writeoff of all research, even successful. That is a contradiction of accounting theory, but it is easier for accountants. They have done it that way for 30 years. They did it the other way for 150 years. And I would hope that you would take a look at the extreme harm done to our economy, and look at all the research that isn't being done and the inventions that are not being developed because of that unwarranted departure from accounting theory.

As we were talking about bond rating agencies, as long as the bond rating agency gets selected by the issuer, we are going to have a situation where they are willing to give triple A to alt A, which is exactly what caused the meltdown. An asset manager, a bond manager who fails to buy double A and triple A rated securities just because they are a bunch of liars, loans, or subprime mortgages will find that that person is replaced by someone who is willing to go for the high rating.

We have talked here about cybersecurity, and Mr. Davidson from Ohio and I are working on a bill to direct both the SEC and FINRA to develop and implement risk controls to safeguard market data and to direct the CAT contractor to develop risk controls to protect CAT data, that is a consolidated audit control, and to prevent that operator from accepting data until it develops the risk controls. And I hope, for the record, that you would respond to those concepts.

I now want to shift toward an interesting issue, and that is rule 30e-3. The folks—the only folks really in the financial services in-

dustry that can't provide information electronically are the mutual funds. And the amount of wasted paper is so great that the pulp and paper manufacturers are lobbying against the efforts. On behalf of over 2 million trees a year, I would hope that you would move forward. And this rule was first introduced in 2015. It will allow mutual fund companies to send annual reports to investors electronically. Of course, investors would still have the option of receiving paper statements.

And I want to point out how much more useful the electronic statement is. I get these paper statements. I put them under something and then the magazines pile on top. I can never find them if, God forbid, I ever wanted to look at them. And since I may not be able to understand them and I want to send them to somebody who does understand them, but I never find them, I never put it in an envelope, and I never mail it anywhere. If you send it electronically, then all I have to do is look under—search my email for emails from info@vanguard.com, I can have it any time I want it and forward it to anybody I want. So electronic is better. It will save investors \$2 billion over 10 years.

And I wonder if you could let us know when we can expect this 2015 project to be completed. If you could answer that one.

Mr. CLAYTON. I got them all. Should I go with that one?

Mr. SHERMAN. Go with that one.

Mr. CLAYTON. We are working on the rule. You make a number of valid points. There are some valid points in terms of people who want paper, but we are not just putting this in the drawer, we are going to look at it.

Mr. SHERMAN. 2015.

Chairman HENSARLING [presiding]. The time of the gentleman has expired.

The chair now recognizes the gentleman from Texas, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

And thank you, Chairman, for being here today. And I am a small business owner, 45 years in Texas. We share some friends, and it is good to have you here today. And I don't have to tell you, and we have talked about how burdensome regulations have just been hampering small business creation and—to stay in business. And I appreciate your involvement in that.

Let me go to Dodd-Frank. The SEC, in the past year, has improperly utilized its resources, attempting to create overbearing rulemakings which do not advance the SEC statutory goals, nor do they help avoid other financial crisis. So in light of the previous administration's improper use of SEC resources, what steps have you taken, since you were sworn in in May, to focus SEC resources on the stated goal of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation?

Mr. CLAYTON. So to go to specific steps taken. Let me talk about the things that in looking at what we do, I have said, there is an area where we need to either do better or focus. And we have spent a lot of time talking about cybersecurity. I have talked a little bit about it and I want to go back to it: retail fraud. That is an area that I am surprised and dismayed at how much retail, just affinity fraud there is—and that is an area where I think we—that is an

area where we make an impact when we devote more resources, not only in terms of finding it and punishing the people that are committing it, but thinking creatively about ways we can structure what we do to make it harder to commit a fraud, particularly ones that affect our retail investors.

In terms of efficiency and capital formation, we looked across the spectrum and said, what can we do quickly that is not going to impact investor protection, that is going to make a difference? Confidential filings, eliminating the requirement for financial statements that are extraneous. We have done a number of things like that. I think they are making a difference.

More generally, I am focused on scaling our approach across the capital markets and across capital formation to reflect the size and type of investment that people are making. We have that going on, we have it going on in a kind of patchwork way. And I want to bring a little more systemization to that that will hopefully foster capital formation. So those are some thoughts.

Mr. WILLIAMS. Thank you. I noticed in your budget request you asked for an additional \$245 million to assist in the procurement of a headquarters lease. What steps have you taken to ensure that taxpayer funds used for any relocation are properly used for that?

Mr. CLAYTON. So we are having the GSA run this process effectively. That is what is happening. And their process is a procurement process that has bidding procedures and competition. And the reason for the 245 is to enable us to effectively set up a competitive process so—let me put it in business terms. We need that money so that one party doesn't think we are captive and that we could have a competitive process across a bunch of different headquarters locations. That is why we need it.

Mr. WILLIAMS. What is the Commission doing to lower the monetary burdens? We have talked a little bit about that associated with going public. And how can we encourage more businesses to go public? And as you talked about, one size doesn't fit all, we know that. So how do we encourage more people to go public?

Mr. CLAYTON. So I think we have started with our confidential submission FAQs. People were worried about the public offering process and that they would have to very early on make public their financials, their business, et cetera. We have delayed that, while still enabling investors to have a long time with that information. Like I have said, I do believe the JOBS Act and saying, "You don't have to do 404(b) until you are a big enough company to warrant that." Those types of measures are helping. We are looking at additional measures of that type to reduce the—look, in annual spend to be public of \$2 million versus an annual spend of \$4 million, that \$2 million delta, that is real money in terms of valuation.

Mr. WILLIAMS. Well, thank you.

I yield my time back, Mr. Chairman. Thank you for being here.

Chairman HENSARLING. The gentleman yields back.

The chair now recognizes the gentlelady from Wisconsin, Ms. Moore, ranking member of our Monetary Policy and Trade Subcommittee.

Ms. MOORE. Thank you so much, Mr. Chairman.

And before I begin my questioning, I was wondering if I could put a couple of letters in the record. I ask unanimous consent to put a letter in the record from the Government Finance Officers Association.

Chairman HENSARLING. Without objection.

Ms. MOORE. OK. And also I would like to put a letter in the record that we sent to the Honorable Walter J. Clayton, II, the Ranking Member Maxine Waters and I, regarding section 1502.

Chairman HENSARLING. Without objection.

Ms. MOORE. Thank you so much.

Thank you for appearing, sir. It is very nice to meet you, and I hope that we will have a very fruitful relationship.

Let me just start out with asking you about a piece of legislation that Representative Rothfus and I are planning to reintroduce regarding the money market mutual funds where the SEC has moved it from a stable to a floating net asset value and imposed liquidity fees and redemption gates on investors of these funds.

As you may know, that our municipalities in many governmental agencies invested in these money market funds, and they have to be stable to protect public funds. And changing the main feature of these funds to floating net assets really meant that cities are forced to go to more expensive investments. And without going on and on, because you know this topic, at a time when our country needs to invest in infrastructure, it is really difficult for cities to do this, make payroll, and we are hoping that this is something you will look at.

Mr. CLAYTON. Thank you, and we are looking at the effects of that rulemaking.

Ms. MOORE. All right. Thank you so much. I was really happy to hear—I have been here a long time, so I was able to hear much of your testimony and able to hear you say very declaratively that materiality is the touchstone for investors and consumers, respectively. You were talking about cybersecurity with Mr. Royce, I believe. But I do think that that has some applicability to section 1502 of the SEC with regard to conflict minerals.

As you know, the acting chair of the Commission and now only a commissioner, Mr. Piwowar, concluded that the court's judgment in April held that—he concluded that they weren't going to enforce the provisions under 1502, although the court only said that the descriptor requirement was inappropriate. And so you say that you are looking at this, and I am hoping that you are going to be informed by your commitment that you have made here today to be very, very proactive on enforcement.

Mr. CLAYTON. Yes. We are looking, and I am engaged with our Division of Corporation Finance and our General Counsel's office. It is not every day that we get a rule that—

Ms. MOORE. But I think it was a misinterpretation of that rule on Mr. Piwowar's part, particularly since you said materiality. Materiality is important to investors, whether they are investing in these conflict minerals, and also to consumers. We see our cell phones here. Nobody wants a cell phone that was financed by rape, murder, mutilation. Would you agree? That is immaterial.

Mr. CLAYTON. The way you characterize it, I agree that I don't want that kind of cell phone as a consumer of cell phones. I want—look, the rules are on the books, it is a mandate.

Ms. MOORE. Thank you.

Mr. CLAYTON. I want to make sure that—I want to make sure that we do it in the right way.

Ms. MOORE. OK. Thank you. You told the Senate—I have 30 seconds left—you told the Senate, on the 26th of September, that Mr. Piwowar's action to prevent staff, 20 senior enforcement officials, to no longer be able to issue subpoenas in the wake of the Bernie Madoff scandal, was not affecting your ability to do enforcement actions. Do you still think that that is the case?

Mr. CLAYTON. I made that statement based on a detailed assessment with the heads of the Division of Enforcement. The heads of the Division of Enforcement feel that them having the subpoena power—the formal authority, it is not with me, it is with them, it is delegated to them—they feel good about where it is now. And I know them. I know that if they change their minds, they are going to tell me.

Ms. MOORE. Thank you for your indulgence, Mr. Chairman.

Chairman HENSARLING. The time of the gentlelady has expired. The chair now recognizes the gentleman from Maine, Mr. Poliquin.

Mr. POLIQUIN. Thank you, Mr. Chairman, very much. I appreciate you holding this hearing.

Mr. Clayton, right over here. And thank you very much for being here, sir. I know you have an affection for the great State of Maine, and I appreciate that. Your kids and your wife will thank you forever if you vacation up there. This is a great time to go up there, Mr. Clayton, we need the business.

Now, I wish Mr. Sherman were here. He is a great guy, but he represents Los Angeles. Now, if you have been to Los Angeles, you know there is a lot of cement and glass and wires over there. I represent rural Maine. We have two population centers, Mr. Clayton, one we call LA, but it is Lewiston Auburn, with 35,000 people. Then we have Bangor with 35,000 people. And in between, which is about an 8-hour drive from point to point, not Lewiston Auburn to Bangor, but beyond that, we have moose and deer and all kinds of critters running around the roads, and we have 400 small towns. And many of those small towns, Mr. Clayton, don't have broadband.

Now, the great thing about trees that Mr. Sherman is concerned about is cutting them down. Well, you cut them down, they grow back. It is one of God's great creations. We cut down those trees, sir, and we turn it into paper. In full disclosure, Mr. Clayton, in northern Maine, the northernmost part of our State, the northernmost part of our country is Madawaska, Maine. We have the Twin Rivers Paper Company, the best paper makers in the world. 525 jobs, and there aren't many other opportunities up there, at least in this industry. 525 jobs, and they make a very thin, fine paper that mutual fund and other financial reports are printed on.

Now, I disagree with Mr. Sherman. He is a good guy, but I disagree with him. Here is why: We have 40 million people in this country that live in rural America, 40 million. Forty-one percent of

our seniors in this country, Mr. Clayton, do not have broadband access. So over in L.A., California, they might be able to print out or take a look at a mutual fund report on the internet; we don't have that in many parts of Maine. And we get power outages throughout the year, not just in the winter during the ice storms.

Now, your job, with all due respect, sir, and the job of the SEC, is to make sure that our small investors are able to care for themselves. So if you are a grandparent or a parent and you want to take care of your kids going to college and you are saving for them or you are a mechanic in Lewiston, Maine, and you are getting ready for your golden years and you have a retirement nest egg, you need to know what the heck you are investing in. I don't worry about the big guys in L.A., California. I worry about the folks in rural America. By the way, Maine is also the oldest average State in the country. It is not Florida, it is not Arizona. It is Maine.

My mom is 89, I love her to death. She can't use a cell phone. Having her trying to find out what her mutual fund holdings are—are you kidding me? So you have in front of you, sir, rule 30e-3. And it simply says that we think it is OK that these mutual fund companies send out a letter to our seniors saying you are no longer going to get your mutual fund reports and other financial reports on paper. Now, 71 percent of our seniors want it on paper. And this is one of the SEC's own commission studies.

All we are saying is what if they are on vacation? What if it got lost in a snowbank? What if that notice came while they were moving or they were on vacation? That is not fair, sir, and that is not right. All I am saying is when you have all these millennials and these Gen X folks, and they understand how all this works, and over the years more and more of rural America is going to be connected with broadband. This problem is going to go away, but it is not going away now.

You have a responsibility, with all due respect, sir, not only to me, but to 40 million people that live in rural America, many of whom are seniors, many of whom don't have broadband connection. Please, Mr. Clayton, please withdraw this rule. It is harmful to our seniors, it is harmful to our small investors, and over time, it is going to go away, and leave it the way it is now. If you don't want your financial reports on paper, then send in the form. That is an opt-out. Don't make it so complicated that you have to do something you might not be able to do. Just let it go. So I implore you to do that in my final 41 seconds, sir. By the way, can I get a commitment from you that you will withdraw this rule?

Mr. CLAYTON. No, I can't make policies sitting right here.

Mr. POLIQUIN. OK. That to me, sir, in Congress-speak, is you are a lean yes. OK.

And do you have any plans over the next 6 to 9 months to do anything crazy with this rule?

Mr. CLAYTON. I don't have any plans to do anything crazy.

Mr. POLIQUIN. Well said, sir. I am going to take that as you will take this under great advisement. You have seen all the comments when it comes to this, how important this is to the small investors that you are responsible to protect, sir. And I appreciate that very much.

Sir, SEC rule 14a-8 that deals with the shareholder proposal process. Are you folks looking at that?

Mr. CLAYTON. Yes.

Mr. POLIQUIN. You are. And do you think that it makes sense to change the ownership threshold or the holding period?

Mr. CLAYTON. I am taking a holistic look at it.

Mr. POLIQUIN. What does that mean?

Chairman HENSARLING. It means the time of the gentleman from Maine has expired.

Mr. POLIQUIN. Thank you, Mr. Chairman. Thank you, Mr. Clayton, very much.

Chairman HENSARLING. The chair now recognizes the gentleman from Connecticut, Mr. Himes.

Mr. HIMES. Thank you, Mr. Chairman.

And welcome, Chairman. It is great to see you again, and I assure you this committee is not usually this much fun. It is really heartwarming for me to see somebody of your caliber and experience in the role that you are now occupying.

And I want to touch on just three things with you this morning. First, I don't want to beat a dead horse, but I do want to add my voice to the concern that you have heard today that has been raised by any number of my constituents and organizations in my district about the risks associated with the online transmission of data to the SEC. And you have heard that a lot today, so I don't want to beat that dead horse, but I do want to add my voice to that and ask that that become a real priority, and that issuers come to feel confidence where I don't think they do now.

Second, I want to touch on just two issues that have been important to me for a long time. And to give you a little bit of context here, I have taken more than my fair share of lumps on this committee because I really do believe that regulation is not something that should be primarily discussed as though it were religious writ, but that there is a good balance to be found, and that sometimes regulation leans too heavily and sometimes it leans too light.

One thing I do feel very strongly about is that there are areas in which I think there are systemic issues and possibly bad behavior. And one of those areas, it will not surprise you to know, is a project I have been working on for some time to look at the remarkable consistency of 7 percent growth spreads in smaller and medium-size IPOs. This grew out of my experience with the JOBS Act, where we worked really hard to try to save new issuers money, a 7 percent growth spread on a \$200 million IPO is \$14 million; that is real money.

I don't want to spend too much time on this because I do have another issue, but your predecessor, when I asked about this and I pointed to academic literature that suggested that there could be collusive behavior in this particular product, I got back a letter that was not entirely satisfying. It said that academic studies have yielded mixed conclusions about the efficiency of the market. I am not sure that is true, and held up the JOBS Act as something that should be watched before we draw any conclusions.

I looked up the data. There have been hundreds and hundreds of IPOs of the size I am talking about since the JOBS Act came into force. Remarkably, the mean IPO growth spread was exactly

7 percent. The data is suggestive, and I am not ready to convict, but I am ready to suggest that there is probable cause for an investigation here.

I will also add that as you have been, I have been in the room where it happened. And so I would love to see the SEC take this up in a serious way, because it is important for our issuers not only to save money, but to have confidence that market dynamics are applying.

Let me give you a second to respond to that, but I do have one other question I want to raise to you.

Mr. CLAYTON. I think it is worth looking at. And I think the way you framed it shows some thought, because it is probably a—if there is something that we should look at here, it is in the market segment; it is not at the top end of the market where there is negotiating power.

Mr. HIMES. Yes, I agree with that. Thank you. I would appreciate that. I will follow up on that with you.

Look, if the facts show that that is a competitive market, I will let this go. But I don't know of any other product or service that is so consistently priced in a purportedly competitive market.

