

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2018

TUESDAY, JUNE 27, 2017

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:05 a.m., in room SD-138, Dirksen Senate Office Building, Hon. Shelley Moore Capito (chairwoman) presiding.

Present: Senators Capito, Coons, Boozman, Daines, Moran, and Van Hollen.

SECURITIES AND EXCHANGE COMMISSION

STATEMENT OF HON. JAY CLAYTON, CHAIRMAN

OPENING STATEMENT OF SENATOR SHELLEY MOORE CAPITO

Senator CAPITO. Good morning. The subcommittee will come to order. And I would like to welcome our witnesses, SEC Chairman Jay Clayton and Acting CFTC Chairman Chris Giancarlo. Thank you both for being here. We look forward to hearing from both of you about the details of your budget requests and your plans to carry out your agency's missions.

As Members of this subcommittee, we have a responsibility to ensure the funds we see are spent wisely. Both of your agencies are seeking increases for fiscal year 2018. The SEC is requesting \$1.8 billion, which is \$242 million, or 15 percent, higher than fiscal year 2017. Since fiscal year 2000, the SEC budget has grown from \$377 million to now \$1.6 billion.

While the SEC is a fee-funded agency, congressional oversight over the Commission's budget is critical. Although these fees come from public companies and exchanges, they are borne by investors and Congress has a responsibility to ensure that those funds are being spent in a manner that protects investors, helps markets operate efficiently, and spurs economic growth for all Americans.

The CFTC is requesting \$281.5 million, almost 13 percent more than fiscal year 2017. For comparison, the CFTC was funded at \$62.7 million in fiscal year 2000 and the budget has now reached at least \$250 million. However, access to more funding does not necessarily ensure that an agency will successfully achieve its mission or spend that funding responsibly. You both have challenges as you have taken the helm of your agencies.

In the case of the CFTC, some leasing costs and practices have raised concerns about effective management of Federal funding. SEC has also had similar issues related to its leasing practices, which is of concern given the proposed budget increase for its upcoming move.

All agencies have to make strategic decisions on how to best allocate resources. As we review your budget requests, I am most interested to hear what decisions you have made to operate more efficiently in order to carry out your responsibilities within current funding levels. We all benefit from a system that promotes fair and orderly markets, so I am concerned when regulations fragment the market, needlessly raising the cost of business and pushing trading overseas.

I ask you to be persistent in trying to work together and coordinate with other Federal regulators, self-regulatory organizations, and your international counterparts. We are also interested in hearing more about your efforts to defend against cyber threats to investors and financial market infrastructure, as well as efforts to ease regulatory burdens. Your jobs have become more challenging with the rise of automated trading and constant technological innovation including areas such as financial technology or FinTech, and the need to operate in markets undergoing digital transformation.

Again, I thank both of you for being here. I look forward to your testimony and learning more about these and other challenges that you face. I will turn to my Ranking Member, Senator Coons, for an opening statement.

STATEMENT OF SENATOR CHRISTOPHER A. COONS

Senator COONS. Thank you. Thank you for convening this hearing, Chairwoman Capito, and I look forward to working with you on these important issues. And I welcome our witnesses, Jay Clayton, Chairman of the SEC, and Chris Giancarlo, Acting Chairman of the CFTC.

Both agencies operate at the forefront of our economy and provide critical protection to American consumers by helping stop fraud and manipulation in our securities and our futures markets. Market users, financial investors, and the U.S. economy as a whole rely on vigilant oversight by the SEC and the CFTC in today's fast-paced ever evolving and often volatile globalized marketplace.

Given the concentration of publicly traded firms that are incorporated in my home State, I am particularly interested in making sure your agencies have the resources they need and are investing these funds efficiently and effectively. Our economy has made notable progress is emerging from the financial crisis of nearly a decade ago, but we can ill afford a rerun of the debacle that cost Americans more than 8 million jobs, more than \$19 trillion in lost household wealth, and \$10 million in housing foreclosures.

That means we cannot let our guard down by reverting to the same practices that led to that crisis in the first place, but must make sure we have the necessary safeguards in place to keep our markets secure and stable. Investors of all types, large institutional investors, individual families, Americans saving for retirement, depend on the work of the SEC and the CFTC to protect against irresponsible and reckless practices. As the investors' advocate, the

SEC is responsible for maintaining fair, orderly, and efficient securities markets and the CFTC carries out market surveillance, compliance, and enforcement programs in all futures and swaps areas.

Unfortunately, the budgetary forecast for the 2018 fiscal year is a gloomy and uncertain one. The statutory budget caps impose challenging and I would say even unnecessary constraints, meaning we have many competing requests all vying for a share of shrinking resources. For the SEC, the President requests \$1.602 billion, a \$3 million drop below the fiscal year 2017 level, and for the CFTC the President seeks \$250 million, a freeze at the fiscal year 2017 level, which represented the third consecutive year of flat funding.

And I note that Acting Chairman Giancarlo submitted an independent funding request seeking \$281.5 million for the CFTC, an increase of \$31.5 million or 13 percent above enacted fiscal year 2017. I look forward to discussing the merits of your proposal today.

The subcommittee's task is to evaluate these requests in that challenging budgetary environment. Today's hearing provides a valuable public forum in which to ask the leaders of the SEC and CFTC a few key questions about whether your agencies are keeping pace with developments in the markets, particularly emerging new and complex financial products and trading platforms, whether you have the right mix of talent and specialized expertise to be vigilant watchdogs, whether you have state of the art information technology to augment and support that human capital and stay ahead of cyber threats, and what would the practical consequences be of budget cuts or a budget freeze and the accompanying reduced resources.

So, Chairman Clayton, Chairman Giancarlo, I am eager to discuss how you are currently using funds provided in fiscal year 2017 to get an insight into that. And as we turn our attention to fiscal year 2018, I want to learn more about your most pressing funding priorities as well as your honest appraisal of the potential impacts of your operations should your funding requests fall short. In the face of many competing demands for tight funding, shortchanging your two agencies in particular, in my view, would be exceedingly irresponsible.

I also want to underscore my continuing opposition to using our appropriation process to impose restrictive policy riders that carry controversial authorizing language that should instead be done by the relevant authorizing committees. And I hope we will continue to work together towards that goal in the fiscal year 2018 cycle.

Chairwoman Capito, I look forward to working with you this year as we evaluate the needs of these two important financial regulators as well as the many other accounts under our purview. Thank you for the opportunity.

Senator CAPITO. Sounds great. Thank you, Senator Coons.

Chairman Clayton, I now invite you to present your testimony. Thank you.

SUMMARY STATEMENT OF HON. JAY CLAYTON

Mr. CLAYTON. Thank you, Chairwoman Capito, Ranking Member Coons, and Members of the subcommittee. Thank you for inviting

me to testify today in support of the President's fiscal year 2018 budget request for the Securities and Exchange Commission. I would like to congratulate you, Madam Chairwoman, on your new role as head of this subcommittee. I would also like to express my appreciation to the Members of this subcommittee for your support for the SEC's important mission. Your support has been crucial to the agency's success and I look forward to working with each of you on the agency's fiscal year 2018 request.

I appreciate the opportunity to discuss with you how the SEC plans to use the \$1.602 billion requested for fiscal year 2018. This level is essentially the same as our fiscal year 2017 appropriation and will provide the funding necessary for the SEC to continue meeting our important tripartite mission—protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

The requested budget will provide the agency with the resources necessary to maintain our oversight of the world's safest, deepest, and most liquid capital markets while continuing our efforts to further promote economic growth and protect American investors. The American public will receive significant value in return for the SEC's \$1.602 billion.

With a workforce of about 4,600 staff, the SEC oversees approximately \$75 trillion in securities trading annually on U.S. equity markets. The disclosures of 8,800 public companies including 77 of the world's 100 largest companies, and the activities of over 26,000 registered market participants including investment advisers, mutual funds, exchange traded funds, broker-dealers, and transfer agents. We also engage with the investing public on a daily basis, from our investor education programs to our SEC.gov portal where on a typical day, investors view or download more than 50 million disclosure documents filed on the SEC's EDGAR system.

As this subcommittee is aware, the SEC's funding is deficit neutral. Whatever amount Congress appropriates to the agency will 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 for every \$1,000 in securities sales. The fiscal year 2018 request seeks to solidify and maintain the SEC's progress in key areas. I will use my remaining time to highlight how we propose to use the resources entrusted with the focus on five key areas: effective agency management, protecting investors, facilitating capital formation, leveraging technology, and leasing.

First, as the agency's senior responsible executive, I am committed to ensuring that the SEC is not only a good steward of the funds that you entrust to us, but also maximizes the value of those funds to the American investor. For fiscal year 2018, the agency will work toward more efficient internal operations. This includes continuing to develop and leverage our capabilities for risk analysis to inform our decisionmaking, including how to most efficiently use our staff resources.

Second, we are committed to protecting and enhancing the world's most vibrant markets. Under our request, more than 50 percent of the resources will be invested in the agency's enforcement and examination programs. In fiscal year 2018, the SEC will continue a robust enforcement program with resources focused on

key areas where misconduct harms investors, undermines confidence, and impairs market integrity. This includes: retail investor fraud, investment professional misconduct, insider trading, market manipulation, and accounting fraud.

Within our national examination program, the SEC has introduced efficiencies that have the agency on track this year, fiscal year 2017, to deliver a 20 percent increase in the number of investment adviser examinations. For fiscal year 2018, the SEC anticipates being able to deliver a further 5 percent increase in the number of investment adviser exams. This is important since investment advisers now manage \$70 trillion in assets, more than three times 2001 levels.

Third, the SEC in fiscal year 2018, will take steps to enhance capital formation, particularly for small and emerging companies and in our public capital markets. While the U.S. capital markets remain the envy of the world, fewer companies are choosing to enter the public capital markets than in the past. As a result, investment opportunities for main street investors are more limited. In fiscal year 2018, the SEC will pursue rule-making initiatives aimed at promoting firms' access to capital markets to generate economic growth while fostering important investor protections. Also in fiscal year 2018, we will take action to staff the new Office of the Advocate for Small Business Capital Formation so that it can pursue its work to better assist small businesses and small business investors.

Fourth, the fiscal year 2018 budget request will help the SEC to stay on top of critical technological developments in our capital markets. The \$240 million that the SEC requests to spend in IT in fiscal year 2018 is modest compared to the amounts that major Wall Street firms spend on their own IT systems. By way of comparison, in 2016 one large financial institution spent more than \$9.5 billion on technology while another spent \$6.6 billion. The fiscal year 2018 budget request relies on continued access to the SEC's Reserve Fund which will allow the SEC to commit to critical long-term IT initiatives that otherwise may have been more difficult to execute.

Key technological initiatives planned for fiscal year 2018 including: expanding data analytic tools to detect potential fraud; improving surveillance tools; increasing investments in cyber security; improving the access to and usefulness of information available through our EDGAR system.

Fifth and last, with the SEC's existing headquarters leased expiring in the next few years, the budget request includes funding so that the General Services Administration (GSA) may commence a competitive procurement process for a successor headquarters lease. The requested funds represent potential expenses for build-out costs, infrastructure, and fees if the outcome of the GSA's competitive acquisition process should require us to relocate. The funds would not be used for SEC operations and, in the event the money is not needed for relocation, would be refunded to the fee payers.

Thank you again for the opportunity to present the fiscal year 2018 budget. I deeply appreciate your continued support of the agency and look forward to working with you. I welcome your comments and advice and would be happy to answer any questions.

[The statement follows:]

PREPARED STATEMENT OF HON. JAY CLAYTON

Chairwoman Capito, Ranking Member Coons, and Members of the Committee:

Thank you for inviting me to testify today, my first appearance before this subcommittee, in support of the President's fiscal year 2018 budget request for the Securities and Exchange Commission (SEC). Before I begin, I would like to congratulate you, Madam Chairwoman, on your new role as head of this subcommittee. I would also like to express my appreciation to the Members of this subcommittee for your support of the SEC's important mission in previous budget cycles. Your support has been crucial to the agency's success, and I look forward to working with each of you on the agency's fiscal year 2018 request.

I appreciate the opportunity to discuss with you how the SEC plans to use the \$1.602 billion requested for fiscal year 2018.¹ This level, which is essentially the same as our fiscal year 2017 appropriation, will provide the funding necessary for the SEC to continue meeting our important tripartite mission—protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The requested fiscal year 2018 budget will provide the agency with the resources necessary to maintain our oversight of the world's safest, deepest, and most liquid capital markets while continuing our efforts to further promote economic growth and protect American investors.

Prior to my confirmation by the U.S. Senate last month, I spent more than two decades in private practice as a securities lawyer. During this time, I had the privilege and opportunity to engage with members of the SEC's exceptional staff on matters ranging from landmark capital-raising IPOs to important matters during the 2008 financial crisis and its aftermath. Now that I have joined the SEC, my experience during my first 6 weeks has strongly reinforced my view that our talented and committed staff is fundamental to the agency's effectiveness. The staff clearly shares the common belief that we serve the American people best when we promote an environment conducive to capital formation while striving to ensure that our markets and our investors remain well protected.

The investing public, and Americans more generally, will receive significant value in return for the SEC's \$1.602 billion budget. With a workforce of about 4,600 staff, the SEC oversees (1) approximately \$75 trillion in securities trading annually on U.S. equity markets; (2) the disclosures of 8,800 public companies including 77 of the world's 100 largest companies; and (3) the activities of over 26,000 registered market participants including investment advisers, mutual funds, exchange traded funds, broker-dealers, and transfer agents. We also engage and interact with the investing public on a daily basis, from our investor education programs and alerts to our SEC.gov portal where, on a typical day, investors and other market participants view or download more than 50 million disclosure documents filed on EDGAR.

Additionally, as this subcommittee is aware, the SEC's funding is deficit-neutral. 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 2 cents for every \$1,000 in covered securities sales.

The SEC also has been a net contributor to the U.S. Treasury in other ways that are not directly related to our appropriations. By law, companies pay a fee to the SEC at the time they register securities for sale. For fiscal year 2018, the fee rate will be set at a level sufficient to collect \$620 million. A small portion of these collections—\$50 million—will be put into the Reserve Fund, which the agency devotes to information technology improvements, while the remaining \$570 million will be deposited in the general fund of the U.S. Treasury.

The fiscal year 2018 request seeks to solidify and maintain SEC progress in key areas. I will now discuss how we propose to use the resources entrusted to us in these areas.

EFFECTIVE AGENCY MANAGEMENT

As the agency's senior responsible executive, I am committed to ensuring that the SEC is not only a good steward of the funds that you entrust to our use, but also maximizes the value of those funds to the American investor. I have devoted a sig-

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

nificant portion of my first 6 weeks at the SEC developing a deeper understanding of the agency's internal operations and management, including how the agency's divisions and offices interact with investors, markets, and companies. For fiscal year 2018, the agency will continue to work toward more efficient internal operations, including through automation, streamlined internal processes, and better use of data. For example, we will continue to develop and leverage our capabilities for risk analysis to inform our decisionmaking, 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 that we can direct resources where they are needed most.

PROTECTING INVESTORS

The SEC is the first line of defense safeguarding millions of investors, and as Chairman I am committed to protecting and enhancing the most vibrant markets in the world. The fiscal year 2018 budget will enable the SEC to have a robust program to monitor, investigate, and enforce compliance with the Federal securities laws. Under our request, more than 50 percent of the requested resources will be invested in the agency's enforcement and examination programs. These resources enable the agency to root out fraud and wrongdoing in our financial system. They also allow us to evaluate broker-dealers, investment advisers, and other regulated entities that interact with investors for compliance with investor protection rules.

This request will enable the SEC to continue the Division of Enforcement's vigorous efforts to investigate and bring civil charges against violators of the Federal securities laws. Successful enforcement actions impose meaningful sanctions on securities law violators, deter future wrongdoing, and result in disgorgement of ill-gotten gains that can be returned to harmed investors. The SEC's enforcement program is led by co-directors Stephanie Avakian, who served as the Enforcement Division's Deputy Director for the past 3 years, and Steve Peikin, an experienced former Assistant U.S. Attorney who also served as chief of the securities fraud task force for the Southern District of New York. In fiscal year 2018, under their leadership, the SEC will continue to focus resources on key areas where misconduct harms investors, undermines confidence, and impairs market integrity. This includes such critical areas as retail investor fraud and investment professional misconduct, insider trading, market manipulation, and accounting fraud.

Additionally, through our work to enforce the Federal securities laws, the Commission regularly obtains orders requiring securities violators to disgorge illegal profits and pay penalties. In fiscal year 2016, these amounts totaled more than \$4 billion. Our priority is to distribute these funds to harmed investors wherever reasonably possible.

The request will also enable the SEC's national examination program, led by the Office of Compliance Inspections and Examinations (OCIE), to focus on conducting risk-based examinations of registered entities, including broker-dealers, investment advisers, investment companies, municipal advisors, national securities exchanges, SROs, transfer agents, and clearing agencies to evaluate their compliance with applicable regulatory requirements. This is an example of an area where flexibility is necessary. Registered investment advisers now manage more than \$70 trillion in assets, which is more than three times 2001 levels. In 2016, the SEC reassigned approximately 100 staff to the national examination program's investment adviser examination unit. As a result of this shift and the introduction of efficiencies, the SEC is on track to deliver a 20 percent increase in the number of investment adviser examinations in the current fiscal year. For fiscal year 2018, OCIE anticipates being able to deliver a further 5 percent increase in the number of investment adviser exams. I expect that for at least the next several years we will need to do more each year to increase the agency's examination coverage of investment advisers in light of continuing changes in the markets.

In the coming fiscal year, OCIE plans to increase the number of inspections to assess compliance with Commission rules designed to ensure that the cybersecurity infrastructure that is critical to the U.S. securities markets is secure and resilient. OCIE also will continue to bolster its risk-based approach to exam selection through the continued development of data analytics tools. These tools help us identify activities that may warrant further examination and efficiently focus our examination efforts.