The other topic, Mr. Chairman, I wanted to raise with you, a couple of Congresses now I have submitted or dropped legislation that would clearly make insider trading a crime. You know the background here better than I do. But I am a big believer that if we are going to convict and send people to jail for a crime, that Congress ought to establish exactly what the law is that is being violated.

That, of course, is not true in the realm of insider trading. Of course, that has led to something else that I think is suboptimal, which is decisions, particularly out of the second circuit, which have resulted in significant numbers of convictions being overturned. To me, that is no way to run a railroad. And I have dealt with this with your predecessor. I get that we have a long tradition of prosecutions here based largely on judicially established law. I was a little disheartened, I guess, to see your quote that you think we do a pretty good job here and you are not sure that legislation is needed. Again, I am a big believer that if we are going to spend people to jail, we ought to have a law that specifies very clearly what they are going to jail for.

So I am wondering if you are open to that notion and whether you are open to the idea that this Congress ought to, actually for the first time, be very clear in statute about what insider trading is.

Mr. CLAYTON. So on where we stand and what I said NYU, I am comfortable that we can do a good job. As far as your question about engaging on it, a concern of mine is that we will run over kind of the same facts and circumstances question in a statutory approach that we do in what I call a judge-made approach. But I am very happy to engage on it. It is an area where I have spent a lot of time, and any time you would like, I would love to talk about it.

Mr. HIMES. Thank you. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Minnesota, Mr. Emmer.

Mr. EMMER. Thank you, Mr. Chair.

Chairman Clayton, thank you for being here today. You might hear this from others, but in the short time that I have been in Congress, I appreciate your style. This is—coming before this committee and being more informational as opposed to adversarial is incredibly refreshing.

I loved your comments this morning when you started, talking about the four things that you are concentrating on. I loved the reference to the one-size-fits-all regulatory regime and how that might be having an impact on companies going public, because it applies the same whether you are big or you are small.

In your statement that we need more companies in the public market so that Main Street investors, those that are saving for retirement, those that my colleague Bruce Poliquin was so concerned about a second ago, can participate, and I added, and realize the reward of growth in America. If that is our goal, that is—we need to achieve it.

I am going to be very simplistic in terms of concentrating on one thing, the CHOICE Act—actually, last year, we passed something out of the this committee called the Main Street Growth Act, and part of it was contemplated within the CHOICE Act that just passed through this committee and out of the House. It contemplated the creation of venture exchanges.

Mr. CLAYTON. Uh-huh.

Mr. EMMER. To improve market quality for smaller companies and their investors. I am just wondering, if this is something that you are interested in—that your SEC will be looking into?

Mr. CLAYTON. So thank you for your comments, I appreciate it. Thanks for the comments on a larger portfolio of public companies. I'm just sorry to take your time, but I want to be clear.

I am not interested in people being able to invest in IPOs. I mean that is nice, it is good. I am interested in them having more companies to invest in.

Mr. EMMER. Choice.

Mr. CLAYTON. Choice.

Mr. EMMER. It is about choice.

Mr. CLAYTON. Choice, and a broader spectrum.

To your question about venture exchanges, yes. Now, I am not—I haven't consulted with Commissioner Stein or Commissioner Piwowar about what a—so I don't want to get ahead of them, but from my perspective, having—and we—this is coming at us organically as well as from a regulatory perspective.

Mr. EMMER. Right.

Mr. CLAYTON. The technology people are using for initial coin offerings is the same kind of technology that you would use to set up a venture exchange. And then the question is what rules do you put around it so that you can have a level of investor protection that we are comfortable with but facilitates the same type of capital formation we are seeing in kind of that small space?

So that is a long—sorry for the long-winded answer, but that is how I am looking at it, and I think it is something we should look at.

Mr. EMMER. Since you have given it some thought, do you have any idea what the SEC could do to allow private entities to create a venture exchange, or is it just too premature at this point?

Mr. CLAYTON. Going back to my comment about coming out organically, I am sure there are a lot of smart folks who operate in the marketplace who are already thinking about this are hearing our colloquy today. They know what I care about. They know that I care that this works and investors get the information they need. They can look across the way we do private offerings today and see the kind of protection that people get, apply that to a venture exchange, and then we have something to talk about.

Mr. EMMER. Right. Actually, your comment earlier today is probably the—it is one that doesn't require a master's degree. It is more common sense, and that is that money will go to where it can realize its highest return in the most efficient manner. I guess I listened to you today in talking about this very narrow issue, which you could start talking about a whole bunch of these issues when it comes to capital formation. I worry the government is going to make itself less than relevant, because the smart people that are out there, the people that have the capital are going to figure out how to operate if government doesn't start doing what it is supposed to do.

So I guess with the little time I have left, the thinking that you have done in this area and maybe any other that would be similar, is there any additional statutory authority that the SEC needs from this committee and from Congress?

Mr. CLAYTON. You guys have been great today because you have asked me that in a bunch of different contexts. In terms of a venture exchange, if we do we will be back here. Let me take you up on it, but not try to be specific today.

Can I go to just one related area on that?

Mr. EMMER. Sure, although my time is running out.

Mr. CLAYTON. We have talked a little bit about the cyber breach and the bad actors. Another area I am thinking about, and it is a DOJ issue, it is a Treasury issue, it is a national security issue, is do we have the tools to get at the bad guys or cyber breaches? So—

Mr. EMMER. Yes. Thank you very much.

Chairman HENSARLING. The time of the gentleman has expired. The chair recognizes the gentleman from Maryland, Mr. Delaney.

Mr. DELANEY. Thank you, Mr. Chairman.

And thank you, Chairman Clayton, for being here all this time. You obviously have superb credentials for the job that you now have, and we are grateful for that.

You said something recently to my colleague just a couple minutes ago about how you really care about making sure investors get the information that they need. Mark Carney, the Governor of the Bank of England, has spoken extensively about his view that investors aren't getting enough information about climate risks, specifically valuation variability around fossil fuel related assets on the balance sheet of companies.

Prior to coming to Congress, I started two companies and took them public. And I used to labor over the risk factors, because I viewed that as the place that I could get in trouble. And so I guess my question to you is, do you think there is enough disclosure in

this area? Because it is not so much of whether what is occurring with climate change will actually have immediate effect on the balance sheets of these companies, but it seems to me the question, almost like the mortgage market when mortgage assets went down in value very rapidly way before defaults went up a lot. But what happened, there was a perception that defaults would go up a lot, and then the assets went down materially in value. And that could happen with fossil fuel assets, which is even before the effects actually hit the income statements and the balance sheets of these companies, people could say, we really have to get out of these assets, and they could fall rapidly and it could affect the insurance industry, financial service companies, energy companies obviously.

Do you have a view as to whether we have enough disclosure in that area?

Mr. CLAYTON. Do I have a specific view on a specific company about whether we have enough disclosure in the area? It is hard for me to judge—

Mr. DELANEY. Not specific company, but companies in general. Do you think there is enough information in the filing statements of companies for investors to allocate capital appropriately based on—

Mr. CLAYTON. I think you framed the question in a very fair way. And you won't like it, but I will answer it with a question that I don't know the answer to, which is when the companies you are thinking of in your mind manage their business and they think about these potential impacts, which as good stewards of capital they should be, does their disclosure reflect that?

Mr. DELANEY. Reflect that. Do you think it does?

Mr. CLAYTON. I don't know what is in their minds, but that is the right question.

Mr. DELANEY. Yes. And I would think that somewhere in your organization people should be figuring that out, because when you think about macro risks, this is clearly one of them, when you think of the size of the assets.

Mr. CLAYTON. And I think that applies to different businesses in different ways.

Mr. DELANEY. It cuts across all industries, right?

Mr. CLAYTON. And I agree with you.

Mr. DELANEY. Are you committed to looking at that issue?

Mr. CLAYTON. Yes.

Mr. DELANEY. OK. Good.

Mr. CLAYTON. That is—one of the things that everybody still says, how do you feel about regulation, if disclosure—what disclosure really should do at the—

Mr. DELANEY. This is not even about new regulation. This is about just enforcing the standard that you just described. If it is material to you, it should be material to investors.

Mr. CLAYTON. Exactly. One of the things I always ask myself in any industry is how do they manage the business?

Mr. DELANEY. Right.

Mr. CLAYTON. How do they look at that? And does the disclosure reflect how they manage the business?

Mr. DELANEY. That is right. And you ask a lot of companies those questions when you are in your other seat.

So two quick questions. A fiduciary role, I know you want it synchronized, right? I agree, right answer, but do you support the rule the way it is? Do you think it is a smart rule?

Mr. CLAYTON. It is not really clear what the rule is yet, because what a rule is is how it is implemented and how you demonstrate compliance.

Mr. DELANEY. Right.

Mr. CLAYTON. That is what this kind of rule is.

Mr. DELANEY. So are you more concerned that it is—are you more concerned about the rule or you generally think it will get implemented well?

Mr. CLAYTON. I like the words.

Mr. DELANEY. Right. OK.

Mr. CLAYTON. No conflicts. Disclose the conflicts. You owe somebody a duty, they should know what it is. The question is, are we going to implement it in a way that adversely restricts choice in terms of what type of relationship you have or adversely restricts what type of assets you can invest in?

Mr. DELANEY. And the tradeoff, I guess, is it could encourage a lot of innovation, right? Because as you know, people are sitting in conference rooms right now thinking of companies they can start to take advantage of the rule, which might be good.

Mr. CLAYTON. It might be good.

Mr. DELANEY. Last question real quickly. We submitted a letter to you about the EDGAR filing. It was signed by 21 of my colleagues.

I ask the chairman to submit this for the record.

Chairman HENSARLING. Without objection.

Mr. DELANEY. I assume you will be getting back to us about this?

Mr. CLAYTON. I actually have it here.

Mr. DELANEY. Good. Wow. The mail system still works.

Mr. CLAYTON. And the questions you asked are the same questions I am asking.

Mr. DELANEY. So what really happened here? Was it that between when companies file their forms and they became public, was there a breach in that short period of time that people were able to capitalize on?

Mr. CLAYTON. So as far as—take this as things aren't—it is an ongoing investigation.

Mr. DELANEY. Yes.

Mr. CLAYTON. But as an example, we have a test filing system in our EDGAR system, so you are going to file your earnings release.

Mr. DELANEY. Yes.

Mr. CLAYTON. You test it the night before.

Mr. DELANEY. Yes, I remember that.

Mr. CLAYTON. People happen to include.

Mr. DELANEY. And so that is where they got it, and so that is where they traded. Do you think it is big or small, the amount of money that was made on that information?

Mr. CLAYTON. I don't know.

Mr. DELANEY. You don't know. Great.

The CHAIRMAN. The time of the gentleman has expired.

The chair now recognizes the gentlelady from Utah, Mrs. Love.

Mrs. LOVE. Thank you so much. I know it has been a long day. I appreciate you being here.

Chairman Clayton, I would like to come back to an issue just of access to capital. The number of companies accessing the capital markets for financing that are going public in recent years have been less than half the average annual number posted in 1990.

Most alarming has been the drop-off in small companies going public. Less than 20 percent of initial public offerings in recent years have been valued at \$50 million or less. By stark contrast, 80 percent of all IPOs in the United States between the years of 1991 and 1997 were valued at less than \$50 million.

The reason for this—the reason why this is so concerning is that small companies account disproportionately for net new job—for new job creation, according to the National Venture Capital Association. Ninety percent of job creation by new companies occur after they go public.

So my question is this: As you know, some experts have attributed the marked decline in small companies going public to the decimalization of stock prices, dropping minimum pricing increments by which stocks are traded, or the tick size from one-sixteenth of a dollar or 6.3 cents to one penny, which occurred in April 2001.

So I know that there are a variety of options regarding this issue. Last year, the SEC launched a pilot program to address this issue or a program to restore wider tick size pricing to small capitalization stocks. I know you have been there since May, but how is that program going so far?

Mr. CLAYTON. I have talked to our economists about this. So far, the results are mixed. They believe we need to let it run a little bit longer to be comfortable that the data they are getting is actually something we can put value on.

Mrs. LOVE. Have you been able to draw any initial conclusions at all regarding the effectiveness of wider tick sizes to the revitalization of the small-cap IPOs?

Mr. CLAYTON. Yes. Let's put it this way: The behavior in the marketplace takes a while to change. So if what you are looking to do is drive more volume in these names, people trade more, it is mixed. There are some places where we are seeing some increased volume, some increased liquidity, and other cases where we are not. I think we need to let it run a little bit more.

Mrs. LOVE. OK. Given your extensive background in this field, does the reduction in tick sizes have anything to do, in your opinion, with the drop-off in IPOs under 100 million?

Mr. CLAYTON. I think it could be a factor. In order for a company to—for it to be attractive for a company to go public, you have to have demand in trading. And one of the things that bankers will tell you, I go to a banker and I say, hey, should I go public? They say, you may not be of sufficient size for the market to be interested enough in your stock for there to develop a trading market where you are going to have pricing that you are happy with.

Mrs. LOVE. So you don't think it is important for companies to go public earlier?

Mr. CLAYTON. No, I do. That is a long-winded way of saying that if we can get more volume in trading in small-and medium-size companies, it would be more attractive to go public.

Mrs. LOVE. Is there anything that you would add to this pilot program? Do you think it is sufficient enough to give you the answers that you need in the long term? I mean I am just—

Mr. CLAYTON. I am hoping that that program, together with the access fee pilot, will give us some information. And I have some expectation. There are people who are much more expert at this than I am, that the way we trade large-cap stocks is not the way we should trade small-cap stocks if we want to attract more capital. So the answer is I think it is going to have value, but there are a lot of factors that go into whether we are doing the right thing in the small and mid-cap market.

Mrs. LOVE. I think you will agree with me that we want to have wealth-creating vehicles—

Mr. CLAYTON. Yes.

Mrs. LOVE. —For the public to participate in phenomenal growth potential of the American economy. I hope that you will continue studying this issue, because this is what makes the world go round. This is what helps hardworking Americans be able to get there. So I hope you will continue to work with that. We have to work faster.

Mr. CLAYTON. I agree with you.

Mrs. LOVE. Thank you.

The CHAIRMAN. The time of the gentlelady has expired.

The chair now recognizes the gentleman from North Carolina, Mr. Budd.

Mr. BUDD. Thank you, Mr. Chairman.

Chairman Clayton, thank you again for being here. So you testified about some of the administrative actions the SEC has undertaken to improve capital formation. And I want to highlight specifically the SEC's decision to expand confidential IPO registration and the submission process to all issuers, large and small.

So has the initial JOBS Act provision proven popular to emerging growth companies, and what have you seen since the July finalization of the SEC decision, in terms of large issuers taking advantage of the SEC decision expanding the confidential registration option?

Mr. CLAYTON. The initial data is positive. People—not just people using it, but people saying thank you, we intend to use it, and both from an IPO perspective but also from the perspective of the follow-on offerings that occur in the first year. So I think the response is positive.

And we are also monitoring on the investor protection side. If there are any adverse views, I would like to hear them. We haven't heard any.

Mr. BUDD. So of the positive result that you have observed or seen and heard, why do you think they have been successful or why do you think they have been positive, and have they achieved that success without compromising fundamental investor protections and transparency?

Mr. CLAYTON. Yes. I think this one was pretty straightforward. It has made it easier, but there is no change in the disclosure. And I think investors still have plenty of time, with the disclosure, to

make an investment decision. I haven't heard anybody say they don't have enough time.

Mr. BUDD. Sure. So do you believe that the collaborative process represented by confidential registrations has meaningfully reduced the risk associated with an IPO?

Mr. CLAYTON. I think it has reduced the risk to the company of the process. And I like the word you used. I think when companies go through the registration process and transform from a private company to a public company, they emerge as better companies. I think the staff review process and the accounting review makes them—I think it makes them better companies.

Mr. BUDD. That makes sense. Chairman Clayton, I also would like to talk about finders. Take the example if two Main Street businesses come together and one would like to raise money and they offer the other a finder's fee and that transaction works out and they actually raise capital, that the SEC has held for about 16 years that this transaction required that a business needs to register as a broker-dealer. That puts them in the same category as Merrill Lynch or J.P. Morgan, like a securities trader. It is an unworkable strategy, in my view.

So is it your view that the SEC could undertake some activity toward clarifying the significant regulatory uncertainty that exists right now with regard to finders, and what would that look like in your world?

Mr. CLAYTON. So this is a line-drawing question. And I know that this committee has explored this issue in the terms of an NMA finder. I think the question you ask is, should we look at that if somebody is doing this on an ad hoc basis, not as a business not in connection with a broad capital raising or account raising, but just—

Mr. BUDD. Maybe you can answer it for both, ad hoc as well.