FACILITATING CAPITAL FORMATION

The SEC performs a critical function for companies seeking to raise capital to grow their businesses. The SEC's efforts in this area contribute to job growth and an expanding economy, as well as help ensure that investors—including Main Street

Americans—have access to a broad range of investment choices. The Commission’s rules seek to facilitate offerings by large and small companies engaged in all manner of commerce, while also protecting investors and maintaining confidence in the U.S. capital markets.

In recent years, the SEC has carried out this responsibility through a number of key initiatives, including most recently in response to the JOBS Act and FAST Act, with a particular emphasis on expanded capital-raising opportunities for smaller businesses. While much progress has been made, I believe the SEC can and should strive to do more to enhance capital formation particularly (1) for small and emerging companies and (2) in our public capital markets. U.S. capital markets remain the envy of the world, but fewer companies are choosing to enter the public capital markets than in the past, and, as a result, investment opportunities for Main Street investors are more limited. Your support for our fiscal year 2018 budget request will enable the staff to develop and present to the Commission rulemaking initiatives aimed at promoting firms’ access to capital markets to generate economic growth while fostering important investor protections. I recently named a new Director of the Division of Corporation Finance, Bill Hinman, who is leading these efforts and working with the staff to develop proposals for consideration. Bill is a recognized leader with more than three decades of experience advising companies of all sizes in capital-raising and acquisitions. We share the view that there is no better architecture for fostering capital formation, providing investment opportunities, and protecting investors than our public company disclosure-based system.

The fiscal year 2018 request also will enable the agency to devote resources to staff the new Office of the Advocate for Small Business Capital Formation. In the near future, the SEC plans to commence a nationwide recruitment effort to identify and hire a Small Business Capital Formation Advocate who will serve as the head of this office. This Office will provide assistance to small businesses and small business investors, conduct outreach to better understand their concerns, and recommend to the Commission ways that the regulatory environment might be improved. Once the Advocate is on board, your support for our budget request will enable the agency to staff this office in fiscal year 2018.

LEVERAGING TECHNOLOGY

Our capital markets have become increasingly complex, with advances in technology driving significant changes, including (1) the way that companies solicit investors and sell their securities to the public, (2) the channels through which individuals receive investment advice, and (3) the manner in which institutional and retail investors transact on our markets. Indeed, technology has contributed to changes in the fundamental structures of markets themselves.

The fiscal year 2018 budget request will help the SEC to stay on top of these critical developments and promote our mission in an evolving landscape. The SEC 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 \$240 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 toward new initiatives. Another large financial institution spent \$6.6 billion in 2016 on technology initiatives.

The fiscal year 2018 budget request relies on continued access to the Reserve Fund. These funds, which have been dedicated to technology, have been important in our efforts to keep pace with the rapid technology advancements occurring in areas regulated by the SEC, as well as meeting emerging cybersecurity challenges. The continued availability of the Reserve Fund historically has allowed us to commit to critical, long-term technology initiatives that otherwise may have been more difficult for us to execute.

Key technology initiatives that will be supported with our fiscal year 2018 request include:

- 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;
- Improving our examination program through risk assessment and surveillance tools that help identify high-risk areas for further examination;
- Increasing investments in cybersecurity, including strengthening our capabilities for monitoring and avoiding advanced persistent threats;

- Enhancing additional systems that support our enforcement program, including applying sophisticated algorithms that foster the detection of potential insider trading and manipulation;
- Improving access and usefulness of information available to the public through our EDGAR electronic filing system; and
- Investing further in business processes automation and enhancements including the retirement of legacy systems.

LEASING

As this subcommittee is aware, the existing SEC Washington, DC headquarters leases expire in the next few years. In addition to the \$1.602 billion request for SEC operations, the budget request includes the \$245 million that the General Services Administration (GSA) requires in fiscal year 2018 in order to commence a competitive procurement for a successor headquarters lease. None of these funds would be used for SEC operations. Rather, these funds represent potential expenses for build-out costs, IT infrastructure, security equipment, and fees if the outcome of GSA's competitive acquisition process should require the SEC to relocate. To provide the subcommittee with assurances that the funds will not be used for other purposes, the proposed appropriations language submitted as part of the budget request provides a mechanism whereby these funds would be refunded to fee payers in the event they are not needed for relocation.

CONCLUSION

Thank you again for the opportunity to present the President's fiscal year 2018 budget request. I deeply appreciate the President's and Congress' continued support of the agency. I look forward to working with the subcommittee to ensure that the SEC has the resources needed to fulfill our important responsibilities to investors and our capital markets. I welcome your comment and would be happy to answer any questions.

Senator CAPITO. Thank you very much.

And next, Chairman Giancarlo, I now invite you to present your testimony. Welcome.

COMMODITY FUTURES TRADING COMMISSION

STATEMENT OF HON. J. CHRISTOPHER GIANCARLO, ACTING CHAIRMAN

Mr. GIANCARLO. Thank you. Good morning, Chairwoman Capito, Ranking Member Coons, and Members of the subcommittee. I am honored to testify before you on the CFTC's 2018 budget request.

For more than 100 years, American farmers and manufacturers have used derivative markets to hedge the cost of production and their delivery price. It assures that we can always find plenty of food on grocery store shelves no matter what the conditions are on the American farm. But derivative markets are not just helpful for agricultural producers. They influence the price and availability of heating in American homes, electric power in our offices and factories, interest rates on homeowner's mortgages, and returns on retirement savings.

These markets allow producers to manage changing production costs like the cost of raw materials, energy, foreign currency, and interest rates. They enable business risks to be transferred from those who cannot bear it to those who can and they free up capital for investment and boost economic growth, job creation, and American prosperity. Yet today these markets are more fragmented, more concentrated, less liquid, and less supportive of economic growth than in the past. The time has come for these markets and

the efforts of those who regulate them to be put more fully into service of American economic recovery.

Turning to our budget, the Commission is requesting \$281.5 million and 713 FTEs for fiscal year 2018 operations. This is an increase of \$31.5 million and 36 FTEs over the fiscal year 2017 level. Now the \$31.5 million in additional funds is not an ad hoc number. It is a careful assessment of what the CFTC needs to execute its mission in fiscal year 2018.

I recognize the enormous task of setting the Federal Government's \$4 trillion budget and I respect the priorities of this Congress and President Trump to balance the budget rather than pile up more debt on American citizens. I know this subcommittee's essential role in appropriating and allocating the resources provided by our fellow taxpayers. Therefore, we did not take lightly the use of bypass authority to present our 2018 budget directly to Congress.

This is my first time directing a Federal agency in its budgeting process. Previously, I spent 30 years in the private sector where I was last a senior executive of a public company. It seemed to me that the budgeting process of government agencies always started with last year's budget to which was added an additional increase. When I became acting CFTC chairman a few months ago, I approached the budget a little differently, the way I did back in business. I sat down with the heads of every unit. I reviewed their missions and their spending. Together, we built this budget up from zero based upon real needs and real expenditures.

No surprise, I found areas where the agency could be more efficient. For example, by returning to regular order in its operations, taking greater care and more precision in its rule drafting, adopting less contracted timeframes for public comment, reducing the docket of new rules and regulations to be absorbed by market participants, and adopting a proper specification process for new technology spending, reestablishing our central service model, and not over interpreting our mission.

I hope that by implementing these changes I could have reduced our 2018 budget request below prior year levels or even held it steady, but it will take some time to see these efficiencies realized in our budget going forward. Rather, I discovered three critical areas where the agency falls short of its current mission.

These are the Commission's budget priorities for fiscal year 2018. They explain the modest increase in our budget request. First, the Office of Chief Economist is under resourced to meet the challenges of the rapidly changing nature of global derivative markets. We must conduct more thorough cost benefit and econometric analysis to support better regulatory policy. Second, as clearing houses grow in size and scope, so too has the complexity of the counterparty risk management oversight programs and procedures of the firms we regulate.

It is said that an ounce of prevention is worth a pound of cure. The better our process for examining derivatives clearing houses, the less taxpayers are at risk of bailing them out if something goes wrong. We must strengthen our examinations capacity to keep pace with the explosive growth and the amount and value of clearance swaps here and abroad.

Third, and finally, to avoid being a twentieth century analog regulator of twenty-first century digital markets the CFTC must keep pace with emerging technology. The world is changing. Our parents' financial markets are gone. A digital transformation is well under way and shows no sign of stopping. For this reason, we have launched LabCFTC, an important financial technology initiative that will help us catch up with the changing nature of markets for which we are responsible.

In conclusion, U.S. derivative markets should be neither the most regulated nor the least regulated in the world, but the best regulated. Providing effective oversight and robust enforcement of our laws motivates the talented men and women of the CFTC. Our standard is operational and regulatory excellence and our proposed budget will meet the standard for the American people.

I submit my written testimony for the record and I welcome your questions. Thank you.

[The statement follows:]

PREPARED STATEMENT OF HON. J. CHRISTOPHER GIANCARLO

Good morning, Chairwoman Capito, Ranking Member Coons and Members of the subcommittee. Thank you for the opportunity to testify on the Commodity Futures Trading Commission ("Commission" or "CFTC") fiscal year 2018 budget request.