Mr. CLAYTON. Yes. I fundamentally agree that if someone is not in the business of doing this type of activity and it is clear that they are not and you have kind of big guys involved or sophisticated people, they don't seem like a broker-dealer to me. OK? But I don't want to go too far down the slippery slope, because when you start going out to five or six people and say, hey, how about investing in this, and by the way, I am taking 7 percent then you sound a lot like a broker to me.

Mr. BUDD. Do you think there will be some efforts from the SEC to clarify that?

Mr. CLAYTON. I think if somebody is worried—in the hypothetical you described, if somebody is worried that we are going to find them a broker-dealer, we probably need to address that.

Mr. BUDD. Certainly. I want to raise the issue of Financial Accounting Standards Board or the FASB current expected credit loss standard. Mr. Zeldin from New York and I are working on a letter right now that virtually every bank in my State views that standard as unworkable. It is onerous and it is hurtful to the availability of credit.

Is there a possibility that the SEC will study this rule at more length before going ahead with its implementation?

Mr. CLAYTON. I can't make that promise today. I understand these issues. I think most of it is a bank capital issue and whether

this is going to require them to hold more capital as a result of an accounting change. I know many of these banks are in dialog with their bank regulators about this. There is a pro-cyclicality to it. But I will look at it.

Mr. BUDD. Thank you.

The CHAIRMAN. The time of the gentleman has expired.

The chair wishes to alert members that votes will be called on the floor soon. If remaining members would voluntarily take 4 minutes, I think we can clear all members and not have to ask our witness back after votes.

The chair now recognizes the gentleman from Indiana, Mr. Hollingsworth, for 4 minutes.

Mr. HOLLINGSWORTH. I will take 4 minutes. Again, I want to add my welcome, especially as a UPenn alumnus as well. I appreciate you being here.

I wanted to cover three topics. Hopefully, I will get to all three. First, you have mentioned several times the desire to have more tailored regulation or regulatory environment for smaller businesses. And one of the things that you brought up was 404(b).

Certainly, one of the bills that I am looking at, dropping raises, the current threshold from \$75 million up to a higher threshold, I wonder what your opinion about that is and if you have come to a decision about what an appropriate threshold might be?

Mr. CLAYTON. I have not come to a decision about an appropriate threshold, but I do think examining that threshold from time to time, like we talk about—I am a believer in the JOBS Act.

Mr. HOLLINGSWORTH. Right.

Mr. CLAYTON. And when something is working, let's see if we can make it work more, being cognizant of not going too far.

Mr. HOLLINGSWORTH. Absolutely. Well, one of the things that people in my district are very concerned about is ensuring that we have capital there for businesses at every stage in their lifecycle. And certainly one of the big speed bumps is going public, and especially for smaller companies that are in need of the capital. They don't want to have these onerous requirements on them. Like you said, it makes a huge difference in valuation. So please continue to look at that.

The second thing I want to talk about was the Volcker Rule and just better understanding how the collaboration amongst different agencies that are charged with this will be carried out over the coming years. It took over 3 years to write the rule itself, and certainly as revisions come up or other changes may be necessary that can't be handled legislatively what the process looks like for both the enforcement changes to Volcker Rule, in terms of coordinating amongst the different agencies.

Mr. CLAYTON. Maybe I am too much of an optimist, but I am optimistic that the Fed, OCC, the SEC, the FDIC, that we can work together on this. I said I believe in retrospective review. This is a rule that has a lot of impact.

Mr. HOLLINGSWORTH. Yes, definitively.

Mr. CLAYTON. So the greater the impact—

Mr. HOLLINGSWORTH. Right.

Mr. CLAYTON. —Probably the more important it is to take a look. I want to be clear. The policy underlying the rule that you

shouldn't take depositors' money and speculate with depositors' money is a good one. The question of defining how—what is proprietary trading and what is not is one that is worthy of some reexamination, particularly some components of that. But—

Mr. HOLLINGSWORTH. Well, I might push back against the characterization that we are taking depositors' money and speculating wildly with it. And whether that actually transpired in a material way and whether that led to the crisis and whether the Volcker Rule really prevents that I think are all questions, as you said, that probably need some reexamination and some thoughtful research surrounding.

I wanted to delve into one other item that is a little bit more esoteric, but has been perturbing me for the last couple of weeks. And thinking about the significant growth in ETFs over recent history—and, look, I am a big believer in financial innovation, but I think when you say Mr. and Mrs. 401(k) and wherever they may be across this country, I think when they buy or sell an ETF, they perceive that they have great liquidity, while the proliferation of ETFs have led to some more exotic strategies underlying some of the ETFs themselves.

And my concern is, in periods of acute stress where money flow is reversed—instead of money flowing in, money is now flowing out in a significant way—that significant redemptions, and especially through the broker-dealers, might lead to challenges in unwinding whatever those strategies are, selling those underlying assets, and that there is a perceived mismatch between apparent liquidity at the retail investor side and actual liquidity in the underlying assets that underlie the trust. Is there any concern to look into that matter?

Mr. CLAYTON. Yes. I think you articulated a risk that is not as well understood as it should be.

Mr. HOLLINGSWORTH. Great. Well, thank you.

And with that, I yield back.

The CHAIRMAN. The time of the gentleman has expired.

The chair now recognizes the gentleman from Arkansas, Mr. Hill, for 4 minutes.

Mr. HILL. I thank the chairman.

I appreciate, Chairman Clayton, you coming to the committee today. And I want to echo my colleagues, we appreciate your tone and your discussion on these topics and your forbearance on all of them.

I want to pick up where my friend Mr. Hollingsworth left off on exchange-traded funds. I am pleased that we have sent a bill to President Trump to enhance research on exchange-traded funds. This was something that the Commission itself thought about doing back in 1987, and, by God, we have rushed right into it now and sent down to the President's desk a directive on writing those rules. If you have questions about it along the way, I hope you will be in touch after that bill is enacted.

But, like my friend said, there had been rapid growth. In fact, some projections show that exchange-traded funds may reach \$6 trillion. And you yourself a few minutes ago talked about the impact of passive money in the markets and price-setting.

For me, you have index funds, you have exchange-traded funds that are proposed on an index that is made up. In other words, someone has innovated an index. And then you have obviously fixed income versus equity. And this is really being, as Trey said, a major innovation in the markets.

The Commission has really just used exemptive relief on approving ETFs. Do you think the Commission should write a rule about exchange-traded funds and approving those under certain conditions instead of just using exemptive relief as a way to tee them up?

Mr. CLAYTON. Whether that is specifically what we should do or we should do something else, we should recognize—and this is a different context, but the same label—one size doesn't fit all. Like you said, an ETF that follows a broadly based or broadly recognized index of large-cap stocks is a much different animal from an inversed leveraged ETF that follows a specific, perhaps not all that liquid, asset class. I think we should have a—there can be a different approach to one versus the other.

Mr. HILL. Right. Well, I just would urge the Commission to look at this. We are now 15 years into this trend. And also when it comes to the pricing issue my friend raised, the impact out in the market reg world on circuit breakers geared to individual stock performance versus a macro move in an index and market opening times. In other words, the synchronization of individual stocks into participants in these indexes I think also merits study and something else to add to your, as Chair White referred to the 50 front burners over at the SEC.

If I could, I want to switch subjects in the minute left and talk about the definition of credit investing. We talked about crowdfunding today. We talked about the JOBS Act. But I have put forth legislation in the past and others are interested on, in the committee as well is expanding the definition of accredited investor, which does allow people with the proper expertise to participate in private market issue.

Do you think that the definition of accredited investor ought to be looked at and be reconsidered?

Mr. CLAYTON. I do.

Mr. HILL. Do you have thoughts as to—any more thoughts?

Mr. CLAYTON. What I don't like about it is the binary nature of it, which is you cross the threshold and then you can invest whatever you want. You don't cross the threshold, you have no options. I am not Pollyanna enough to think that we can have 10 different—

Mr. HILL. Parse that out, right.

Mr. CLAYTON. But it shouldn't be that binary, because if it is that binary then we do need to constrict it.

Mr. HILL. Thanks for your time today.

Mr. CLAYTON. Thank you.

Mr. HILL. I yield back.

The CHAIRMAN. The time of the gentleman has expired.

The chair now recognizes the gentlelady from New York, Ms. Tenney.

Ms. TENNEY. Thank you, Mr. Chairman.

And thank you, Chairman Clayton for being here today. I am going to echo the same sentiment that my colleague Mr. Emmer said. And I love your one-size-fits-all regulation leads to one size, and I think that goes beyond even the jurisdiction of this committee and obviously the agency you chair. It is in all sectors, as I come from one of the most regulated States in the Nation, New York.

But I just wanted to ask you a little bit about the DOL rule quickly. I know Chairwoman Wagner touched on it, but many of my constituents, especially the 401(k)-dependent constituents and the regular middle income level people, really rely on the relationship with brokers. And I understand there has been a delay for about 18 months, and I just wondered if you could just describe your relationship right now with the Department of Labor, with Chairman Acosta, and your efforts to revise and implement this rule so that it doesn't hurt our investor community and also protects seniors and others who rely on their 401(k). If you could just touch on your relationship and the delay that we are seeing right now.

Mr. CLAYTON. As I said, as I have said many times, I thank Secretary Acosta for reaching out on this, because it is a reality. We have to put our heads together. We at the Commission have been working on where we think this ought to go, citing the things that I outlined quickly: Choice, clarity, consistency, and cooperation.

We are at a point where we are ready to engage. And I look forward to engaging with the Department of Labor and Secretary Acosta's staff on this. They put a lot of thought into where they got to. We should benefit from that thought, but we need to drive toward a consistent approach to the marketplace.

Ms. TENNEY. So as you undergo that analysis, is that something that we can have in a transparent way and work with us on this as we go forward so we know what to expect and our investor world knows what is going to be happening?

Mr. CLAYTON. Yes. It is easy for me to say yes, because the Administrative Procedures Act requires me to do that. When we are ready to pull it forward, you guys will have a—there will be a lot of people taking a fair shot at this.

Ms. TENNEY. Thank you. I greatly appreciate it, and just thank you for your service and doing what you are doing. We are grateful to have you here for this long day, but I just wanted to say thanks again.

And I yield back, Mr. Chairman. Thank you so much.

The CHAIRMAN. The gentlelady yields back.

And since she does yield back, the gentleman from Ohio, Mr. Davidson, is recognized for 2 minutes.

Mr. DAVIDSON. Mr. Chairman, thank you.

Chairman Clayton, thank you for being here today, and thanks for the work you are doing to uncover the facts and the truth behind what has actually been happening there at the SEC. You have answered a lot of questions about cybersecurity, so I won't belabor points that you have really already made, but I was encouraged to hear the thoughtfulness that you are putting into what do we actually need to have.

And we are moving forward on a bill, as you know, that will provide additional instructions and give some intersection between the migration to Consolidated Audit Trail and the cybersecurity approach that you have been doing.

And I guess one question is, have you given thought to layers of data, so that instead of all of it being in the Consolidated Audit Trail, all of it being in EDGAR, some of the data not necessarily being held but accessible as part of that approach?

Mr. CLAYTON. I have given thought to it. The more important thing is that the people who know this better than I do give thought to it, but I have asked the same question that you asked and whether that is practical. There is some data that is mission critical for the SEC, and we need to get it, but having that kind of thoughtful approach is the way I am trying to do this.

Mr. DAVIDSON. Thank you. And then on the Consolidated Audit Trail, the net of the cybersecurity concerns, how do you feel the project is moving? Any concerns for the scope and the feasibility for Consolidated Audit Trail?

Mr. CLAYTON. The Consolidated Audit Trail, the genesis was the flash crash and our ability to get at what was happening in the marketplace around the time of an event like that. And we learned that the data was stored in a bunch of different places and it was hard to bring it together to do an analysis. I still want to be able to do that, and I want to be able to do that pretty quickly.

That is the question I am asking the SROs and the provider. So I think that is context to your question. I hope I got there.

Mr. DAVIDSON. It is intersecting interest. My time has expired. I yield back, Chairman.

Mr. CLAYTON. Thank you.

The CHAIRMAN. The time of the gentleman has expired.

I want to thank the witness for his testimony today.

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 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing stands adjourned.

[Whereupon, at 1:40 p.m., the committee was adjourned.]

A P P E N D I X

October 4, 2017

**Testimony on “Examining the SEC’s Agenda, Operations, and Budget”
by
Jay Clayton
Chairman, U.S. Securities and Exchange Commission**

**Before the
Committee on Financial Services
United States House of Representatives
October 4, 2017**

Chairman Hensarling, Ranking Member Waters, distinguished members of the Committee, thank you for the opportunity to testify before you today about the work of the U.S. Securities and Exchange Commission (SEC or Commission or agency).¹

It is an honor to testify before this Committee for the first time. Since joining the SEC, my experience has strongly reinforced my view that our talented and committed staff is fundamental to the agency’s effectiveness. The SEC’s mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation is deeply engrained throughout our offices and divisions. I also want to thank Commissioners Stein and Pivowar for their valuable counsel and guidance to me as well as for their unwavering commitment to the Commission.

With a workforce of about 4,600 staff in Washington and across our 11 regional offices, the SEC oversees, among other things (1) approximately \$72 trillion in securities trading annually on U.S. equity markets; (2) the disclosures of over 8,100 public companies, of which 4,300 are exchange listed; and (3) the activities of over 26,000 registered entities, including investment advisers, broker-dealers, transfer agents, securities exchanges, clearing agencies, mutual funds, exchange traded funds, the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB), among others. We also engage and interact with the investing public on a daily basis through a number of activities ranging from our investor education programs to alerts on our SEC.gov portal. Additionally, on a typical day, investors and other market participants view disclosure documents filed on our EDGAR system more than 50 million times.

In a July speech, I outlined the principles that should chart the course for the SEC moving forward. The principles reflect my interactions with the men and women of the Commission staff.

¹ The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the President, the full Commission, or any Commissioner.

These guiding principles are as follows:

- 1) The SEC's tripartite mission – protect investors, maintain fair, orderly and efficient markets and facilitate capital formation – is its touchstone;
- 2) Our analysis starts and ends with the long-term interests of the Main Street investor;
- 3) The SEC's historic approach to regulation is sound;
- 4) Regulatory actions drive change, and change can have lasting effects;
- 5) As markets evolve, so must the SEC;
- 6) Effective rulemaking does not end with rule adoption;
- 7) The costs of a rule now often include the cost of demonstrating compliance; and
- 8) Coordination is key.²

While I will not go into great detail on all of the principles here, I would like to highlight the second principle, which is particularly important to me – that our analysis starts and ends with the long-term interests of the Main Street investor; or as I call them, “Mr. and Ms. 401(k).” At a time when greater responsibility is shifting to Main Street investors to save for their own retirement, I am confident that this is the correct metric for our analysis of success in meeting our tripartite mission.³ If Mr. and Ms. 401(k) are able to invest in a better future, then the SEC is serving them and our markets well.

Cybersecurity

Cybersecurity is an area that is vitally important to the SEC, our markets and me personally. The prominence of this issue and the heightened focus the agency has on it is the result of various factors, including (1) the increased use of and dependence on data and electronic communications, (2) the greater complexity of technologies present in the financial marketplace and (3) the continually evolving threats from a variety of sources. Cybersecurity touches the daily lives of virtually all Americans, whether it is our accounts with financial services firms, the companies we invest in or the markets through which we trade.

² Remarks at the Economic Club of New York (July 12, 2017), *available at* <https://www.sec.gov/news/speech/remarks-economic-club-new-york>.

³ See Investment Company Institute, 2017 Investment Company Fact Book (2017), *available at* https://www.ici.org/pdf/2017_factbook.pdf (Defined contribution plans and IRAs comprised 59 percent of retirement assets at year-end 2016); see also Brookings Institute, Perspectives on Securities Regulation, Featuring a Conversation with U.S. Securities and Exchange Commission Chairman Jay Clayton (Sept. 28, 2017), *available at* <https://www.brookings.edu/events/perspectives-on-securities-regulation/>.

On September 20, I issued a press release and statement that (1) discussed the Commission's cybersecurity risk profile, (2) reviewed our approach to oversight and enforcement and (3) disclosed a 2016 intrusion that I recently discovered may have led to illicit trading.⁴

The press release and statement are part of an ongoing assessment of the SEC's cybersecurity risk profile and preparedness that I initiated upon joining the Commission in May. The initiative has various components, including the formation of a senior-level cybersecurity working group to coordinate information sharing, risk and threat monitoring, incident response and other cross-divisional and interagency efforts and an assessment of reporting and escalation procedures.

I will now discuss the 2016 intrusion. In August 2017, in connection with an ongoing investigation by our Division of Enforcement, I was notified of a possible 2016 intrusion into our EDGAR system. In response to this information, I immediately commenced an internal review. Through this review and the ongoing enforcement investigation, I was informed that the 2016 intrusion into the test filing component of our EDGAR system provided access to nonpublic EDGAR filing information and may have provided a basis for illicit gain through trading.

We believe the 2016 intrusion involved the exploitation of a defect in custom software in the EDGAR system. When it was originally discovered, the SEC Office of Information Technology (OIT) staff took steps to remediate the defect in custom software code and reported the incident to the Department of Homeland Security's United States Computer Emergency Readiness Team (US-CERT). Based on the investigation to date, OIT staff believes that the prior remediation effort was successful.

The first stage of our review and investigation of the 2016 intrusion consists of two related components. The first component focuses on the 2016 intrusion itself, including efforts to determine its scope and whether there were or are any related vulnerabilities in our EDGAR system. Various agency personnel, including members of the Division of Enforcement, the Office of the General Counsel and the Office of Inspector General (OIG) have been involved in this effort. The second component consists of our investigation into trading potentially related to the intrusion. This investigation is being conducted by our Division of Enforcement and is ongoing.

⁴ Press Release 2017-170, *SEC Chairman Clayton Issues Statement on Cybersecurity: Discloses the Commission's Cyber Risk Profile, Discusses Intrusions at the Commission, and Reviews the Commission's Approach to Oversight and Enforcement* (Sept. 20, 2017), available at <https://www.sec.gov/news/press-release/2017-170>; Statement on Cybersecurity (Sept. 20, 2017), available at <https://www.sec.gov/news/public-statement/statement-clayton-2017-09-20>.

Importantly, in conducting this type of review and related forensic analysis, it is a priority and a constraint to maintain the security and day to day operational capabilities of EDGAR, which is a critical component of our disclosure-based market system and accepts filings virtually continuously during the week.

In addition, I formally requested that the OIG begin a review into what led to the intrusion, the scope of nonpublic information compromised and our efforts in response. I specifically requested that the OIG provide recommendations for how the SEC should remediate any related system or control deficiencies.

There are limits on what I know and can discuss about the 2016 incident due to the status (ongoing and incomplete) and nature (enforcement) of our reviews and investigations. Nevertheless, I directed the issuance of the press release and statement on September 20. I made this disclosure because I believed that, once I knew enough to understand that the 2016 intrusion provided access to nonpublic EDGAR test filings and that this may have resulted in the misuse of nonpublic information for illicit gain, it was important to disclose the incident and our cybersecurity risk profile more generally to the American public and Congress.

The matter involving our EDGAR system concerns me deeply and on many levels. I am focused on getting to the bottom of the matter and, importantly, lifting our cybersecurity efforts moving forward.

I recognize that I am not the only one who is deeply concerned. Rightfully, it will cause this Committee and others to increase their focus on whether the Commission's approach to cybersecurity appropriately addresses our cybersecurity risk profile. This is all the more reason it was appropriate to disclose the 2016 intrusion when I did, even though our review and investigation were, and still are, ongoing.

I will now provide an update on developments in our review and investigation over the past week. Our efforts are organized into five principal work streams:

- 1) The review of the 2016 EDGAR intrusion by the Office of Inspector General. Staff have been instructed to provide their full cooperation with this effort;
- 2) The investigation by our Division of Enforcement into the potential illicit trading resulting from the 2016 EDGAR intrusion;
- 3) A focused, operational review of and, as necessary or appropriate, uplift of our EDGAR system. Our EDGAR system has been undergoing modernization efforts. We have added, and expect to continue to add, additional resources to these efforts, which are expected to include outside consultants, and will increase the focus on cybersecurity matters;
- 4) The more general assessment and uplift of our cybersecurity risk profile and efforts that we initiated shortly after my arrival at the Commission this past May, including,

without limitation, the identification and review of all systems, current and planned (e.g., the Consolidated Audit Trail (CAT)), that hold market sensitive data or personally identifiable information; and

- 5) The agency's internal review of the 2016 EDGAR intrusion to determine, among other things, the procedures followed in response to the intrusion. This review is being overseen by the Office of the General Counsel and has an interdisciplinary investigative team that includes personnel from regional offices and will involve outside technology consultants.

Each of these efforts is moving forward and, as is the nature of matters of this type, will require substantial time and effort to complete.

I also have an update to previous disclosure regarding the scope of the 2016 intrusion into our EDGAR system.⁵ Last week, I reported that, based on the information available at the time, we believed that the 2016 intrusion did not result in unauthorized access to personally identifiable information and that our investigation of these matters, as well as the extent and impact of the intrusion, is ongoing. As part of the investigation, our staff have been continuing their forensic analysis of data accessed from our EDGAR servers.

As a result of these efforts, I was informed this past Friday that an EDGAR test filing accessed by third parties in connection with the 2016 intrusion contained the names, dates of birth and social security numbers of two individuals. We are reaching out to the two individuals to notify them and will offer to provide them with identity theft protection and monitoring services. Should our review uncover additional such individuals whose sensitive information may have been accessed, we will contact them and offer them identity theft protection and monitoring as well. I will also make sure to keep the Committee informed of the ultimate findings and conclusions of our internal review into the 2016 intrusion.

I will now speak more broadly regarding our cybersecurity efforts.

We must remain on top of evolving threats when it comes to securing our own networks and systems against intrusion. This is especially true when protecting systems dealing with sensitive market and other data involving personally identifiable information. This means regularly evaluating progress, pursuing improvements and making it a priority to invest sufficient resources so our systems keep up with the fast-changing threat environment.

Looking forward, and to further the efforts discussed above, I have authorized the immediate hiring of additional staff and outside technology consultants to aid in our efforts to protect the security of the agency's network, systems and data. I have also directed the staff to

⁵ Press Release 2017-186, *SEC Chairman Clayton Provides Update on Review of 2016 Cyber Intrusion Involving the EDGAR System* (Oct. 2, 2017), available at <https://www.sec.gov/news/press-release/2017-186>.

take a number of steps designed to strengthen our cybersecurity risk profile, with an initial focus on EDGAR. This effort includes assessing the types of data we take in through the EDGAR system, and whether EDGAR is the appropriate mechanism to obtain that data. Another part of this effort includes reviewing the security systems, processes and controls we have in place to protect data submitted through EDGAR.

The staff will also conduct similar reviews of other systems we use at the SEC, assessing the types of data we keep and the related security systems, processes and controls. We will also work to enhance our escalation protocols for cybersecurity incidents in order to enable greater agency-wide visibility and understanding of potential cyber vulnerabilities and attacks. More broadly, we are evaluating our cybersecurity risk governance structure, which has included the establishment of our senior-level cybersecurity working group and may include additional enhancements to promote the management and oversight of cybersecurity risk across the SEC's divisions and offices.

Other initiatives resulting from the general cybersecurity assessment we initiated in May are ongoing or will commence shortly. These include internal, Commission-level incident response exercises and continued interaction on cybersecurity efforts with other government agencies and committees, including the Department of Homeland Security, the Government Accountability Office and the Financial and Banking Information Infrastructure Committee.

Despite the attention given to widely-publicized cyber-related incidents experienced by the Commission and others, I still am not confident that the Main Street investor has received a sufficient package of information from issuers, intermediaries and other market participants to understand the substantial risks resulting from cybersecurity and related issues. As a general matter, it is critical that investors be informed about the threats that issuers and other market participants face.

To be sure, we are continuing to examine whether public companies are taking appropriate action to inform investors, including after a breach has occurred, and we will investigate issuers that mislead investors about material cybersecurity risks or data breaches. As is noted in my July speech and on various other occasions, I would like to see more and better disclosure in this area.

Cybersecurity must be more than a firm-by-firm or agency-by-agency effort. Active and open communication between and among regulators and the private sector also is critical to ensuring the nation's financial system is robust and effectively protected. Information sharing and coordination are essential for regulators to anticipate potential cyber threats and respond to a major cyberattack, should one arise. The SEC is therefore working closely with fellow financial regulators to improve our ability to receive critical information and alerts, react to cyber threats and harmonize regulatory approaches.

Overall, by promoting effective cybersecurity practices in connection with both the Commission's internal operations and its external regulatory oversight efforts, it is our objective to contribute substantively to a financial market system that recognizes and addresses

cybersecurity risks and, in circumstances in which these risks materialize, exhibits strong mitigation and resiliency.

Regulatory Agenda

We have been hard at work developing our regulatory agenda, consistent with the eight principles outlined above. As you know, we have a number of statutorily-mandated items that we need to address, and we are considering how to advance those while also pursuing other initiatives that are central to the fulfilment of our statutory mission. Mandated rulemakings include those required by both the Fixing America's Surface Transportation (FAST) Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act. In the coming weeks and months, I expect the SEC's near-term rulemaking objectives to be fully reflected in our upcoming Regulatory Flexibility Act Agenda. As a general matter, I believe it is important that these publicly available agendas provide the necessary transparency and accountability for agency matters. If these plans are to meet their intended purpose, they must be streamlined to inform Congress, investors, issuers and other interested parties about what the SEC actually intends – and realistically expects – to accomplish over the coming year.

Putting together a rulemaking agenda has not slowed work to fulfill the SEC's mission. As you know, Commissioners Michael Piwowar and Kara Stein advanced a number of important matters before I came on board, including moving to a two business day standard settlement cycle – or T+2.

I would like to now highlight several of the SEC's accomplishments since I joined my fellow Commissioners and the women and men of the SEC in May.

Facilitating Capital Formation

The U.S. capital markets have long been the deepest, most dynamic and most liquid in the world. They provide businesses with the opportunity to grow, create jobs and furnish diverse investment opportunities for investors, including retail investors, pension funds and other retirement accounts. Our markets also have long provided the United States economy with a competitive advantage and American Main Street investors with better investment opportunities than comparable investors in other jurisdictions. We should be striving to maintain and enhance these complementary positions, including being mindful of emerging trends and related risks.

In this regard, I continue to be troubled by the negative trend in the number of public companies – fewer companies are choosing to go public in their growth phase or at all and, consequently and significantly, there are fewer investment opportunities for Main Street investors. It is clear to me that our public capital markets are relatively less attractive to growing businesses than in the past. Based on my review and discussions with Commission staff and others, the reporting, compliance and oversight dynamic between private and public markets appears out of sync. Costs – ranging from direct compliance costs to the consumption of management and employee bandwidth – for public companies, particularly smaller and medium-

sized companies, far outstrip those of comparable private companies. Thus, many companies with the choice of going public may be incentivized to stay private or stay private longer.

I view Mr. and Ms. 401(k) as bearing a potentially significant cost as a result of the shrinking number of public companies. I expect this dynamic, if not addressed, will lead to fewer opportunities for Main Street investors to invest directly in high quality companies. To be clear, it is not fewer opportunities to invest in IPOs themselves that troubles me. But without IPOs of growing companies, we have a shrinking and generally more mature portfolio of public companies. This is a significant concern. A shrinking proportion of public companies, particularly smaller and medium-sized companies, has costs beyond investment choices, including that there will be less publicly available information about the operations and performance of companies that are important to our economy.

I believe a key to restoring vibrancy in our public markets is a recognition that a one size regulatory structure does not fit all. Fortunately, this is not just a theory – through Congress’s enactment of, and the SEC’s work on, the Jumpstart Our Business Startups (JOBS) Act, there is an ecosystem displaying that a scaled disclosure and regulatory system provides incentives for companies to conduct public offerings while maintaining the world’s most robust investor protections. To be clear, this does not mean that we would sacrifice or limit the core principles of our public disclosure regime and other essential investor protections for the sake of accelerating public issuances. It is clear to me that companies that go through the U.S. IPO process emerge as better companies, with better disclosure. We want to encourage and preserve that dynamic. Overall, the SEC will strive for efficiency in our processes to encourage more companies to consider going public, which will result in more choices for investors, job creation and a stronger U.S. economy.

To this end, the SEC, through the Division of Corporation Finance (Corporation Finance), is undertaking efforts to promote capital formation, especially in our public markets. Corporation Finance recently announced that it would accept voluntary draft registration statement submissions for certain securities offerings, including for initial public offerings and offerings within one year of an IPO, for review by the staff on a non-public basis.⁶ This expanded policy builds on the confidential submission process established in response to the JOBS Act. We believe this approach provides a meaningful benefit to companies and investors, and a number of companies have already pursued this path.

Corporation Finance also issued guidance clarifying that companies may omit from draft registration statements interim financial information that otherwise will not be required when a

⁶ *Draft Registration Statement Processing Procedures Expanded*, Division of Corporation Finance Announcement (June 29, 2017) [Supplemented August 17, 2017], available at <https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded>.

company files its registration statement.⁷ This guidance should enable a company to reduce costs associated with preparing financial information that ultimately would not be included in its filing. Importantly, this guidance saves costs, but investors continue to benefit from the full array of financial information required when a company publicly files its registration statement.

Corporation Finance is also considering whether there are other areas in which interpretive guidance could assist companies without reducing investor protections, and whether enhancements can be made to staff processes to further benefit companies and investors.

Additionally, we are taking steps to fill the position of Advocate for Small Business Capital Formation (Advocate) and form the Office of the Advocate for Small Business Capital Formation (Office) and the Advisory Committee on Small Business Capital Formation (Advisory Committee), as required by Congress in the SEC Small Business Advocate Act of 2016. Among other statutorily-mandated functions, the Advocate will identify areas in which small businesses and small business investors would benefit from changes in Commission regulations or self-regulatory organization (SRO) rules. The Advocate also will work to identify problems that small businesses have securing access to capital, including any unique challenges to minority- and women-owned businesses.

We recently announced the application process for selecting the Advocate, which will cast a wide net that will encourage people with expertise and interest in facilitating capital formation throughout the country to apply. I anticipate that the Commission will select the Advocate in the coming months which will allow him or her to continue the agency's work through the Office and the Advisory Committee to facilitate capital formation for small businesses across the country.

Much work remains to be done in this area, but I am pleased with the staff's efforts to provide additional opportunities for issuers and investors alike.

Disclosure Effectiveness

I expect that the Commission will move forward in the near term on a number of additional initiatives aimed at promoting capital formation. For example, the Commission will soon consider a rule proposal required by the FAST Act to modernize and simplify the disclosure requirements in Regulation S-K in a manner that reduces costs and burdens on companies while still providing for the disclosure of all required material information.

The staff is also developing recommendations to finalize rule amendments that would eliminate redundant, overlapping, outdated or superseded disclosure requirements. In addition, the staff is developing recommendations for the Commission on final rule amendments to the

⁷ See Securities Act Forms Compliance and Disclosure Interpretation 101.04 and 101.05, available at <https://www.sec.gov/divisions/corpfin/guidance/safinterp.htm>.

“smaller reporting company” definition, which would expand the number of issuers eligible to provide scaled disclosures.

Further, the agency is continuing our initiative to modernize and simplify our disclosure requirements generally. We have a number of projects underway related to that effort, including, among others:

- (1) Considering changes to the rules in Regulation S-X related to requirements for financial statements for entities other than the issuer; and
- (2) Updating industry-specific disclosure requirements, such as the property disclosure requirements for mining companies and preparing recommendations for proposed rules to modernize bank holding company disclosures.

CEO Pay Ratio Disclosure

Corporation Finance also is examining existing disclosure rules, with an eye toward easing compliance burdens while maintaining the mandated disclosure. The SEC is required to implement rulemakings mandated by statute in accordance with applicable law, including the pay ratio disclosure rule adopted pursuant to Section 953(b) of the Dodd-Frank Act. This rule was adopted on August 5, 2015, and will continue to be implemented on schedule.

In response to questions about the pay ratio rule, the Commission recently approved interpretative guidance to assist companies in their compliance efforts.⁸ Specifically, the interpretative guidance clarifies the disclosure rules mandated by Congress in a way that is true to the mandate and, to the extent practicable, allows companies to use operational data and otherwise readily available information to produce the disclosures. Additionally, the staff issued guidance which includes examples illustrating how reasonable estimates and statistical methodologies may be used. The staff will continue to monitor the rollout of the rule, in particular for whether unanticipated costs or difficulties have arisen.

Standards of Conduct for Investment Advisers and Broker-Dealers

I have made clear in public statements that I am focused on the standards of conduct that investment professionals must follow in providing advice to Main Street investors. The extensive study of the subject to date illustrates the complexity of the issue and the fast-changing nature of our markets, including the evolving manner in which personalized investment advice is provided. Main Street investors should have access to high-quality, affordable investment advice and a diverse range of investment products without sacrificing the protections of the securities laws.

⁸ Press Release 2017-172, *SEC Adopts Interpretative Guidance on Pay Ratio Rule* (Sept. 21, 2017), available at <https://www.sec.gov/news/press-release/2017-172>.