I appreciate the support your Committee has shown the Commission and for understanding the critical role we play in regulating the derivatives markets. I am pleased to be here today with Securities and Exchange Commission's (SEC) Chairman Clayton, and I very much look forward to our discussion today and working collaboratively with him as we move forward.

For more than 100 years, farmers and ranchers have used listed derivatives markets to hedge their costs of production and delivery price so that Americans can always find plenty of food on grocery store shelves. But derivatives markets are not just beneficial for agricultural producers. They influence the price and availability of heating in American homes, the energy used in factories, the interest rates borrowers pay on home mortgages and the returns workers earn on their retirement savings. In addition, more than 90 percent of Fortune 500 companies use derivatives to manage commercial or market risk in their worldwide business operations. In short, derivatives serve the needs of society to help moderate price, supply and other commercial risks to free up capital for economic growth, job creation and prosperity.

It is imperative that we get our regulation of America's derivatives markets right, and that regulation needs to be supportive of economic growth. To do that, our oversight of market participants, here and abroad, should provide a model of regulatory excellence. We need to review, and where it makes sense, reform, rewrite, and appropriately simplify our regulations to allow market participants to effectively manage risk.

It is these basic tenets that form the basis of the Commission's fiscal year 2018 budget request. With this budget request, the Commission will be able to support regulatory excellence without sacrificing other important Commission work, such as Enforcement or Surveillance activities. In the fiscal year 2018 request, the Commission placed importance on specific capabilities that will allow the Commission to enhance economic cost benefit analysis capabilities; strengthen Commission examinations capabilities over swaps clearing houses; and address the regulatory challenges related to market innovation.

BUDGET REQUEST

The Commission is requesting \$281.5 million and 739 full-time equivalents (FTE) for fiscal year 2018 operations. This is an increase of \$31.5 million and 36 FTE over the fiscal year 2017 level. The \$31.5 million in additional funds is not a formulaic or superficial number, but a thorough and informed assessment of what the CFTC needs to execute its mission in fiscal year 2018. This amount differs from the President's budget request of \$250 million.

Under my direction, the Commission has utilized its ability to provide a budget directly to the Congress. This is the first budget submission under my leadership, and I believe it is important to articulate the needs of the Commission based on my perspective and vision for a renewed and refocused CFTC.

On January 20, I began a process of looking at every function and every expenditure undertaken by the Commission. In the private sector, we would never simply take last year's budget number and add a percentage increase. Rather, each dollar requested had to serve a purpose. Likewise, when I sat down with our leadership team, my budget baseline was zero. We built our budget from the ground up. Drawing on my business experience, I have already identified several areas in which the agency can run more efficiently and save taxpayer dollars. For example, I reviewed the needs of the offices that provide various support services to our divisions, and I intend to gain efficiencies by instituting a central-services organizational model that is a best practice in the private sector. We also discovered areas within our current mission where we need additional investment. The \$281.5 million fiscal year 2018 budget request reflects the current needs of the CFTC based on this analysis.

The era of Dodd-Frank implementation at the CFTC is now drawing to a close. It is time for the agency to resume normalized operations and practices. That means a return to greater care and precision in rule drafting, more thorough econometric analysis, less contracted timeframes for public comment and a reduced docket of new rules and regulations to be absorbed by market participants. It also means that the CFTC will embrace the administration's directive that each Federal agency minimize the costs incurred by regulation. We plan to accomplish this through the KISS initiative I launched in March, which includes both internal and external reviews of rules and processes. It is another way of looking for opportunities where we can reinvest and maximize current resources.

Normalizing operations at the CFTC also means working cooperatively with other Federal market regulators, like the SEC, and where appropriate, the CFTC should look to delegate responsibility to the National Futures Association and other SROs for certain compliance matters.

In addition, we are reevaluating the focus of our enforcement efforts. The Commission's enforcement function is staffed by experienced and decorated former prosecutors, and I can proudly say is one of the premier civil law enforcement arms of the Federal Government. Yet, the Commission's enforcement efforts must look to benefit from cooperation, and where appropriate, defer to the civil and criminal capabilities of other Federal and State regulators and enforcement agencies.

RESOURCES FOR INCREASED ECONOMIC COST BENEFIT ANALYSIS

The additional resources requested for economic analysis will be invested in building the Commission's capacity to systematically analyze large volumes of trade data and improve our understanding of the markets.

The additional investment in economic capabilities will boost the CFTC's analytical expertise and monitoring of systemic risk in the derivatives markets, in particular with regard to central counterparty clearinghouses. It includes the expansion of sophisticated econometric and quantitative analysis devoted to risk modeling, stress tests, and other evaluations necessary for market oversight. Furthermore, such analysis will help the CFTC fulfill the Presidential Executive Order on Core Principles for Regulating the U.S. Financial System, relating to the core principle of fostering economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry.

A common criticism of the rule-making process has been the lack of quantitative assessments of costs and benefits. While there was a paucity of relevant data for Dodd-Frank implementation, we believe that market participants and the public expect the CFTC to leverage the data sources now available to inform future rule-making. The current staff dedicated to economic analysis is inadequate to meet appropriate standards for econometric analysis required by a regulatory agency with oversight of more than 35 to 45 percent of the global derivatives markets.

Looking beyond rulemaking, the new data sets have opened up possibilities for more effective analysis of the U.S. derivatives markets. For example, Commission economists are focused on developing the capability to integrate activity and positions across futures and swaps markets, and thus gain a holistic view into the derivative exposures of market participants and the interaction between the futures and swaps markets.

There is growing awareness that just looking at the total notional size of activity in the market might not be representative of the true extent of risk transfer. We have taken some initial steps to convert notional amounts into risk-based measures; however, additional resources are necessary to develop these analytical capabilities. Without the requested increase, the CFTC will continue to rely on outdated, anachronistic models and metrics of studying our markets.

RESOURCES FOR EXAMINATIONS TO COVER INCREASED DCOS

The Commission is also requesting additional resources that would strengthen the Commission's examinations capability and enable it to keep pace with the explosive growth in the number and value of swaps cleared by designated clearing organizations (DCOs), pursuant to global regulatory reform implementation. As the size and scope of DCOs has increased, so too has the complexity of the counterparty risk management oversight programs and liquidity risk management procedures of the DCOs under CFTC regulation here and abroad.

Currently, there are 16 DCOs registered with the Commission and there is one pending application for registration. The Commission projects that the number of DCOs will continue to expand in fiscal year 2018, and volume will continue to grow at existing DCOs. Since the end of 2011, the total amount of initial margin held by registered DCOs for futures and swaps has grown by more than 168 percent from \$119 billion to \$320 billion. For swaps alone, the growth is even more dramatic. For example, at LCH Clearnet Ltd, the amount of initial margin held for swaps has grown by more than 600 percent since 2010.

The growth in volume has been accompanied by an increase in the complexity of products. For example, the risks posed by credit default swaps differ from those posed by interest rate swaps. Accordingly, DCOs have developed a large number of individualized margin models and other risk management tools to address these risks. This, in turn, generates a corresponding increase in the complexity of the Commission's oversight responsibilities.

The Commission is seeking to position additional resources to enable it to continue to fulfill its responsibilities relating to systemic risk. Increases in the number of DCOs, the volumes cleared, and the complexity of the products necessitate increases in the resources devoted to the oversight of clearing, through timely and thorough examinations of DCOs. These examinations cover a range of issues from the size of financial resources, to margin, to treatment of customer funds, and cyber security. In addition, the Commission will also continue to develop capabilities for conducting stress testing and back testing to assess the impact of stressful market scenarios across the clearinghouses.

Many of the DCOs are expanding their registration in other jurisdictions around the world. Those jurisdictions look to the Commission to provide insight regarding the effectiveness of the programs implemented by the DCOs. The Commission supports the expanding market participant registrations through information sharing and compliance discussions in the areas of cybersecurity, liquidity risk management, default management and other high profile risk management issues.

RESOURCES TO FURTHER IMPLEMENT FINTECH

Earlier in the year, President Trump issued an Executive Order establishing an American Technology Council. The President said, "It is the policy of the United States to promote the secure, efficient, and economical use of information technology to achieve its missions. Americans deserve better digital services from their Government. To effectuate this policy, the Federal Government must transform and modernize its information technology and how it uses and delivers digital services."

I could not agree more. That is why in fiscal year 2018, the Commission requests additional funds to increase staffing and resources to address financial technology innovation (FinTech). The Commission aims to address three fundamental issues arising from transformations in FinTech: (1) how the CFTC should leverage FinTech innovation to make it a more effective regulator; (2) how FinTech can help the CFTC identify rules and regulations that need to be updated for relevance in digital markets; and (3) the role of the Commission in supporting U.S. FinTech innovation in CFTC regulated markets. With these additional investments, I plan to execute a phased approach that will achieve these three objectives.

So much of our world today, from information to music to manufacturing to transportation to commerce, and even farming, has undergone a digital transformation. It should be no surprise to anyone that our capital, commodity and futures markets are going through the same digital transformation. The electronification of markets over the past 30 to 40 years and the advent of exponential growth in digital technologies have altered trading, markets and the entire financial landscape with far ranging implications for capital formation and risk transfer.