Since my confirmation, the Department of Labor's (DOL's) fiduciary rule has partially taken effect. Staff conversations with investors and firms, prior to the DOL's proposed extension, as well as various press reports, indicate that broker-dealers are considering, and some have started taking, a variety of actions to comply with the DOL Rule, including: (1) increasing compliance resources and efforts (*e.g.*, disclosure, documentation and training, in particular, with respect to costs and rollover recommendations); (2) increasing the use of robo-advice; and (3) reevaluating and changing the types of products and accounts (and related fees) offered to retirement investors, focusing particularly on products or accounts that would address the compliance requirements driven by the Best Interest Contract Exemption (*e.g.*, shifting some or all of their retirement accounts to level-fee advisory accounts).

Further, staff understands mutual fund complexes are considering various approaches to accommodate broker-dealers' efforts to level compensation across similar types of products in response to the DOL Rule. These approaches include, for example: (1) issuing "clean shares" that do not have any sales loads, charges or other asset-based fees for sales or distribution (thus allowing brokers to set their own commissions that would be paid directly by investors);⁹ and (2) issuing "T-shares" – or "transaction shares" – that have uniform sales charges across all fund categories.

While the SEC and the DOL have different statutory mandates, rulemaking processes and jurisdictions, actions taken by one regarding standards of conduct are going to have a significant effect on the other's regulated entities and the marketplace. In other words, effects of the DOL rule extend well beyond the DOL's jurisdiction, and vice versa. It is important that we understand these effects and work closely and constructively with DOL to implement appropriate standards of conduct for financial professionals who provide advice to retail investors. We are engaging expeditiously and constructively with our colleagues at the DOL to best serve the interests of investors.

As for Commission action related to standards of conduct, the SEC has been reviewing this area for some time. In recognition of the vast changes in the marketplace since the SEC last solicited information four years ago, on June 1, 2017, I issued a statement seeking public input on standards of conduct for investment advisers and broker-dealers.¹⁰ In it, I articulated some

⁹ Related to this effort, on January 11, 2017, the Division of Investment Management issued interpretive guidance to Capital Group clarifying that Section 22(d) of the Investment Company Act of 1940 does not prevent a broker acting in an agency capacity from charging its customers a commission for transacting in "clean shares" of a registered investment company. Capital Group used the term "clean shares" to refer to a class of fund shares without any front-end load, deferred sales charge or other asset-based fee for sales or distribution. Capital Group, SEC Staff Letter (Jan. 11, 2017), available at <https://www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm>.

¹⁰ Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers (June 1, 2017), available at <https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31>.

key principles – clarity, consistency and coordination – that I expect to guide our approach. Specifically, our standards should be clear and comprehensible to the average investor, consistent across retirement and non-retirement assets and coordinated with other regulatory entities, including the DOL and state insurance regulators.

I also hope that my June 2017 statement will shape constructively the conversation on this important matter, so that we can properly tailor an approach or package of approaches that we believe will best address the issues identified. To date, we have received over 150 comments from investors and the industry, expressing a range of views. I also have personally met with various Main Street investor and industry groups and have found those conversations beneficial.

The Commission and its staff have extensive experience regulating broker-dealers and investment advisers, and we are reviewing the information interested parties have submitted. I look forward to continuing to work with my fellow Commissioners and the SEC staff as we evaluate our next steps on this important topic.

Equity, Fixed Income and Security-Based Swap Markets

The SEC has a responsibility to ensure that our securities markets provide vibrant, efficient and fair mechanisms for facilitating the formation and transfer of capital. In the decade plus since the adoption of Regulation NMS, technological advancements and innovations and commercial developments have led to significant changes in the way our trading markets operate. Generally speaking, our securities markets continue to be highly efficient and resilient. That said, it is imperative that we continuously examine and reassess our regulatory market structure. There are a few specific market structure issues and initiatives that I would like to now highlight.

Several recent Commission rulemaking proposals have been aimed at enhancing transparency in the market structure space. In July of last year, the Commission proposed amendments to Rule 606 of Regulation NMS that would require broker-dealers to disclose standardized information on their handling of large orders, both in response to customer requests and on a quarterly, aggregated basis. This proposal would also enhance existing broker-dealer order routing disclosure requirements for smaller orders.

In November 2015, the Commission proposed amendments to Regulation ATS to impose new transparency requirements on alternative trading systems (ATSs) that facilitate transactions in NMS stocks. That proposal would also greatly increase the Commission's active oversight over the design and operation of such ATSs.

Both of these transparency-focused rulemaking proposals, which the Commission released prior to my Chairmanship, have received broad support from commenters. I support both initiatives, and I have asked the Commission staff to prepare final rulemaking recommendations for the Commission's consideration.

Just as investors look for material information upon which to base their investment decisions, the Commission uses data to support and enhance our oversight function, including in our analysis of market structure, as well as for investigations, examinations and market analyses and reconstructions. The SROs also use data in carrying out their regulatory responsibilities.

Currently, trading activity in stocks is tracked through a number of systems. No single system tracks the orders that are routed and executed across multiple trading venues. As the Committee is aware, pursuant to Commission rule and the CAT National Market System (NMS) Plan, a Consolidated Audit Trail, or CAT, is currently being developed by a CAT plan processor (Thesys) and the securities exchanges and FINRA. The CAT is intended to provide these SROs and the Commission with consolidated cross-market data that is more complete, accurate, accessible and timely than the data currently available to regulators.

Of paramount concern to the Commission is the protection of sensitive CAT data. I appreciate that security issues are particularly acute with respect to a data repository that contains comprehensive information on trading activity in the securities markets, especially in light of recent events. I am therefore focused on issues of data security with respect to CAT. I have made this point clear to both Thesys and the SROs, and will continue to do so. I expect that the roll-out of the various components of CAT data reporting, the first phase of which is scheduled to take effect on November 15, 2017 (wherein the SROs will report data to the central repository), will reflect an ongoing assessment of the sensitivity of the data reported and related security concerns and protections.

Among the defenses built into the CAT NMS Plan are requirements for the plan processor to develop a comprehensive information security program that addresses the security and confidentiality of all information within the CAT data repository and associated operational risks. And the SROs, which have direct oversight of the plan processor, are obligated to monitor the information security program to ensure that it is consistent with the highest industry standards for the protection of data. For the subset of data that may be extracted from the CAT data repository, the SROs and the SEC have independent obligations to protect any such data. With respect to the SEC specifically, we have committed to review periodically the effectiveness of our confidentiality and data use procedures in connection with our access to the CAT.

Other components of the Commission's analysis of market structure are two pilot programs – one currently in force, and the other being developed by Commission staff. The Tick Size Pilot, which began in October 2016, is testing the impact of wider tick sizes on the trading of stocks of certain smaller capitalization companies. Preliminary analyses of the pilot data indicate that the impact of the wider tick sizes on market quality has been mixed. For many covered securities, quoted spreads and depth of book have increased, and volatility has decreased. At the end of this month, trading center data will become publicly available and enable more robust analysis of the pilot data.

I have also asked the Commission staff to develop a proposal for a pilot program that would test how adjustments to the access fee cap under Rule 610 of Regulation NMS would affect equities trading. The Equity Market Structure Advisory Committee (EMSAC)

recommended a pilot program of this type. I am supportive of this type of pilot program because it should provide the Commission, as well as market participants and the public, with more data to assess how transaction-based fees and rebates affect order routing behavior, execution quality and market quality. I expect that the Commission will consider a transaction fee pilot proposal of this nature in the near future.

More generally, I believe that a thoughtful and methodical, data driven approach to market structure will help us fulfill our mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation. Pilot programs such as the ones I just described allow us to evaluate whether adjustments to our market structure are necessary or appropriate, and if so, how to appropriately tailor them. At the same time, I also recognize that pilot programs – whether in the form of Commission or SRO initiatives – cannot simply live on in perpetuity. Once pilots have achieved their purpose in terms of providing the Commission and SROs with adequate data for reasoned decision-making, they should either be wound down or, when appropriate, made permanent.

Overall, as the Commission has evaluated equity market structure, the EMSAC has been a valuable and helpful resource to the Commission in providing expert advice and recommendations. Specifically, in addition to an access fee pilot recommendation, the EMSAC has provided the Commission with six thoughtful recommendations relating to NMS plan governance, SROs' proposals requiring technology changes, limit-up/limit-down mechanisms, market wide circuit breakers, the market opening and Regulation NMS Rules 605 and 606. The Commission recently extended the term for the EMSAC until early 2018, which will enable the EMSAC to continue to provide us with input as we consider market structure initiatives, including the contemplated transaction fee pilot proposal.

Separately, as I have stated previously, I believe that the time is right for the Commission to broaden its review of market structure to include our fixed income markets. The fixed income markets are critical to our economy and, increasingly, Main Street investors, yet less attention has been paid to their efficiency, transparency and effectiveness relative to the equity markets. We are in the process of establishing the Fixed Income Market Structure Advisory Committee (FIMSAC). We hope to have the first FIMSAC meeting as soon as December of this year.

Finally, with respect to the regulatory regime for swaps and security-based swaps, Commodity Futures Trading Commission (CFTC) Chairman Christopher Giancarlo and I started talking soon after I joined the Commission. At our very first meeting, we discussed ways in which we could harmonize our respective rules and regulations. SEC and CFTC staff have been meeting to identify initial areas of focus, and it is my hope that the continued coordination will result in real regulatory efficiencies.

Regulatory Relief and Assistance for Hurricane Victims

The SEC has been closely monitoring of the impact of Hurricane Harvey, Hurricane Irma, and Hurricane Maria on investors and capital markets. Agency officials have been and will remain in close communication with market participants and key market infrastructure

providers, as well as FINRA and other regulators concerning the storms and their aftermath. We are also actively working with firms in affected areas to ensure that investors continue to have access to their securities accounts.

Last week, as part of its evaluation of impacts on regulated entities in affected areas, the Commission announced it was providing regulatory relief to publicly traded companies, investment companies, accountants, transfer agents, municipal advisors and others affected by Hurricane Harvey, Hurricane Irma, and Hurricane Maria.¹¹ The loss of property, power, transportation and mail delivery due to the hurricanes poses challenges for some individuals and entities that are required to provide information to the SEC and shareholders.

To address compliance issues caused by Hurricane Harvey, Hurricane Irma, and Hurricane Maria, the Commission issued an order that conditionally exempts affected persons from certain requirements of the federal securities laws for specified periods following the natural disasters. The Commission also adopted interim final temporary rules that extend the filing deadlines for specified reports and forms that companies must file pursuant to Regulation Crowdfunding and Regulation A. The exemptive relief and rules are structured for a broad class of companies and others affected by the hurricanes and their respective aftermaths.

Some companies and other affected persons may require additional or different assistance in their efforts to comply with the requirements of the federal securities laws. The Commission staff will address these and any disclosure-related issues on a case-by-case basis in light of their fact-specific nature. Those affected by the hurricanes that require additional assistance are encouraged to contact Commission staff for individual relief or interpretive guidance. We also ask any member of Congress assisting constituents on these matters to contact us as well and to encourage their constituents to reach out to our staff.

Additionally, our Office of Investor Education and Advocacy issued an Investor Alert warning investors about the potential for investment scams in the wake of these disasters, including those promising high returns for small, thinly-traded companies that supposedly will reap huge profits from recovery and cleanup efforts.¹² The SEC brought several enforcement actions against individuals and companies following Hurricane Katrina in 2005.

Enforcement

I am committed to the responsibility of safeguarding our capital markets and American investors with energy and purpose and ensuring that there is no room for bad actors therein. Through the dedication and expertise of our Division of Enforcement (Enforcement) staff and its

¹¹ Press Release 2017-181, *SEC Provides Regulatory Relief and Assistance for Hurricane Victims* (Sept. 28, 2017), available at <https://www.sec.gov/news/press-release/2017-181>.

¹² Investor Alert: Be Vigilant For Investment Scams Related to Hurricanes Harvey and Irma (Sept. 6, 2017), available at https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_harvey.

leadership, we are able to root out fraud and shady practices effectively and with unwavering purpose. Enforcement is focused on protecting all investors – without favor for account size, geography or other measures of priority – and that is clear from recent enforcement actions targeting pump and dump schemes, insider trading and a boiler room on Long Island ripping off seniors' hard earned retirement savings. Successful enforcement actions impose meaningful sanctions on securities law violators, result in penalties and disgorgement of ill-gotten gains that can be returned to harmed investors and deter wrongdoing.

While a vigorous enforcement program is at the heart of the Commission's work to protect investors and maintain the integrity of the securities markets, the SEC's enforcement program also plays an important part in ensuring that investors and other market participants have access to material information to make informed investment decisions. The SEC has brought significant enforcement actions against issuers that committed reporting and disclosure violations. Comprehensive, accurate and timely financial reporting is the bedrock upon which our markets are based and Enforcement remains focused on pursuing violations in this area.

Our actions against parties who engage in insider trading also help promote investor confidence. Trading on material, non-public information undermines the fairness and integrity of the securities markets and creates an unlevel playing field. The SEC is committed to taking action against those who breach their duties – and subvert our markets – in pursuit of personal gain, having charged more than 700 defendants in civil insider trading cases since fiscal year 2010.

Through these efforts to root out financial fraud, insider trading and other misconduct in the securities industry, Enforcement serves a critical role in helping the Commission fulfill its tripartite mission. Moving forward, the SEC will continue to focus resources – including data collection and analysis, which has greatly enhanced our ability to detect unlawful behavior – on key areas where misconduct harms investors and impairs market integrity. In particular, I have asked the Division of Enforcement to evaluate regularly whether we are focusing appropriately on retail investor fraud and investment professional misconduct, insider trading, market manipulation, accounting fraud and cyber matters. I believe our Main Street investors would want us to focus on these areas.

Examinations

Another critical tool for the SEC to meet its mission is our national examination program, led by our Office of Compliance Inspections and Examinations (OCIE). Commission staff conduct risk-based examinations of registered entities, including broker-dealers, investment advisers, investment companies, municipal advisors, national securities exchanges, clearing agencies, transfer agents and FINRA, among others. Our examination staff work closely with staff members in our regulatory divisions to provide input on policy and regulatory issues and initiatives and also are in regular communication with Enforcement staff to discuss trends and observations and provide referrals.

Our examination program is one of many areas where we have doubled down on our focus on doing more with our limited resources. In this regard, I note that registered investment advisers now manage more than \$70 trillion in assets, which is more than triple 2001 levels. In light of this trend, in 2016, the SEC reassigned approximately 100 OCIE staff to the investment adviser examination unit. As a result of this shift and the introduction of various enhancements to OCIE processes, advancements in OCIE's use of technology and other efficiencies, the SEC is on track to deliver an increase of more than 40 percent in the number of investment adviser examinations this fiscal year – to approximately 15 percent of all investment advisers.¹³

While this has been a very positive step, more needs to be done to continue to increase investment adviser examination coverage levels, while at the same time being careful to avoid decreasing examination quality. To that end, the SEC will continue to explore additional efficiencies and improvements to our risk-based examination program. One way to achieve this is through the continued leveraging of data analysis. We have developed tools that scan an array of data fields to help us analyze and identify potentially problematic activities and firms. This allows us to make better decisions concerning which firms to examine and appropriately scope those examinations, among other things. I expect that for at least the next several years we will need to do more to increase the agency's examination coverage of investment advisers in light of continuing changes in the markets.

In the coming fiscal year, OCIE also plans to increase the number of inspections to assess compliance with Commission rules, such as Regulation Systems Compliance and Integrity (Regulation SCI), to ensure that the cybersecurity infrastructure that is critical to the U.S. securities markets is effective.

Municipal Securities Investor Outreach

The municipal securities market plays a vital role in building and maintaining America's infrastructure. State and local governments issue municipal securities to help finance a wide range of public projects and to provide cash flows for governmental needs, among other things. At the same time, municipal securities themselves provide an important investment option for millions of individual Americans. Retail investors hold as much as 75 percent of outstanding municipal securities – both directly and indirectly through mutual funds and other funds.

I have concerns, however, that some retail investors do not sufficiently understand and appreciate the unique aspects of municipal securities and the municipal securities market. Therefore, I have asked the staff to prepare a new series of educational materials –

¹³ In fiscal year 2016, OCIE completed nearly 1,450 investment adviser exams, more than it had completed in any of the prior seven fiscal years and 20 percent more investment adviser exams than it completed in fiscal year 2015. In fiscal year 2017, OCIE completed more than 2,100 investment adviser exams, a significant increase over fiscal year 2016.

including Investor Bulletins – that are geared specifically to prospective and existing retail investors in municipal securities. I anticipate that the Investor Bulletins will provide basic, plain-language information concerning the characteristics, features and pricing of municipal bonds – including, for instance, background information on their tax status, pricing determinations and call provisions.

More generally, the Commission and its staff will remain vigilant and focused on municipal securities issues. Our staff will continue to administer and vigorously enforce our rules and the statutory provisions within our jurisdiction concerning municipal securities brokers and dealers, municipal advisors, municipal issuers and investors in municipal securities. We will also continue to closely oversee and coordinate with the Municipal Securities Rulemaking Board.

Agency Operations

I have devoted a significant portion of my first five months as Chairman to developing a deeper understanding of the agency’s internal operations and management. I have come to appreciate more directly what I had witnessed from my years in private practice – the knowledge, expertise and professionalism of the SEC staff. It has been a top priority for me to engage with, and understand the perspectives of, the SEC’s workforce.

I am particularly excited to report that the SEC staff’s engagement and morale are high, thanks in significant part to the leadership and efforts of division and office directors, supervisors and staff. Setting a new record for the agency this year, nearly 80 percent of the eligible workforce shared their views by completing the Office of Personnel Management’s Federal Employee Viewpoint Survey in May and June of 2017.

This year’s survey results showed notable increases in employee engagement, overall satisfaction and leader effectiveness indices. These are critical indicators for our organization because our diverse workforce is our most valuable asset. It is only through the hard work of our employees that we are able to accomplish our mission.

Since 2012, the SEC’s rating on the Partnership for Public Service “Best Places to Work” has improved by 20 percentage points, from 56 percent to 76 percent and last year we were ranked 6th among 27 mid-sized agencies. In fact, this success has earned us distinction as a role model for other federal agencies. In April 2017, the House Oversight and Government Reform Committee invited the SEC’s Chief Human Capital Officer to testify on the agency’s survey results as the “most improved” mid-sized federal agency.¹⁴ We aim to continue building upon these 2017 results in the years to come.

¹⁴ April 6, 2017, testimony on “The Best and Worst Places to Work in the Federal Government” by Chief Human Capital Officer Lacey Dingman before the U.S. House of Representatives Subcommittee on Government Operations can be found at https://oversight.house.gov/wp-content/uploads/2017/04/Dingman_SEC_Testimony.pdf.

Efficiencies and Resource Needs

I take very seriously the SEC's responsibility to ensure that the SEC is a good steward of the funds Congress entrusts to our use, and maximizes the value of those funds to the American investor. We are engaged in ongoing efforts to find efficiencies in internal operations, including through automation, streamlined internal processes and better use of data. We will continue to develop and leverage our capabilities for risk analysis to inform our decision making, including how most efficiently to use staff resources. Given the pace of change in today's capital markets, it is more important than ever that agency operations be nimble so we can direct resources where they are needed most.

For example, with Congressional approval, the SEC in June 2017 combined the agency's various EDGAR filer support functions into one EDGAR Program Office. As this Committee knows and as discussed above, the EDGAR system is central to the agency's mission and critical to the functioning of the capital markets. On a typical day, investors and other market participants view or download more than 50 million disclosure documents filed on EDGAR. This new office also will coordinate and rationalize the agency's enhancements and investments related to EDGAR, including modifications to conform with changes to Commission rules, and will help consolidate the agency's filer support functions.

Other internal improvement initiatives include combining the agency's various communications-related functions, crafting proposals for Commission consideration to convert paper filings into electronic formats and exploring ways to better apply and schedule examination staff resources towards significant risks to investors. We will continue to explore opportunities for efficiencies and cost savings in the months to come.

The agency's efforts to streamline operations are reflected in the SEC's budget requests over the next two years. The President's request for fiscal year 2018 is for \$1.602 billion for SEC operations, which holds the SEC budget at essentially the same level it has been in fiscal years 2016 and 2017. This request reflects savings and efficiencies in progress throughout the SEC, sufficient to offset required cost increases, and continues investments in technology, as described further below.

It is important to note that the SEC collects transaction fees that offset the annual appropriation to the Commission. Whatever amount Congress appropriates to the agency will, by law, be fully offset by transaction fees, and will not impact the deficit or the funding available for other agencies. The current transaction fee rate is just over two cents (\$0.02) for every \$1,000.00 in covered securities sales.

Fiscal Year 2019 Budget Request

For fiscal year 2019, the SEC's budget request totals approximately \$1.7 billion for SEC operations. I do not make a request for additional funds lightly, especially in a tight budgetary

environment. But after an evaluation of the SEC's capabilities and needs, I believe this request is necessary for the SEC to continue the effective pursuit of our tripartite mission.

This request would allow the agency to lift the hiring freeze implemented at the start of fiscal year 2017 and recruit professionals with key skills and market expertise such as electronic trading, cybersecurity, retail investor fraud, investment adviser oversight and market analysis. The agency anticipates a need to hire such individuals in key positions to effectively carry out our core mission. The request seeks additional funds for development, modernization and enhancement of information technology systems, including additional investments in protecting the security of the SEC's network and systems. These funds, coupled with those from the SEC Reserve Fund, would allow the continued implementation of a number of key multi-year technology initiatives, discussed further below, which will enhance the SEC's ability to collect, analyze and act on large amounts of data.

Leveraging Technology

Advances in technology have driven significant changes in securities markets. Today, companies support human decision-making with automated algorithms, which ingest massive amounts of unstructured data to make trading decisions. Investors are using innovative platforms to conduct transactions and research investments. Firms solicit investors through sophisticated, multichannel communications.

In recent years we have seen an extraordinary increase in the volume and velocity of data available to the securities industry, investors and the SEC. The ever-increasing volume of data demands advanced analytics tools and best-in-class infrastructure that is dynamic, scalable and secure. Similarly, demand from the public for SEC information has never been higher. Last year, SEC.gov received 10.4 billion page views – double from just two years ago – and the public downloaded more than 2.6 petabytes of data. The information the SEC provides is driving the marketplace, and helping companies attract funding, grow and create jobs.

All of these shifts require the SEC to expand our own technology capabilities and increase our efficiency. The SEC's budget requests seek the resources needed to stay on top of these critical developments and promote our mission in an evolving landscape. The Commission has made progress in modernizing our technology systems, with the benefits of increasing our use of data analytics, increasing program effectiveness and streamlining operations.

The \$234 million that the SEC plans to spend on information technology in fiscal year 2018 is quite modest, by way of comparison, to the amounts that the major Wall Street firms spend on their own information technology systems. For example, in 2016 one large financial institution alone spent more than \$9.5 billion on technology firm-wide, with \$3 billion of that dedicated to new initiatives. Another large financial institution spent \$6.6 billion in 2016 on technology initiatives.

The fiscal year 2018 and fiscal year 2019 budget proposals would support a number of key information technology initiatives, such as:

- (1) Increasing investments in information security to address, as a top priority, the ability to monitor and avoid advanced persistent threats, and to improve risk management and monitoring;
- (2) Expanding data analytics tools to integrate and analyze the large and ever-increasing volume of financial data we receive, enabling us to detect potential fraud or suspicious behavior earlier and allocate resources more effectively;
- (3) Improving our examination program through advanced risk assessment and surveillance tools that help identify high-risk areas for further examination;
- (4) Enhancing additional systems that support our enforcement program, including applying sophisticated algorithms that foster the detection of potential insider trading and manipulation;
- (5) Streamlining public access to our EDGAR electronic filing system; and
- (6) Investing further in business processes automation and enhancements, including the retirement of legacy systems, which will drive cost efficiencies and improve security across the agency.

Leasing

An important component of the SEC's funding needs over the next two years is to support the leasing of office space. The current leases for the SEC's headquarters buildings (Station Place I, II and III) will expire in fiscal years 2019, 2020 and 2021, respectively. In addition to the funds requested to support our operations, the SEC is requesting funds in fiscal year 2018 necessary to participate in the General Services Administration's (GSA's) competitive procurement process for a successor lease for the SEC's headquarters. In accordance with its standard process, GSA has requested that the agency set aside the funds that might become necessary to cover construction and related costs should the SEC need to move from its current building.¹⁵ None of these funds would be used for the operations of the SEC, and the agency has proposed appropriation language that provides a mechanism whereby any unused portion of these funds would be refunded to fee payers.

Similarly, in fiscal year 2019, funds will be required for the GSA procurement of a new lease for the SEC's New York Regional Office, for which the current lease is set to expire in 2021. As with the SEC's headquarters lease procurement, GSA requires that the SEC set aside funds for potential construction and related costs in the event that the competitive acquisition

¹⁵ According to GSA's schedule, a new lease would be awarded in fiscal year 2018.

process might result in the SEC needing to move to a new building. None of these funds would be used for the operation of the SEC, and any unused portion would be refunded to fee payers.

Conclusion

My aim for today's testimony is to provide a window into the scope of the SEC's daily work to advance our mission of protecting investors, maintaining fair, orderly and efficient markets and facilitating capital formation. In closing, I want each of you – and all of your constituents, including, in particular, Main Street investors – to know that the SEC is open for business. We want to serve you and hear from you. Whether it be through providing educational resources and investor alerts on investor.gov, supporting small businesses and other issuers seeking to raise capital or vigorously enforcing the securities laws, SEC staff and division and office leadership stand ready and willing to engage with any and all who we can assist, and who can inform us, on issues consistent with our tripartite mission.

I thank this Committee and its members, especially the Chairman and Ranking Member, for their continued support of the SEC and its staff, and I look forward to answering any questions you may have.

Congress of the United States
Washington, DC 20515

September 26, 2017

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Clayton:

As members of the House Financial Services Committee, we write in regard to your statement from September 20, 2017, regarding cybersecurity and the U.S. Securities and Exchange Commission's (SEC) Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system.

According to your statement, a "software vulnerability" in the EDGAR system was exploited and led to the unauthorized access of nonpublic information. This raises serious concerns for all market participants regarding the fairness of the capital markets and the security and accuracy of information stored on the EDGAR system.

As you know, the EDGAR system is the central location in which companies must file SEC registration statements, periodic reports, and other required forms. In total, the system receives and processes approximately 1.7 million filings each year. Given the amount of information filed, disseminated, and stored through the system, the EDGAR system maintains an important role in the capital markets by increasing efficiency and fairness for all investors and companies while promoting transparency. However, the system only benefits all market participants when market participants are assured that the information contained on the system is properly safeguarded and that the underlying reports are accurate.

In light of this cybersecurity breach, we request that you provide us answers to the following questions:

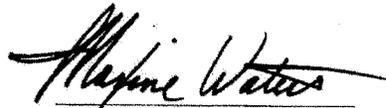
1. When was the software vulnerability discovered and what steps did the SEC take to address this particular vulnerability?
2. When did the SEC learn of potentially illicit trades using the information accessed through the software vulnerability? Please provide us with an overview of the potentially illicit trading activity, including the size and scope of the trades and number of companies involved.
3. What types of information and/or filings were accessed through this software vulnerability?
4. How many companies' filings and/or data were improperly accessed through this breach?

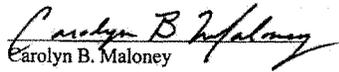
5. Has the SEC notified companies and shareholders affected by the unauthorized access of information? If not, does the SEC plan to do so and when?
6. While you state that the SEC does not currently believe the breach resulted in the unauthorized access of personally identifiable information (PII) of investors, this is not guaranteed in future breaches. What steps does the SEC plan to take to ensure individuals' identities are protected in the future?
7. What steps, if any, does the SEC plan to take to better address cybersecurity vulnerabilities in the EDGAR system?

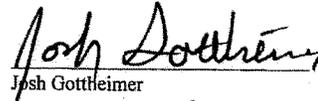
Cybersecurity is a growing threat in the financial services industry, and we look forward to working with you to better address cyber vulnerabilities moving forward. Thank you in advance for your timely responses to our questions.

Sincerely,

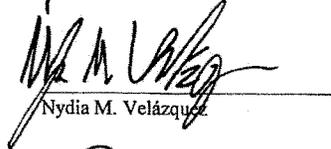


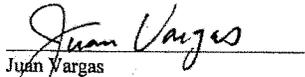
John K. Delaney

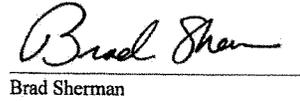
Maxine Waters

Carolyn B. Maloney

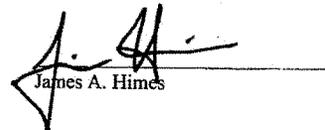
Josh Gottheimer

David Scott

Nydia M. Velázquez

Juan Vargas

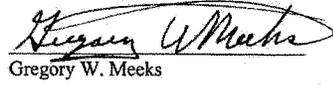
Brad Sherman

Kyrsten Sinema

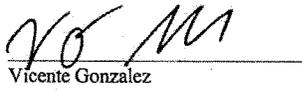
James A. Hines


Wm. Lacy Clay

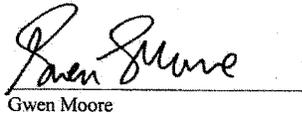

Ed Perlmutter

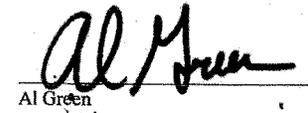

Gregory W. Meeks


Joyce Beatty


Vicente Gonzalez


Stephen F. Lynch

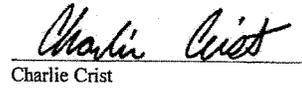

Gwen Moore


Al Green


Roben J. Kihuen


Keith Ellison


Daniel T. Kildee


Charlie Crist

House Committee on Financial Services
Examining the SEC's Agenda, Operations, and Budget

Questions for Record for the Honorable Jay Clayton, Chairman of the U.S. Securities and Exchange Commission, from Congresswoman Joyce Beatty:

- In December 2016, the SEC Advisory Committee on Small and Emerging Companies sent your predecessor, Chairwoman Mary Jo White, a recommendation regarding disclosure of board diversity. In this recommendation letter, the advisory committee found that the previous 2009 rule regarding diversity disclosures “failed to generate information useful to stockholders, employees and customers in assessing board diversity.”

To remedy that, the Committee made a recommendation for the Commission to amend Item 407(c)(2) of Regulation S-K to require issuers to describe the extent to which their boards are diverse and require them to include each board member’s race, gender and ethnicity, to the extent individual directors self-identify.

Are you aware of this recommendation by the Advisory Committee? If so, what are your plans for moving forward with their recommendation?

Response:

I am aware of, and have read, this recommendation by our Advisory Committee on Small and Emerging Companies, and I am appreciative of the effort and thoughtfulness that underlies the recommendation. When the Commission adopted board diversity disclosure requirements in 2009, it recognized that companies may define diversity in different ways and noted that for purposes of the disclosure requirements, companies should be allowed to define diversity in ways that they consider appropriate. While I believe it is important for the rule to maintain its flexibility, if a company considers diversity in identifying board nominees, it should provide clear disclosure about how it does so. For example, companies should be transparent to investors about the experiences, perspectives, qualities and/or attributes they consider, which may include, but are not limited to, race, gender, and ethnicity.

I have asked the Division of Corporation Finance to continue to (1) monitor disclosures in this area, evaluate compliance with the existing rule, and consider the Advisory Committee’s recommendation and other feedback we receive from investors, registrants and other parties and (2) make recommendations to the Commission regarding additional Commission action, if any, as appropriate.

Questions for Record for the Honorable Jay Clayton, Chairman of the U.S. Securities and Exchange Commission, from Congressman Hultgren :

Capital Formation/FSOC

- As you know, since the passage of the Dodd-Frank Act, members of the House Committee on Financial Services have raised concerns about the encroachment of bank-like regulation on our capital markets.
 - 1) Generally speaking, what has been your experience as a member of the FSOC during your time as Chairman of the SEC?
 - 2) Do you believe other members of the FSOC are sensitive to how the regulations from their agencies impact the capital markets?
 - 3) What do you feel your role is on the FSOC for ensuring the SEC's jurisdiction is not encroached upon by other regulators, such as the Federal Reserve?

Response:

The SEC, together with the U.S. Commodity Futures Trading Commission (CFTC), is a primary regulator of the U.S. capital markets, and we have developed significant expertise over the years in regulating these markets. The SEC shares oversight of the broader financial services industry with other financial regulators charged with overseeing related or overlapping financial activity and market participants. Understanding the impact of regulatory activity among financial regulators was important prior to the formation of the Financial Stability Oversight Council (FSOC) and is no less important today. Overall, I believe that the FSOC has proved to be a useful mechanism for engagement and consultation on regulatory initiatives that affect the capital markets. More broadly, the FSOC provides an important forum for identifying systemic risks across different markets and market participants.

It is, of course, important for other regulators to be sensitive to the effects of their regulatory regimes and actions on the capital markets and market participants. In this regard, my experience to date is that the FSOC's members generally recognize that the federal regulatory members operate under distinct statutory mandates and have different regulatory missions. I am able to share with the FSOC's members my perspective about potential impacts of current and proposed regulations of other regulatory bodies on capital markets, and our respective staffs also have ongoing engagement on such matters. I am committed to working closely and cooperatively with my fellow regulators to further the work of the FSOC, while at the same time being sure to focus on furthering the Commission's own mandate.