Other breaking digital innovations present equal regulatory challenges. These innovations include "big data" capability to enable more sophisticated data analysis and interpretation; artificial intelligence to guide highly dynamic trade execution; "smart" contracts that value themselves and calculate payments in real-time; behavioral biometrics that can detect and combat online fraud; and distributed ledger

technology, more commonly known as blockchain, that will challenge orthodoxies that are foundational to today's financial market infrastructure.

The pace of investment in these technologies, and in FinTech more broadly, has accelerated in recent years. According to one measure, investment has increased at a cumulative annual growth rate of more than 45 percent from 2011 to 2016. We are seeing a powerful convergence, as the costs of launching new ventures and applying new technologies have dropped enormously, while the speed and scalability with which they can be brought to market have increased dramatically.

The world is changing. Our parents' financial markets are gone. The 21st century digital transformation is well underway, and the digital technology genie will not go back in the bottle. In order for the CFTC to remain an effective regulator, it must keep pace with these changes or our regulations will become outdated and ineffective.

EFFECTIVE USE OF RESOURCES

Just as I did in the private sector, I will strive as a government official to maximize how limited resources are used. Earlier this year, I notified you of actions we took to streamline and centralize business management functions from the mission delivery divisions to administrative services, a change that will produce long-term savings. In addition, we realigned portions of the surveillance staff under the enforcement division and refocused a team on developing improved market intelligence. Each of these actions leverages existing processes, and increases the efficiency and effectiveness of the Commission's core functions. Moreover, these actions will allow us to better manage our resources while maintaining, but not increasing, our Division of Enforcement's legal resources.

The Commission has also worked to improve its administration of its leases. CFTC entered into a memorandum of understanding (MOU) with the General Services Administration (GSA) to administer all future CFTC leases. In addition, the CFTC cleared the lease accounting issues highlighted in the fiscal year 2015 financial statements audit, received an unmodified, or "clean," opinion on its fiscal year 2016 financial statements and earned the certificate of excellence in accountability reporting from the Association of Government Accountants.

In fiscal year 2018, I have plans to review additional opportunities to streamline operations and further maximize the effective use of our resources. The Commission's organizational structure must evolve to support the changing times. These types of organizational reviews are critical to ensure that resources and staff are devoted to the most important priorities in the CFTC's mission to oversee the Nation's derivatives markets.

CONCLUSION

The U.S. derivatives markets should be neither the most regulated nor the least regulated of the world—but the best regulated. This quest for superior regulatory oversight and unswerving enforcement of our laws motivates the work of the hundreds of talented men and women who serve their country at the CFTC. Only with such a commitment can all Americans experience the economic benefits that risk-transfer markets afford. This budget request ensures that the CFTC can meet such a standard for the American people. The fiscal year 2018 budget submitted by the Commission reflects the true needs of a policy setting and civil law enforcement agency that has the duty to ensure the derivatives markets operate effectively. This budget will give the Commission the resources it needs to put in place and oversee responsible regulations that allow for innovation and enable our markets to remain competitive and safe at home and abroad.

Senator CAPITO. Thank you very much, Director.

And I am going to begin—or Chairman, excuse me—begin the questions and I will begin with my 5-minute question.

Chairman Clayton, you mentioned in your opening statement that fewer companies are going public and your concern and some of the plans that you have to try to improve this situation. Could you kind of dig down more granular to what kind of impact that has on people's retirements, ability to invest, and what kind of choices are being curbed by this phenomenon and why is this occurring.

Mr. CLAYTON. Well, thank you, Madam Chairwoman, and I would like to because when I started this job this was a matter of

concern to me, the fact that we have gone from roughly 8,000 public registrants to 4,400 or so in the last 15 years. Let me start with the impact on main street investors.

Senator CAPITO. Right.

Mr. CLAYTON. That is fewer choices for main street investors, 8,000 down to 4,400. If that number continues to shrink, the choices for main street investors will, in my view, by definition shrink. Our public capital markets are wonderful. They offer access to investments on a relatively costless basis compared to investing in private sector investments. Said another way, it is very difficult for main street investors to access—

Senator CAPITO. Right.

Mr. CLAYTON [continuing]. Private sector investments because of the fixed costs of making such investments, the compliance costs, et cetera. So this is troubling to me because the public equity markets, public debt markets are where our main street investors look for their investing needs.

What are the drivers of this? I think they are multifaceted. I think that people would tell you it is one thing or another. Regulation is certainly one of them. The fixed costs and ongoing annual costs of being a public company have gotten higher. They have gotten—they have increased, you know, much in excess of inflation. The ability to raise capital in private markets has gotten easier. There is more private capital available. And there is something that we are continuing to explore, and I want to explore further, which is the liquidity available for small and mid-sized public companies that enter our public markets is not what people would like it to be. So—

Senator CAPITO. And that is why you created your committee?

Mr. CLAYTON. Yes.

Senator CAPITO. Your small business committee.

Mr. CLAYTON. Yes.

Senator CAPITO. Yes.

Mr. CLAYTON. That is one of the drivers, yes.

Senator CAPITO. Thank you. I think that is concerning because obviously that is a lot of retirement dollars that people look to, you know, in the long term to be able to access. And you want to look at growth obviously to take you into your later years and if your options are curbed your ability to really have a comfortable retirement in your later years is certainly curbed as well.

LEASING

I want to ask both of you something. Let us go to the space and the leased space area because you both have issues, I think, related to this and some questions. I will start with you, Chairman Giancarlo. You know, the Inspector General estimates that the CFTC will spend throughout four of its offices over the terms of the current lease between \$44 to \$56 million on empty office space. What steps are you taking to reduce that footprint? And the other question I have and I am going to ask you to respond to this too, Mr. Clayton, is on the telework issue do you have—I understand that you have a lot of vacant offices because of your telework policies. Are you working to kind of reign the lease options in for that maybe shared space and all those kinds of things?

Mr. GIANCARLO. Thank you for that question. Our average——

Senator CAPITO. Let's go to the empty offices first.

Mr. GIANCARLO. Yes. So we have four offices here in Washington, New York, Chicago, and Kansas City. Our average leasing percentage is about 85 percent occupancy, but in some of our offices such as Kansas City and New York, it is less than that. Those leases were entered into several years ago, I think at a time when perhaps there was an expectation among some that the CFTC would become a much bigger agency, and that space was taken on.

We are handing that authority to enter into leases back to GSA and we are searching now as hard as we can to fill that space, whether through sub tenancy or otherwise. We have been working very hard in Kansas City in particular and have had a number of—or entertained a number of offers. Unfortunately, they were not—did not make economic sense for us. But we continue to find ways to utilize that space.

In New York, our LabCFTC initiative that I talked about is one way that we would use some of that space in New York City by situating that effort in New York where a lot of the new innovation is taking place. I am sorry. Your second question was?

Senator CAPITO. Well, let me go to Mr. Clayton now and then telework was my question, but I am running out of time, so let me hear.

Mr. CLAYTON. Sure. And I will try and do both. Yes. Teleworking has increased. It is one aspect of technology that I believe and our staff that handles operations believes could actually reduce the required footprint per employee. We have been working to do that. Rough data, it used to be 290 square foot per employee. We are now down to about 245 square feet and we are looking to trend down to around 230 square feet per employee with teleworking and other technological advancements contributing to that efficiency.

Senator CAPITO. Okay. And what about telework for you since I have—he gave me a quick answer?

Mr. GIANCARLO. Yes. So we are in negotiations with our union right now and that is one of their requests, for increased telework. I must say that having come from the private sector, telework is an idea that is less—found to be less attractive in the private sector. And IBM just, after going through a long experiment with it, is going in a different direction. I think there is value in having our employees together in one place. The ability to look at different ideas and stimulate one another, I think, is present when people are together in one space.

Senator CAPITO. Thank you.

Senator Coons.

Senator COONS. Thank you, Chairwoman Capito. Thank you to both our witnesses. And I would like to ask unanimous consent that a written statement to us from Anthony Reardon, National President of the National Treasury Employees Union (NTEU), be entered in the record.

Senator CAPITO. Without objection.

[The statement follows:]

PREPARED STATEMENT OF ANTHONY M. REARDON
NATIONAL PRESIDENT
NATIONAL TREASURY EMPLOYEES UNION

Chairman Capito, Ranking Member Coons and Members of the Subcommittee on Financial Services and General Government Appropriations, thank you for the opportunity to present this statement on behalf of the National Treasury Employees Union (NTEU). Our union is proud to represent the bargaining unit staff at the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC).

The employees of the CFTC and the SEC are among the most professional, hard working and dedicated of any in the public or private sector. The rapidly changing practices in the financial markets as well as new forms of fraud and wrongdoing mean that these two agencies must continue to recruit and retain employees with the highest level of skills. Commitment to this goal will mean that fraud will be reduced and investors, savers, retirees, end users and others who participate in the market will not be victimized by those who would do them financial harm.