Equity Market Structure

- There has been a lot of speculation regarding what is next for equity market structure. How will exchanges continue to differentiate themselves, and where will traders look for an edge? There's a lot of conversation about the speed race and complexity between trading venues, but one development that has not gotten a lot of consideration before the Commission is what is happening inside the matching engine of exchanges. Instead of having competing trading algorithms, we may end up with competing order type algorithms within the exchange matching engines.
- 1) What do you believe are the implications for our market structure of new order type algorithms within the exchange matching engines, if any?

Response:

Regarding the general premise of your question, I believe you are correct. Exchanges are continually seeking ways to compete for order flow by offering new order types with complex functionalities that may appeal to market participants. In general, I believe competition for order flow among exchanges is beneficial because of the incentives it can generate for innovation and lower fees. That said, market participants have commented that, to some extent, innovative and/or complex exchange order types may enable a wider range of benefits from algorithmic strategies. It also has been asserted that those benefits may not extend to the market more broadly. Staff will continue to monitor the innovations in order types and their impacts on the capital markets, market participants and investors.

- 2) Do you believe this trend could lead to excessive market complexity as the exchanges use this as a means to differentiate their trading venues? For example, what happens if certain order types that claim to account for or "predict" future market conditions actually contribute to new market conditions?

Response:

I believe you are correct in this area as well. The U.S. equity market structure is complex. Currently, twelve registered securities exchanges, dozens of alternative trading systems, and many more broker-dealers compete for equity order flow and volume. The increasingly diverse array of order types offered by exchanges adds to this complexity. New algorithmic order types and strategies can alter market conditions and lead to responses from other market participants that may be difficult to predict or value from a market integrity and efficiency perspective. One of the ways in which self-regulatory organizations have sought to address the potential of algorithmic trading to create instability has been to develop automated mechanisms that moderate price volatility. For example, the "Limit Up-Limit Down Plan" is a national market system plan that imposes limits on the extent to which prices can move too far too fast within a five-minute period. Staff will continue to explore these issues and proactively analyze their implications for our markets and investors.

- 3) Does the Commission plan to opine on this topic? Or, does the Commission intend to put this question before the Equity Market Structure Advisory Committee?

Response:

A registered exchange must file a proposed rule change with the Commission when it wishes to offer a new order type that materially affects its operations. The proposal is published for public comment, and the Commission then must decide whether to approve or disapprove the proposal. The process thereby provides an opportunity for the public to raise concerns about the effect of a proposed new order type on, among other things, market stability and integrity. The Commission's order either approving or disapproving the proposal provides an opportunity for the Commission to address these issues.

The SEC's Equity Market Structure Advisory Committee's (EMSAC) charter expired in January 2018. Going forward, rather than extending EMSAC, our plan is to organize targeted roundtables and other meetings among market participants on discrete equity market structure issues, which will feature experts on each topic representative of a broad diversity of viewpoints. I expect that order type and order complexity will be discussed in one or more of these meetings. More broadly, these meetings will provide further opportunities for discussions about these critical issues affecting our equity markets.

Money Market Fund Rules

- On July 23, 2014, the Securities and Exchange Commission adopted amendments to the rules that govern money market funds. The rules, which went into effect last fall, require a floating net asset value (NAV) for institutional prime money market funds, and implement liquidity fees and redemption gates.

On December 8, 2016, the Capital Markets Subcommittee held a hearing that included testimony regarding the impact of these rules on our fixed-income markets. Testimony of Anthony Carfang, Managing Director of Treasury Strategies, noted, "SEC regulations that went into effect in October 2016 have crippled the market for private sector and municipal money market mutual funds (MMFs). The regulations contain a number of provisions which make these funds less attractive to investors. The result has been a \$1.1 trillion dollar shift of capital out of the private sector and into government funds, limiting capital availability and raising borrowing costs for America's businesses and municipalities."

Following implementation of the rules:

- 1) Has the Commission conducted a review of the 2014 Rules and their impact on fixed income markets? If not, does the Commission intend to conduct such a study?
- 2) Are the findings of Treasury Strategies consistent with the findings of the Commission?
 - a. Specifically, is the "\$1.1 trillion dollar shift of capital out of the private and into government funds" attributable to the 2014 Rules?
 - b. How much of this shift is attributable to the 2014 Rules, if any?

- c. Are there any other factors, such as the interest rate environment, that contributed to this shift?
- 3) Has the Commission considered if the 2014 Rules contribute to an increased cost of borrowing for states and local governments issuing debt? If so, how does the Commission weigh this against investor protection and broader market implications?
- 4) The history of this rulemaking suggests that, through the Financial Stability Oversight Council, the Federal Reserve exerted pressure on the Commission to institute new rules covering money market funds.
- a. Have you discussed the 2014 Rules with the Chair of the Federal Reserve, Janet Yellen?
 - b. Do you believe there is an increased risk investment companies sponsoring money market funds could be designated as systemically important by the FSOC if the 2014 Rules are repealed? Have you discussed this with the current Chairman of the FSOC, Secretary Mnuchin?

Response:

The staff of the Commission has been monitoring the implementation of the 2014 reforms on an ongoing basis, including reviewing their impact on money market funds (MMFs), municipal issuances and the short-term funding markets. Based on their review and analysis, the staff has shared the following observations:

- As MMFs were implementing the 2014 reforms, there was a shift in assets of approximately \$1.1 trillion from prime MMFs into government MMFs.¹ Although there was a large reallocation among fund types, overall MMF assets remained largely stable (at about \$3 trillion) throughout this period and to date.
- The time period after the Commission adopted the 2014 reforms was a period of extraordinarily low and stable interest rates, which may have affected investments in MMFs and allocation of investments across different types of MMFs. As a result of these low and stable interest rates, the yield differential between prime and government MMFs has been relatively low and relatively constant compared to historic spreads. While it is difficult to separate actions driven by regulated change from actions driven by market factors (and the two may not be independent), the minimal difference in return between prime MMFs and government MMFs may have led some investors to move to government MMFs to avoid any potentially higher risk associated with holding prime MMFs. More recently, we have experienced a rising interest rate environment, with the Federal Reserve raising short-term interest rates several times. This has resulted in yield increases for MMFs generally, and also may affect investment choices among MMFs going forward.

The staff has further informed me that as the reforms went into effect, many fund managers chose to realign some of their fund offerings and close other funds, many of whose assets had been shrinking during the extended low interest rate environment. These changes have led to

¹ Based on staff analysis of Form N-MFP data.

some reductions in investment in municipal MMFs, particularly when combined with the reallocation of assets from prime to government MMFs that I mentioned above.

Some market participants and municipal issuers suggest that this decrease in demand for short-term municipal securities from MMFs and related increase in demand for government securities from MMFs as discussed above may have adversely affected the short-term municipal funding market. The staff has observed the following:

- Although the amount of outstanding municipal securities increased by 5% from \$3,617 billion in 2013Q4 to \$3,803 billion in 2017Q3, the municipal securities held by all types of MMFs decreased from 8.1% in terms of amount of outstanding in 2013Q4 to 3.6% in 2017Q3.² This decline may be attributable to the shift to government MMFs as well as a number of other factors, including a reduction in the creditworthiness of third party providers of credit and liquidity enhancements for municipal securities held in MMFs, a trend that preceded the 2014 reforms.³
- More broadly, it is noteworthy that: (1) other types of mutual funds have increased their holdings of the total outstanding municipal securities from 13.9% in 2013 to 17.9% as of 2017Q3; and (2) US-chartered depository institutions have also increased their supply of capital to municipal issuers from 10.9% of the total in 2013 to a total of 14.7% as of 2017Q3.

Regarding the cost of short-term municipal borrowing, staff has informed me that in the recent interest rate environment, yield spreads for short-term municipal securities (compared to short-term Treasuries) have been similar to yield spreads prior to implementation of the 2014 reforms, although more recently the absolute yield has increased as a result of the increasing interest rate environment. These yield spreads did increase right around the October 2016 implementation date for the reforms, but the increase dissipated shortly thereafter.

In considering potential adverse effects on short-term funding markets against goals of the reforms, it is important to note that the Commission at the time indicated that the impetus behind the reforms was a concern that MMFs, as they existed then, could pose risks to investors and the broader markets. The Commission in particular was concerned by MMF features that may have created a first-mover advantage that would, in turn, incentivized investor runs during periods of market stress. The Commission's adopting release further noted the harm that can result from rapid investor redemptions during periods of market stress, as the Reserve Fund's Primary Fund "broke the buck" and other prime institutional funds experienced heavy redemptions — which in turn caused fund managers to retain cash, and that in turn constrained liquidity in short term financing markets. Ultimately, as the 2014 release describes, the Department of the Treasury intervened with its Temporary Guarantee Program — extraordinary measures that helped quiet

² See Federal Reserve Board's Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts Third Quarter 2017 available at <https://www.federalreserve.gov/releases/z1/current/z1.pdf>.

³ See https://www.moodys.com/research/Moodys-downgrades-US-muni-obligations-backed-by-banks-and-securities--PR_248937.

the market disruptions. Treasury was subsequently prohibited by statute from undertaking such measures in the future. The Commission's 2014 rulemaking therefore included certain structural measures that were designed to mitigate run risk in MMFs. These measures include new tools that are designed to allow funds to manage heavy redemptions and additional price transparency to potentially mitigate the first mover advantage incentives. I caution that these measures, while believed by many with market experience to be beneficial for various reasons, have not been tested in practice.

The FSOC, of which the Chairman of the SEC is a member, is charged with making determinations on whether certain nonbank financial companies and financial market utilities are designated for heightened supervision and prudential standards. The FSOC also has the ability under Section 120 of the Dodd-Frank Act to make recommendations to primary regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices. It was under that authority that the FSOC previously proposed recommendations for structural reforms of MMFs.

Because, as the SEC Chairman, I am only one voting member of the FSOC, and designations of systemically important financial institutions are made by the FSOC as a whole, I cannot speak with any meaningful degree of certainty as to whether, if the SEC's 2014 MMF rules were amended or repealed, there would be an increased risk of designation of individual investment companies sponsoring MMFs. Furthermore, I note that on November 17, 2017, in accordance with a Presidential Memorandum, the U.S. Department of Treasury issued a report that provides several recommendations on the FSOC determination and designation process. For similar reasons, I cannot predict whether those recommendations will be implemented, and, if so, how those changes might affect any decision about designating companies sponsoring MMFs as systemically important.

Finally, I have not had any substantive discussion regarding the potential repeal of the SEC's 2014 MMF rules or the potential impact of repeal with either the former Chair of the Federal Reserve Board, Janet Yellen, current Chairman Jay Powell, or the Chairman of the FSOC, Treasury Secretary Steven Mnuchin.

Reg AB II

- When the SEC put forward its revised 2017 regulatory agenda, one of the items that appears to have fallen off the list from the previous Fall (2016) is continued work on Regulation AB II, the rules designed to enhance transparency and disclosures for asset-backed securities (ABS). We appreciate that the Commission has done a lot of work with respect to certain asset classes (finalizing in August 2014 a portion of the asset level disclosure rules for several asset classes including auto, CMBS, and RMBS), but to date asset level disclosure requirements for many asset classes are still considered an open item per the Final Reg. AB II rules.

1. Does the SEC intend to finish its work on Regulation AB II?

2. Will the market see regulatory guidance in the areas of credit card, student loan, equipment loans/lease and floorplan ABS?

Response:

Since adoption of the Regulation AB II disclosure requirements in 2014, there have been a number of developments in this space. Among other things, the U.S. Department of the Treasury released its report on the U.S. capital markets in October 2017 recommending that the SEC signal that it will not extend Regulation AB II disclosure requirements to additional securitized asset classes (which include asset backed securities collateralized by equipment loans or leases, floorplan financings, student loans, and revolving credit card debt) in the near term.

We are continuing to monitor this area, and amendments to Regulation AB appear on the Commission's Longer Term Regulatory Flexibility Act agenda for future consideration. I have asked the staff to continue to monitor regulatory and market developments in this area and, to the extent necessary or appropriate, make recommendations to the Commission.

Questions for Record for the Honorable Jay Clayton, Chairman of the U.S. Securities and Exchange Commission, from Congressman Tom MacArthur:

- Please describe the pros and cons of the current relationship between the exchanges regulatory role as SRO's and commercial interests as market participants?

Response:

In designating the national securities exchanges as self-regulatory organizations (SROs), the Securities Exchange Act of 1934 assigns to them the responsibility to oversee trading on their respective markets, regulate the conduct of their members, and enforce compliance by their members with the federal securities laws.

The SRO model is viewed as having several benefits. Given the complexity of the U.S. securities markets, it can be more efficient and effective for the exchanges, which are more intimately familiar with the nuances of market and member operations, to develop and enforce rules relating to their markets and the conduct of their members. Moreover, direct supervision at the federal level could involve a significant expenditure of public funds, while self-regulation allows the government to leverage its resources through its oversight of SROs. SROs can establish and enforce standards of conduct for market participants that go beyond the legal requirements of the federal securities laws, including ethical standards. Moreover, the flexibility afforded by self-regulation can be important in regulating a complex, varied, and dynamic securities industry.

On the other hand, conflicts can arise. For example, funding is limited and exchanges must choose between funding their business operations and funding regulation, oversight and enforcement. This conflict has become more apparent as exchanges have transitioned to for-profit businesses that operate in a highly competitive environment and have shareholders to whom they must answer. Exchanges also can face conflicts when regulating members that send significant order flow to the exchange or that may even be competitors (*e.g.*, members that operate an alternative trading system). Exchanges are responsible to monitor their listed issuers for compliance with the exchange's listing standards, and to delist those issuers that no longer are compliant with the listing standards. However, exchanges also must compete with other exchanges to attract and retain listings.

The Trading Venues Subcommittee of the SEC's Equity Market Structure Advisory Committee (EMSAC) looked at these potential conflicts, and, more specifically, at existing limits on exchanges' liability, the impact of their role in the governance of National Market System (NMS) Plans, and their operation of consolidated market data feeds. The Subcommittee concluded that overall the current regulatory structure works well and generally is operating fairly and effectively and did not believe that a significant overhaul of the current structure was necessary. The EMSAC supported the Subcommittee's recommendations that the SEC take action to make the role of NMS Plan Advisory Committees more significant, formalized, and uniform and to promote more efficient technical implementation of SRO proposed rule changes. I have asked the staff to continue to monitor this issue, and we welcome continued dialogue with you as well as with market participants.

Questions for Record for the Honorable Jay Clayton, Chairman of the U.S. Securities and Exchange Commission, from Congressman Robert Pittenger:

- Mr. Chairman: I am concerned about unintended negative consequences of the CECL accounting standard recently developed by FASB. Forecasts by many respected corporate CFOs of slower economic growth and fewer consumer choices under CECL are worrisome, and I believe, deserving of an in-depth examination before the standard is implemented. The new standard is likely to incentivize short-term lending and adversely affect the price and availability of loan products such as the 30 year fixed rate mortgage, small business loans, and loans to non-prime customers. I am also concerned that through its effect on the cost and availability of capital, CECL will drive pro-cyclicality so that economic downturns are accelerated and recoveries are delayed. I urge the SEC to do everything in its power to delay the rule pending a thorough quantitative impact study (QIS) by a respected third party, and, if significant negative consequences to growth, credit availability, financial stability, or employment are identified, prevail upon FASB to re-issue the standard so it may accomplish FASB's narrow accounting objectives without broadly detrimental effects on the US economy.

Response:

The FASB's project that led to the issuance of the new credit losses standard has its origins in the financial crisis, where some market participants believed the existing "incurred loss" model resulted in the untimely and delayed recognition of credit losses, and ultimately, lower levels of loan loss reserves than otherwise may have been anticipated by management. Accordingly, FASB's stated objective for issuing the new credit losses standard was to provide users of financial statements with "more decision-useful information about the credit risk inherent in financial assets and the change in expected credit losses occurring during the period." As opposed to the prior "incurred loss" model, the new credit losses standard is intended to more closely align an entity's financial reporting with management's estimate of expected credit losses.

The FASB, as an independent accounting standard setter, focuses on developing accounting standards for financial reporting that provides investors with the information they need to make informed investment decisions. When setting standards, the FASB states that it weighs whether the expected improvement in the quality of the information provided to users justifies the cost of preparing and providing that information. It is of course true that information can affect the analysis of what capital allocation decisions should be made or what actions should be taken by management. However, the FASB does not seek to influence the outcome of those decisions in determining what standards should apply. While I share your concerns about the availability of credit and liquidity, particularly in times of stress, I believe that it is appropriate for the FASB to focus on the quality of the information provided to investors, and not specific outcomes, in order to ensure continued investor confidence in the accuracy and quality of reported information, which is critical to capital formation over the long term. I further believe that the way management evaluates performance and assesses risk in practice should be a touchstone for FASB's standard setting, and they have assured me that is the case in this instance.

To be more specific, while financial institutions are still evaluating the effect of the new standard, some have indicated that the new requirement to immediately recognize expected losses instead of deferring losses until “incurred” (as under the existing standard) could adversely impact an entity’s ability to lend in an economic downturn or slow an economic recovery. I am concerned by these issues. But I would also be concerned if financial reporting standards were not providing investors with relevant, reliable, and timely information about a financial institution’s credit risk and its change in expected credit losses. Many of the concerns expressed appear to me to be the result of the interaction of the new standard with existing regulatory capital requirements.

We at the SEC want to be as helpful and constructive as is practicable. Specifically, with regard to knock-on regulatory effects, I appreciate that financial institutions need to plan for potential changes to their regulatory capital requirements and am aware that these regulatory capital requirements are currently being analyzed by the appropriate banking regulators and other supervisory bodies in connection with the changing accounting standards. In particular, the Basel Committee on Banking Supervision, which provides a forum for regulator cooperation on banking supervisory matters, recently issued transition guidance with respect to the impact of accounting changes on regulatory capital and specifically indicated that it will further monitor the effect of the new standard’s impact on capital. In addition, the U.S. Treasury, in response to the President’s Executive Order on Core Principles for Regulating the United States Financial System, recommended that the potential impact of the new standard on banks’ capital levels be carefully reviewed by U.S. prudential regulators with a view towards harmonizing the application of the standard with regulators’ supervisory efforts. Most recently, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation jointly noted that they are considering whether it would be appropriate to make adjustments to their capital rules in response to CECL and its potential impact on regulatory capital.

The Commission’s Chief Accountant has expressed his encouragement and support for these efforts to ensure regulatory requirements are updated, if necessary, to account for the impact of any change resulting from the new standard. I also support the ongoing efforts by the appropriate banking regulators and other supervisory bodies to analyze the regulatory capital requirements in connection with the changing accounting standards. Our experience demonstrates that when an accounting standard is changed in a way that provides investors with better information but has unwarranted results under other regulatory standards, it may be necessary to consider modifying those standards (e.g., the bank capital rules) to address that unwarranted result. SEC staff will continue to engage with the prudential regulators on this issue and provide any assistance they require as they undertake their process for reviewing their standards.

Separately, the Commission staff has actively monitored the FASB’s standard-setting process and continues to monitor implementation activities undertaken by stakeholders and the FASB. In particular, the Commission staff has actively monitored the FASB’s Transition Resource Group for Credit Losses (TRG), whose members include financial statement preparers (including community banks and credit unions), auditors, users, and financial services regulators, and has

encouraged banks to bring questions about the accounting standard before the TRG for discussion. The staff of the Office of Chief Accountant has been and will continue to assess whether FASB's standard is having its intended effect of aligning reporting with management's analysis and whether there are any unintended negative consequences.

Questions for Record for the Honorable Jay Clayton, Chairman of the U.S. Securities and Exchange Commission, from Congressman Brad Sherman:

- Will you move the SEC toward a situation where either you or the Financial Accounting Standards Board defines non-GAAP terms that are important to investors, like “same store sales” and “backlog”?

Response:

The FASB establishes accounting standards that companies follow in preparing financial statements that are included in periodic reports filed with the SEC. The SEC establishes rules for information presented elsewhere in those reports, which would include non-GAAP financial measures that are included in documents submitted to the SEC.⁴ As has been discussed in some detail, in principle, the FASB could define a non-GAAP term by adding it to the Accounting Standards Codification (i.e., writing it into GAAP), or modifying an existing GAAP item that is frequently modified by issuers to create a non-GAAP measure. In addition, while the SEC already regulates the way in which non-GAAP items are disclosed to investors, the SEC could implement more specific requirements around certain terms. Deciding whether to exercise that authority involves both policy and practical considerations.

With respect to the policy considerations, on the one hand, bringing greater definition to non-GAAP terms could enhance comparability and also minimize the possibility that the non-GAAP number would be used inappropriately. On the other hand, investors also value understanding the key metrics that an issuer’s management uses in running the particular business at issue, and requiring the use of certain uniform metrics that are not those used by the managers of that business may diminish key investor insights into management’s decision-making. Thus, the SEC’s requirements to date focus on prohibiting misleading metrics and requiring disclosures to help investors put the non-GAAP numbers into their proper context.

With respect to the practical considerations, the FASB recently solicited broad stakeholder input⁵ regarding standard setting projects it should consider adding to its agenda, including financial performance reporting (which includes non-GAAP financial measures). The FASB has also conducted other outreach to investors as well as other stakeholders to better understand their use of non-GAAP financial measures. SEC staff has observed from comment letters and other forums that market participant feedback indicated that constituents wanted the FASB to prioritize projects on distinguishing liabilities from equity, segment reporting, and financial performance reporting. With respect to financial performance reporting, the feedback suggested that market participants were most interested in a project that provided disaggregated information regarding financial performance.

⁴ Item 10(e)(1)(ii)(C) of Regulation S-K states “a registrant must not...present non-GAAP financial measures on the face of the registrant’s financial statements prepared in accordance with GAAP or in the accompanying notes.”

⁵ See FASB Invitation to Comment: Agenda Consultation at: http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168357653&acceptedDisclaimer=true.

The FASB also received feedback that highlighted resource concerns relating to potential new standard setting projects. In recent years, the FASB has completed major standard-setting projects regarding revenue,⁶ leases,⁷ and credit losses.⁸ Market participants indicated that they are focused on successful implementation of these new standards and thus have limited resources to devote towards additional major standard setting projects. Recognizing the importance of being able to solicit and receive market participant feedback throughout the standard-setting process, the FASB ultimately decided to limit the number of new projects.

Notwithstanding the above, the FASB has demonstrated a willingness and ability to take on a standard setting project in an attempt to improve the GAAP standards where the existing standards may not best reflect the underlying economics.

Beyond the work of the FASB, I also would like to highlight that over the past two years, the SEC staff has been active in assessing the non-GAAP financial measures used by companies and investors, including ensuring that the existing requirements contained in SEC rules and regulations are adhered to in connection with the presentation of any non-GAAP financial measures. The Division of Corporation Finance and the Office of the Chief Accountant have worked together to analyze the wide range of non-GAAP financial measures presented in the marketplace and, where appropriate, have issued comments asking companies to provide disclosures required by SEC rules and regulations or to revise the disclosures in order to comply with those rules and regulations. In the staff's view, this process has led to significant improvements in non-GAAP financial measures, including the related disclosures.

- FASB, using the power you've given them, requires the immediate write-off of all research and development costs, even successful ones. This is a contradiction of accounting theory. I would hope that you would take a look at the extreme harm done to our economy and look at all the search that is not being done and the inventions that are not being developed because of that unwarranted departure from accounting theory. Will you do that?

Response:

In 2003, the SEC determined that the Financial Accounting Foundation (FAF) and the FASB met the criteria for its financial accounting and reporting standards to be recognized as "generally accepted," as set forth in the Sarbanes-Oxley Act of 2002.⁹ The FASB focuses on developing accounting standards to show a complete, transparent, and unbiased picture of a company's financial position and performance, providing investors with useful information upon which to make informed investment decisions.

⁶ See FASB ASC Topic 606

⁷ See FASB ASC Topic 842

⁸ See FASB ASC Topic 326

⁹ See SEC Release Nos. 33-8221; 34-47743; IC-26028; FR-70, available at <https://www.sec.gov/rules/policy/33-8221.htm>.

You have highlighted research and development costs in your question. Expenditures for individual research and development projects normally have a degree of uncertainty, although the element of uncertainty may diminish as a project progresses to become a new or improved product or process.

The theoretical question for the standard setters has been whether it serves a useful purpose to investors for companies to expense those expenditures as incurred or to accumulate them as an asset that is allocated over some future period. This question represents a fundamental challenge of associating, on a direct cause and effect basis, research and development expenditures, on the one hand, with uncertain revenues on the other hand. Other than costs relating to inventory and internally developed software costs, research and development costs are generally recorded and expensed as incurred.

The approach to recording research and development costs as expenses is intended to reflect the uncertainty of future benefits involved. For example, if expenditures are undertaken for research and development to create a new product or service and they are recorded as assets, but those activities lead to abandoning old efforts in favor of new discoveries, or the market evolves, or a competitor comes to market first, and the expenditures for the original research fail to produce revenue (or even sufficient revenue) to recover the accumulated costs, a company would need to expend further costs for the accounting effort of determining whether, and by how much, the "asset" may have to be written off, with the critical accounting judgments of "when" and "how much" presenting a possible risk for manipulation. I understand these issues have significance in FASB's analysis. That said, it is possible to strike the balance differently, as the International Accounting Standards Board (IASB) does for certain types of costs.

Regardless of the expense and/or capitalization treatment for research and development costs, disclosure requirements are important. Where material, companies are required to provide informative disclosures regarding, among other things, research and development activities in Commission filings, including in the business description, management's discussion and analysis, and the financial statements.

SEC staff has continued to observe that standard setting considerations for costs are not limited to just research and development but also include financial statement treatment of a wide range of other costs. I believe that the FASB could consider as part of its agenda setting activities the need for a broader project on accounting for costs that would expand to more than just research and development costs. As discussed above, the FASB monitors and considers standard setting requests received from constituents in prioritizing the projects on its agenda. I am supportive of the FASB's process of soliciting and monitoring feedback from constituents in determining which projects should be taken on by the FASB. Mindful of the practical considerations mentioned above, I am supportive of the FASB further exploring whether a broader project on accounting for costs should be added to the agenda in the future.

- Mr. Davidson of Ohio and I have introduced a bill to direct the SEC and FINRA to develop and implement risk controls to safeguard market data and to direct the CAT contractor to develop risk controls to protect CAT. The CAT operation would be

prevented from accepting data until it develops risk controls. What is your response to this concept?

Response:

Establishing risk controls to safeguard Consolidated Audit Trail (CAT) data is critically important. SEC Rule 613 and the CAT NMS Plan require the self-regulatory organizations (SROs) and the CAT Plan Processor to develop and implement such controls.

Specifically, the CAT NMS Plan approved by the Commission requires the SROs to ensure that the CAT repository meets specific data security requirements, including those regarding connectivity and data transfer, encryption, storage, access, and personally identifiable information (PII). The Plan Processor must develop a comprehensive information security program that addresses the security and confidentiality of all information within the CAT repository and associated operational risks, which includes all relevant standards from the National Institute of Standards and Technology (NIST) Cybersecurity Framework. The CAT NMS Plan also requires regular security audits performed by a qualified third party auditor.

In addition, any PII data that CAT collects must be subject to heightened security protocols and standards. For example, PII must be stored in a database that is physically separate from the transactional database, access to PII must follow a role-based access model, and any login system that is able to access PII must be further secured via multi-factor authentication. Because of the sensitive nature of PII, I have directed Commission staff to evaluate the need for PII in the CAT. This evaluation—which is ongoing—includes consideration of, among other things, what PII data elements need to be collected and retained in the CAT in order to achieve the regulatory goals of the CAT and how PII in the CAT would be used by the SEC and SROs.

The SROs, which have direct oversight of the Plan Processor, are obligated to monitor the CAT's information security program to ensure that it is consistent with appropriate industry standards for the protection of data and are required to implement comparable information security policies and procedures with respect to their handling of CAT data. The CAT's Chief Information Security Officer is required to review each SRO's CAT-related information security policies and procedures to ensure that such policies and procedures are comparable to the information security policies and procedures applicable to the Plan Processor.

Similarly, the Commission, in approving the CAT NMS Plan, committed to implementing policies and procedures relating to the Commission's handling of CAT data that are comparable to the standards applicable to the SROs (and, in turn, the CAT repository), and the Commission will periodically review the effectiveness of these policies and procedures. A cross-divisional steering committee of senior Commission staff has been tasked with designing policies and procedures regarding Commission access to, use of, and protection of CAT data.

The CAT repository also is expected to be a facility of each SRO. The SROs are "SCI Entities," and the CAT system is an SCI system. As a result, the CAT repository is subject to the requirements of Regulation SCI. The CAT NMS Plan states that data security standards of the CAT System shall, at a minimum, satisfy all applicable regulations regarding database security,

including provisions of Regulation SCI. The SROs are responsible for ensuring that the CAT repository as operated by the Plan Processor complies with Regulation SCI, including the establishment, maintenance, and enforcement of written policies and procedures reasonably designed to ensure that the CAT system has levels of capacity, integrity, resiliency, availability, and security adequate to maintain its operational capability.

In addition to these data security controls, I expect that the roll-out of the various components of CAT will reflect an ongoing assessment of the sensitivity of the data reported and related security concerns and protections.

- When do you expect to complete the rulemaking process for 30e-3 regarding allowing mutual fund companies to send annual reports to investors electronically?

Response:

Proposed rule 30e-3 under the Investment Company Act of 1940 would permit funds to transmit their reports and certain other materials to their shareholders by making the reports accessible on their websites subject to certain conditions being satisfied relating to (1) the availability of the report and materials; (2) obtaining shareholder consent; (3) notice to shareholders; and (4) delivery of materials upon request of the shareholder. We received a significant number of comment letters on the proposal, including from consumer advocates, the fund industry, intermediaries and other service providers, environmental groups, and other constituencies.

The staff continues to consider all of the comments received and the issues raised regarding this proposal and, at my direction, is evaluating available options with regard to this rulemaking. As expressed in the Commission's Fall 2017 Regulatory Flexibility Act Agenda, I expect the Commission to take further action on recommendations from staff on rule 30e-3 during 2018.

Questions for Record for the Honorable Jay Clayton, Chairman of the U.S. Securities and Exchange Commission, from Congresswoman Nydia M. Velazquez:

- Chairman Clayton, the hack of the EDGAR system raises serious questions about the SEC's cyber defenses and potentially puts at risk the safety of our financial system. The SEC currently houses sensitive information from some of our largest most systemically important financial entities, and our securities markets' technological infrastructure. That information is often obtained in the course of examinations under Reg SCI. If such information were to be compromised, it could leave some of our most systemically important financial institutions vulnerable to attack. During your review of the SEC's cyber policies, what steps were taken to ensure this extremely sensitive information is properly safeguarded on the SEC's servers?

Response:

Recognizing that in today's environment no system can be immune to a potential intrusion, it is critically important that Commission systems storing sensitive data are subject to appropriate management, operational, and technical security controls. The SEC, like all federal agencies, is required to follow the National Institute of Standards and Technology (NIST) Risk Management Framework, which is a framework designed to improve information security and strengthen risk management processes. In addition, we are in the process of implementing the NIST Cybersecurity Framework (CSF), which is a framework of industry standards and best practices to help organizations manage cybersecurity risk. We have submitted an implementation plan to the Department of Homeland Security and are executing on that plan—its successful implementation is a priority.

We are also working closely with the Government Accountability Office (GAO) to address its findings regarding our information technology and critical system infrastructure. To date, SEC staff has implemented all but two information technology security recommendations from GAO that were open as of the start of fiscal year 2017 and has either completed or are working to address all of the recommendations issued as part of the GAO's July 27, 2017 audit report on information security. We have prioritized completing these recommendations and will continue to track them until GAO is satisfied with our implementation.

The SEC has a number of additional efforts underway to review and uplift our EDGAR system as well as other systems that hold market sensitive data or personally identifiable information. We are reviewing the security systems, processes, and controls we have in place to protect the data we maintain. As an important part of this effort, we have engaged an independent consultant to conduct its own assessment and make recommendations.

In addition, as I announced at the Committee's hearing, I have authorized the creation of a new position, the Chief Risk Officer, whose responsibilities will include identifying, monitoring and mitigating risks across our Divisions and Offices. I have also authorized the hiring of additional staff and outside technology consultants to aid in our efforts to protect the security of the agency's network, systems, and data.

Follow Up Question:

- Chairman Clayton, have you looked at alternative ways to ensure this sensitive information is shared with the appropriate regulators while limiting the potential for it to be compromised?

Response:

Active and open communication between and among regulators is critical to ensuring that the nation's financial system is robust and effectively protected. Information sharing and coordination are essential for regulators to anticipate potential cyber threats and respond to a major cyberattack, should one arise. Such information sharing, however, necessitates regulators to put in place protections for sensitive information they receive from, and produce to, other regulators. The SEC has information sharing arrangements with other regulators, which, among other things, set forth the types of information to be shared as well as the means for safeguarding it. These safeguards can include, for example, requirements to use appropriate security measures when transmitting the data as well as restrictions on who can access the data. Recently, I have asked our staff to catalogue, prioritize, and assess these arrangements, starting with the federal financial regulatory agencies that we interact with the most often. This project is in its early stages and involves multiple offices, including our Offices of Information Technology and General Counsel.