COMMODITY FUTURES TRADING COMMISSION

NTEU supports CFTC's request for \$281.5 in funding for fiscal year 2018. This request is extremely modest and in fact with the increased duties the CFTC has been given in recent years, resources above this amount would be entirely appropriate. Funding at least at this level is critically important to allow the employees of the CFTC to perform their work in an effective and professional manner. Every day, the duties of the CFTC to protect consumers in the marketplace grow more complex. Having a vigorous free market require that the "cops" detailed to that "beat" have the resources necessary to police the ever growing marketplace and the advancing technological developments that enable both market expansion and market fraud.

Further, to the benefit of American families and businesses, the CFTC has returned billions of dollars to cheated investors, in fact more than its entire appropriation. Congress should not be penny wise and pound foolish when it comes to protecting the investments of American consumers, only to see the victimized lose retirement investments or life time savings.

NTEU is seeking parity in pay and benefits with other financial regulatory agencies, particularly the SEC. There are many incidents of some of the brightest and most skilled CFTC employees leaving CFTC for positions at the SEC or elsewhere in Federal service because of better pay and benefits. Not only does CFTC lose these superior employees but morale problems develop for those employees remaining at CFTC.

Even with the agency's request of \$281.5 million, CFTC will still not fully have the resources it needs to perform its mission. However, we believe that this amount can be workable along with certain flexibilities and initiatives. Congress has imposed a fence of \$50 million within CFTC's budget for IT. This has not been requested by the agency nor by the previous administration. Yet it represents 20 percent of CFTC's appropriation and denies the agency the flexibility it needs to follow its mission under very limited funding. Congress should give CFTC more flexibility with its limited appropriation. Further, CFTC can benefit from the following workplace reforms:

- Increased telework*: many agencies allow employees 2 or more days of telework per week, which increases productivity, efficiency, and staff retention as well as cost savings for the Agency. With increased telework, CFTC could promote office sharing and reduce rented office space. In addition, one additional telework day per week could save up to an estimated \$300,000 per year in transit subsidies.
- Insourcing*: CFTC currently has just under 700 full-time equivalent employees and 400–600 contractors. Contracting companies charge overhead costs while contract employees lack the accountability, expertise, and institutional knowledge of CFTC employees. Moving these contractor responsibilities in-house would translate into improved productivity, better work product, and savings in overhead costs.
- Restructuring*: in some sections or divisions, supervisors are responsible for very small numbers of employees (e.g., one supervisor for three employees). This creates inefficiencies both in reporting and in cross-unit coordination. Reducing the number of administrative units and the layers of supervision would improve efficiency at the CFTC.

—*Additional flexible work schedules*: increased flexibility in work schedules (such as a 4/10 schedule) would increase productivity and staff retention as well as reduce the amount the Agency spends on transit subsidies.

SECURITIES AND EXCHANGE COMMISSION

American investors benefit from the highly skilled employees at SEC and NTEU is pleased to be a part of the successful efforts to make the SEC a workplace that attracts the best and brightest of their field. Over the past 5 years NTEU has worked with SEC management to improve employee engagement. In the most recent Federal Employee Viewpoint Survey (FEVS), the results were increasingly positive for SEC. The Partnership for Public Service also recognized SEC as the “most improved” of any mid-sized agency. These positive results reflect the culmination of a persistent, multi-year effort by NTEU and the SEC management in working together to create an environment that engages employees and supports their commitment to excellence on behalf of America’s investors and our markets. There must be no backtracking in this excellence.

Therefore, NTEU believes that at least a modest increase in funding is required. The administration has proposed an appropriation of \$1.602 billion for SEC. NTEU believes that a minimum of \$1.781 billion is needed for the Commission to perform its important duties in protecting investors and maintaining market fairness. This figure matches the previous administration’s fiscal year 2017 request. Recent funding improvements at SEC have just begun to provide the staffing level needed for the additional duties created under the Dodd-Frank Act. But the continued growth of the regulated market demands that the SEC receive increased staffing just to stay even. \$1.781 billion will allow SEC to hire an additional 250 FTEs.

I would remind the subcommittee that SEC funding is deficit neutral. While the appropriations process allows this subcommittee to give important oversight to the SEC, the agency is not funded by tax revenue, rather it is fully funded by fees paid by the industry which are adjusted to cause no negative impact on the Federal budget deficit. Moreover, in these difficult financial times, in fiscal year 2015, SEC distributed over \$4 billion (more than twice its budget) to cheated investors through disgorgement or contributed to the general fund through civil penalties. None of these monies are retained by SEC.

The Dodd-Frank Wall Street Reform and Consumer Protection Act established the Securities and Exchange Commission Reserve Fund. The Reserve Fund is a separate fund in the Treasury from which the Commission may obligate amounts determined necessary to carry out SEC functions. The Reserve Fund is funded by deposits from registration fees collected by the Commission. The 2018 Budget proposes to eliminate the Reserve Fund in 2019. Registration fees currently deposited in the Reserve Fund would be redirected to the General Fund of the Treasury. NTEU strongly opposes this proposal. First, it would deny SEC needed resources towards its mission. Second, it is contrary to the principles of the Investor and Capital Markets Fee Relief Act that fees paid to the SEC should be used for SEC purposes and not diverted to general revenue. To do so is to impose a hidden tax on registrants.

NTEU is concerned about the use of government contractors performing sensitive work at SEC. The Office of Credit Ratings (OCR) is using contractors as part of their examination teams. The Office of Compliance Inspections and Examinations (OCIE) is using contractors to perform asset verification and net capital analysis, as well as to conduct examinations. These inherently governmental functions are being assigned to contractors who have insufficient training and are not covered by the same ethical standards or conflict of interest rules as SEC employees. These are short-term employees who work for outside companies and whose employment can be terminated at any time for any reason. On the other hand, SEC permanent employees are covered by a whole host of important conflict of interest and ethical rules. The differing standards for SEC contractors and employees leave a gaping hole in the SEC’s ethical regime. We are pleased that there have been some indications that Chairman Clayton does not plan on increasing the number of contractors.

The 11 SEC field offices serve a very important role in discovering fraud and deceit in local communities across the Nation. NTEU is disturbed by a provision in H.R. 10 that could close some of these field offices. NTEU found that the evidence is SEC would actually benefit from an increased number of field offices, specifically in the Midwest, southwest, northwest and mid-Atlantic areas. Not only could this be economical due to more moderate office space costs in these places, but NTEU members at SEC strongly believe that geographical proximity of SEC staff to situations of fraud and wrongdoing has a strong impact on enforcement and discovery. SEC should give serious consideration to the opening of new field offices in parts of the country that are underserved or suffer from investment fraud above the norm.

We would welcome language in the appropriations bill that would prevent closure of any of the eleven field offices.

The core of SEC's work is in enforcement and examination. This is where the bad actors are caught and punished and the innocent protected. NTEU would support an additional 131 FTEs in the Division of Enforcement. No less than this should be funded.

Limitations on employee investigatory travel budgets also harm the ability of SEC front line employees to do their job in an effective and professional manner. Employees at the SEC believe the importance of this work will become increasingly critical in the near future. For example, because of low returns in the bond market in which many people have their post retirement savings concentrated, retirees are increasingly looking for new investments promising higher returns. While some senior citizens may find the higher yielding investments they are seeking, others will become victims of fraud and Ponzi schemes. Without proper SEC staff in numbers, quality, training and mobility, we will see an increasing number of seniors at risk of being cheated out of their retirement savings and investments. Seniors should not lose their retirement savings to unscrupulous advisors because of an understaffed or weak SEC.

Like the CFTC, even with NTEU's recommended funding, SEC will still not fully have the resources it needs to perform its mission. Again, we believe that this amount can be workable along with certain flexibilities and initiatives. Congress should not impose any funding inflexibilities on SEC and management should implement cost saving workplace efficiencies such as a more robust telework program, which increase morale and saves on leasing costs.

NTEU appreciates the opportunity to present our views to the subcommittee and hopes to continue to work with the Chair and the Members of the subcommittee on funding for these two agencies as well as other matters under the subcommittee's jurisdiction. Thank you.

RESPONSIVENESS TO INQUIRIES FROM DEMOCRATS

Senator COONS. If I might, to both witnesses first. There is concern that the administration is choosing to not respond to requests from Democrats which counters a longstanding bipartisan tradition upheld by both parties. Will you commit to responding to questions and requests for information from both majority and minority?

Mr. GIANCARLO. Certainly.

Mr. CLAYTON. Yes, Senator.

Senator COONS. Thank you both.

If I might, first, Chairman Giancarlo about the CFTC. The funding has remained flat for three fiscal years and your testimony today and your justification materials describe the \$31.5 million increase you are seeking after a thorough bottom-up budgetary review to support three key priorities as you articulated in economic and cost-benefit analysis, continued advances in market intelligence, and helping financial technology innovators navigate regulatory compliance. You also proposed to devote a portion to sustaining current IT investments.

2018 FUNDING LEVELS

What particular setbacks would the CFTC experience if your request to increase does not get provided by this subcommittee and if your budget authority is frozen at \$250 million as proposed by the President? How would you address those needs? Would you abandon your proposed enhancement in FinTech, market intelligence, cost-benefit analysis, or would you consider reducing spending in other areas?

Mr. GIANCARLO. Thank you for that question. I said in my testimony that our markets are changing dramatically before our eyes. When people think of CFTC, they often think of a scene from a

funny movie from the 1980s called Trading Places with trading pits. Well, those trading pits are all closed. That world is gone. Our markets are virtual. They are online. They are electronic. They are algorithm driven. They are not pit trading anymore. And yet our rule set is very much still written for that old world.

We have to dramatically move to the future. A great hockey player, Wayne Gretzky, said that the reason he was successful is because he did not skate to where the puck was, but he skated to where the puck is going. Our budget that I have put forward enables us to skate to where the puck is going. Those economists will help us understand the rapidly changing nature of the markets.

When I travel and meet with farmers and ranchers and others that use our markets, they are very concerned about development such as high frequency trading and the virtual nature of trading in markets. And unfortunately, we just do not have all the answers for them because we do not really have the capacity to look into that future direction. We need to build up that econometric unit. We need the separate LabCFTCs. We can start understanding some of these new technologies like block chain, like machine learning, like big data computing that firms are using to trade in our markets.

Mr. Clayton mentioned that one firm alone has devoted, I think the number was \$9 billion, just to technology. We are proposing a \$57 million technology budget. We really need this budget that we have put forward.

Senator COONS. Well, thank you. I appreciate that. And given the history of our having had a crash that in no small part was contributed to by a misunderstanding or failure to effectively and transparently regulate a burgeoning derivatives and swaps market, your request strikes me as wise.

Mr. Clayton, I might just ask you as well. The budget request for SEC of \$1.602 billion is \$3 million below a freeze. Last year's request was \$180 million more. Your request appears to shave about 2 percent from each of the operating divisions except for the Inspector General. I am concerned that that might be going in the wrong direction in terms of protecting investors. How do you believe a freeze will help the SEC police highly sophisticated markets and increase oversight of investments advisors when we have such a robust market? You are making admirable progress in terms of inspections and overview, but why not continue to invest?

And then last, the administration proposed eliminating the SEC Reserve Fund. I would be interested in your view on the wisdom of doing so.

Mr. CLAYTON. Okay. Let me—we are essentially flat, maybe down actually less than, you know, \$3 million and we have probably a percent cut due to attrition. We have Senator no reduction in force or anything like that. I am comfortable that we can continue to fulfill our mission in the same way we have in the past at this funding level. It also gives me an opportunity, a new person in this seat, to assess where we may need funding going forward.

Again, I agree with Chairman Giancarlo. Our markets are changing and the pace of change is increasing. And I am—I will tell you one thing I am certain of. There will be areas that, this time next year, I would want more funding that I do not know about today.

Just to give you the analysis I went through when getting in the seat, and I want to thank the staff for really getting me up to speed quickly on the needs of the Commission. At our current funding level, I am comfortable. You know, if you took a percent, I would be pretty bummed out. It would hurt. And I think if, you know, I had a few more dollars, could I spend them wisely, but I would not know where to spend a whole lot more right at this time. So I am very comfortable.

And the SEC Reserve Fund, I am seeking to continue to have the SEC Reserve Fund at \$50 million. This has been dedicated to technology in the past. Technology spend is more than an annual event. Sometimes 2, 3, 4 years for implementation design testing. And it is very helpful to have a dedicated source of funds for technology.

Senator COONS. Thank you. I think we can all agree broadly that Federal agencies have not historically done a great job of IT procurement and I think having a reserve fund and the ability to prepare for it and procure it on a long-term basis makes great sense, particularly in an area where staying ahead of the IT curve is so important.

Thank you, Madam Chairwoman.

Senator CAPITO. Senator Moran.

Senator MORAN. Chairwoman, thank you very much. Chairman Clayton, Chairman Giancarlo, thank you very much for your public service. Welcome to the capacity of the positions you now hold and look forward to working with you.

SWAP DEALER DE MINIMIS LEVEL

Let me start with the CFTC. Chairman, as you know, the swap dealer de minimis level is set to drop to \$3 billion by the end of the year. I am concerned this will negatively impact farmers and ranchers, folks in Kansas who utilize that risk management tool. They would find themselves suddenly with fewer options for potential counterparties to help them meet their risk management. Are you able to provide any assurance that this risk management tool will remain at a level of \$8 billion or higher provided the CFTC does not receive data showing that it should be lower?

Mr. GIANCARLO. Thank you, Senator. And may I just say for the record, in regard to a question from the Chairwoman, I meant to say the GSA and not the GAO in response to a question. I would like to just correct the record. Thank you very much.

The question you raised, Senator Moran, is a very important one about getting this de minimis level right. And the question is if by falling to \$3 billion do we serve the purpose of capturing more swap dealers, or do we in fact have market making activity leave the marketplace, the type of market making activity that actually serves our smaller market participants and therefore defeat our very efforts of capturing more in our regulatory grasp by forcing them to part the markets.

When these levels, the current \$8 billion and the proposal to drop to \$3 billion were set 5 years ago by the CFTC, it was in complete absence of the type of data necessary to be able to answer the question: What is the right balance? A year ago under Chairman Massad's direction, our Division of Intermediary and Swaps Oversight took up that question and delivered a report. The report con-

tained no recommendations and at the time I was very concerned about the data analysis that was done in that report.

What I have done this year is to ask that division to do an analysis using our most recent data, and to try to address the question as to whether in seeking to lower it will we in fact be successful in capturing more swap dealers that should be regulated by us. We have 140 under our existing framework. Or, will we simply drive those who are making liquidity in the market out of the market and hurt the very ones who rely on those non-financial firms, those non-big Wall Street firms to provide them with trading liquidity in the market, the very ones you are talking about, our farmers and our ranchers and our other agricultural producers.

So once I get that data, and I hope to have it, then we will address that question fresh as to what is the right level, whether it is \$8 billion, whether it is \$3 billion, whether it is \$15 billion. I do not know what the answer is, but I am hoping to be guided by a pure data analysis and I come to it with a very open mind to get to the right outcome.

Senator MORAN. I appreciate that answer. And you think you would have a conclusion in time to make a difference before the drop occurs?

Mr. GIANCARLO. Yes.

Senator MORAN. Thank you.

Mr. Clayton or Chairman Clayton, I have raised this topic numerous times with your predecessor. It still remains an issue, and that is regarding the fiduciary duty rule. I am worried there is a lack of regulatory harmonization occurring between the SEC and the Department of Labor. I wanted to see if you had any updates for this subcommittee regarding the SEC's actions to sort of catch up with the Department of Labor when it comes to the fiduciary duty rule.

Mr. CLAYTON. Thank you, Senator, and yes. Several weeks ago I put out a request for information to the public in light of the Department of Labor moving forward with the fiduciary rule, at least the first phase of it. And, look, it is not separate. What is happening at the Department of Labor is going to affect the markets we regulate and vice versa. And it is my intent as chairman to try and move forward and effectively deal with that in a way that is coordinated so that our main street investors have access to investment advice and access to investment products.

I do not want to see any of these actions that we would take reduce the access to investment advice or the access to investment products, at the same time very much fulfilling our investor protection mission.

Senator MORAN. The SEC, is there a level of cooperation with the Department of Labor that, at least in my opinion, did not exist in the past?

Mr. CLAYTON. I am confident that we are going to have cooperation in this regard. It is a very complicated issue. I do not think it would have been here this long if it were not complex, but I am confident that we are going to cooperate.

Senator MORAN. Since the Chairman used time to correct his answer to your question, my third answer, Madam Chairwoman—

Senator CAPITO. All two seconds.

Senator MORAN. I wanted to raise this issue about EU financial market overhaul referred as Mifid II. Understanding this is an EU initiative, I wanted to check with you to see where the SEC might be in its stance on how the SEC intends to respond. My interest in this issue stems from entrepreneurs and small companies. If financial research becomes too difficult or too expensive to access, I think that is very damaging to our economic growth. Mr. Chairman.

Mr. CLAYTON. You identified the potential issue, which is—or I would say the largest potential issue, which is a reduction in research availability. This is a situation where an action taken by another regulator has an impact on firms. They have to change their behavior. That change in behavior impacts the way they are regulated here. And as a result, they may reduce or otherwise adjust the amount of research they provide. We are looking at this. We are engaged with our colleagues in Europe. And we are also looking at other ways to deal with it and the potential adverse impacts.

Senator MORAN. I know Senator Tillis raised this topic with you. I wanted to raise this as well to make sure that you had—so that you could know you had support in trying to resolve this issue in a positive way for entrepreneurship and small businesses. Thank you.

Mr. CLAYTON. Thank you. Thank you very much.

Senator CAPITO. Senator Daines.

Senator DAINES. Thank you, Chairwoman Capito, Ranking Member Coons. Chairman Clayton, Acting Chairman Giancarlo, thank you for testifying on behalf of your agencies' fiscal year 2018 budget proposals.

I want to thank you, Chairman Clayton, for addressing the specific issue we spoke about just last month. I appreciate the quick response—sometimes unusual in Washington, DC. So thank you for being a contrarian and being responsive. And I want to thank Acting Chairman Giancarlo for speaking in Great Falls, Montana, not Great Falls out in this part of the world, at our Ag Summit, for visiting our farmers and ranchers there in the heart of the Golden Triangle earlier this month. We just need now to get Chairman Clayton out that way and we will be two for two.

FUTURES COMMISSION MERCHANTS

It is important that we get the SEC and CFTC's budgets right so you can continue to safeguard the investors, police the markets, and encourage capital formation. Mr. Giancarlo, there is a Brookings Institution report which shows that since March of 2017 the number of futures commission merchants has dramatically fallen from 171 in March of 2007 to just 64 in March of this year. That is over 62 percent consolidation in the market. My question is what are the practical impacts of this reduction?

Mr. GIANCARLO. Thank you for that question. This is a very important issue, one that I have been very concerned about at the CFTC. There are a number of factors in this. Fraud and mismanagement by some of these firms, firms like Revco and MF Global have caused the loss of some of these firms. The prolonged period of low interest rates has also been a factor in the reduction

of FCMs. But there is no question that some misdesigned regulation and overregulation, in a number of cases, has been the case.

SUPPLEMENTARY LEVERAGE RATIO

And one of the areas that I have been particularly concerned about is something called a supplementary leverage ratio that puts a cost on firms providing clearing services to our farmers, our ranchers, our grain elevators, and not just that, smaller manufacturers that use smaller FCMs for their services. The costs that the supplementary leverage ratio places on them has reduced the availability of these services.

We have seen a number of famous names like BAYSCH, which was a futures commission merchant in this space for over 100 years, go out of business and in so doing let these smaller accounts go as they transferred their larger accounts in a fire sale to some of the bigger Wall Street firms. So increasingly smaller market participants are having to go to Wall Street if they are even able to access an account to help them trade in our markets. We have lost that sort of more retail level tier of FCM services because of, I think, misidentified—and the biggest flaw in the leverage ratio, it goes against one of our core reg reform efforts to bring more clearing activity in the swaps markets.

Senator DAINES. So is there something that you would recommend Congress should consider, an action perhaps we should take, to reverse this trend?

Mr. GIANCARLO. Well, Secretary Mnuchin and the Treasury just put forward a report that calls for two adjustments. Not to do away, not to eliminate the leverage ratio, but to make two adjustments in it that would actually allow for a greater provision of services. So I am not sure it requires congressional action. It requires the relevant agencies, not just ourselves and the SEC, but also FDIC and a number of the market regulators and banking regulators to make these two adjustments in the leverage ratio that Chairman Mnuchin in his report is recommending. I think if we do that we could do it without congressional action in this area.

Senator DAINES. Well, I am happy to kind of work with you as well as Mr. Mnuchin to solve this problem.

CFTC GOVERNANCE

I want to shift gears here and talk about CFTC governance. Earlier this week Commissioner Sharon Bowen announced her intention to retire early in the coming months, although her term does not expire until April 2018. The question, could you share your thoughts on the practical impacts of not filling all five commissioner slots?

Mr. GIANCARLO. You know, I think whoever came up with the idea of commissions with five members was a wise person because I think there is a logic to a five member commission structure. It allows for a range of views to be brought to bear in setting policy. It also allows for a balancing of efforts. I have spent the last 3 years, almost 3 years, as the only Republican on a commission, which at various times had two or three Democrats on it. It currently has one Democrat.

And when you are in that environment, it makes it very hard to really reach a broad consensus and have the type of give and take. So I think it is vitally important that we get back to a five member commission. I think we are a better commission with five members than we are without.

Now, having said that, we continue to work very well at the commission. Commissioner Bowen and I work very well, and so work is getting done. But I think we are better for it when we have a full commission.

Senator DAINES. And given your perspective and experience in working with other commissioners, what traits do you believe are most important for us to consider to ensure the CFTC functions properly to ensure market integrity and price stability?

Mr. GIANCARLO. Certainly in the markets that the CFTC regulates I think it is vitally important that commissioners be willing to get out of Washington, frankly, and meet with the users of these markets and understand their concerns. Meet with farmers and ranchers such as we had the opportunity to——

Senator DAINES. And thank you for modeling that by coming to Great Falls earlier this month.

Mr. GIANCARLO. Well, it was a pleasure, and I must say it is one of the most beautiful parts of the world. From someone who grew up in Northern New Jersey, I love our State, but I have to say Montana is spectacular.

Senator DAINES. I do concur with your remarks. Thank you.

Senator CAPITO. Senator Boozman.

Senator BOOZMAN. Thank you, Madam Chair.

Chairman Clayton, Senator Moran also raised this issue and I am also concerned with the negative impact of the EU's Mifid II, the impact that it could have on the ability of U.S. firms to produce investment research and inform capital formation. I understand the SEC is looking into this. I hope that you can at least provide some short-term relief while we work on it toward a permanent solution. So short-term relief, working for a permanent solution. Is there any limitation hindering your ability to provide relief?

Mr. CLAYTON. I cannot—let me say this. I am not certain that the power that we have will be able to facilitate all relief that people might want, but this is something that the staff is very much looking into. The amount of relief that may be necessary may depend on the amount of cooperation we receive from our European counterparts. So there is kind of a multivariable assessment going on here, but I want to assure you that this is an issue that I am aware of, that the staff is aware of, and we are looking to ensure that the fear that people have that research becomes restricted does not occur.

Senator BOOZMAN. All right. So you are—it is good to be aware, but we do need to move forward——

Mr. CLAYTON. Yes.

Senator BOOZMAN [continuing]. And make that awareness, turn into action.

Mr. CLAYTON. Yes. No. There is a fixed timeline that I am working against.

Senator BOOZMAN. No. I understand.

Mr. CLAYTON. Yes.

GLOBAL HARMONIZATION OF REGULATIONS

Senator BOOZMAN. Very much. Chairman Giancarlo, as you pointed out, the derivatives market are global and this allows U.S. companies to manage their risk wherever they do business around the world. This also means that coordination among authorities in various jurisdictions overseeing these markets has never been more important. We often hear that the breadth of the CFTC's application of Dodd-Frank to entities and transactions outside the U.S. has actually encumbered coordination and led to overlapping and at times conflicting rules applying to the same entities and transactions. This not only puts U.S. market participants at a disadvantage, but it encourages non-U.S. companies from doing business in the U.S. or with U.S. companies. Is this something you intend to review, and if so, what do you think needs to be changed?

Mr. GIANCARLO. Thank you for that. This is, I think, one of the most challenging issues in the post-financial crisis era. The Pittsburgh Accords in 2009 addressed the issue of global swaps market reform and called for coordination in the implementation of reforms, but to do so in a way that was not protectionist or market-places did not seek to advance their own interests.

Unfortunately, I think since then some of the effort has been to try to create rule sets with identity as opposed to coordination. I have called for an approach that like—that I refer to as comity. What we need to do is recognize the goals of financial market reform that we are all pledged to and that I personally support, which are the reforms of Title 7, which affects the global swaps market. But I think we need to do so in a way that recognizes that different jurisdictions are going to have different details of implementation. And it is not necessary for one jurisdiction to have identical rules to another, but that they adopt all of the core reforms in a way that is suitable for their own jurisdiction.

Senator BOOZMAN. Thank you. Mr. Clayton, recently there was a report that was released that had to do with the Financial Accounting Standards Board (FASB). What plans do you have in mind to comply with the Treasury's report recommendations of that? And further, what ways can the SEC work with the FASB to ensure that financial products and services are not significantly altered due to the CCL standard?

Mr. CLAYTON. This new standard which is going to be implemented over the next several years on currently expected credit losses, there have been questions raised by the industry and including by the U.S. Department of the Treasury whether an accounting will actually have operational effect and cause, worst case, a restriction in lending.

We are looking at this. We have met with people in the industry, continuing to monitor it. Again, it is a bit of a multivariable problem because what does this say about bank capital requirements? Well, bank capital requirements adjust as a result of this accounting rule, but it is something we are engaged with both the industry and with our banking regulatory counterparts to make sure that it does not have an adverse impact.

Senator BOOZMAN. Okay. Thank you very much. Thank you, Madam Chair.

Senator CAPITO. Thank you. Well, we finished the first round of questions and I have just two quick questions, so we will begin a second round that should not take all that long.

But, Secretary Clayton, when—I keep calling you Secretary. Chairman Clayton, I am sorry. I was on the Financial Services Committee in the House and on the conference committee for the Dodd-Frank bill. Much of the discussion during that time was around the dark spaces or the lack of transparency in terms of trading, in terms of the platforms, in terms of the interconnectedness of where the platforms are and who is controlling those. And that is about as technical as I can get on that. Can you tell me where you see 9 years later the transparency factor has been improved and how it differs from where it was during those times?

Mr. CLAYTON. That is a broad question.

Senator CAPITO. Yes, it is.

Mr. CLAYTON. I do believe that the reforms and bringing certain trading within clearinghouses has significantly increased transparency. As I have discussed with you and with others and as Chairman Giancarlo noted, our markets are constantly evolving, so some of the transparency issues that we may have identified 9 years ago or 8 years ago have been addressed. I think the question we keep asking ourselves is where are today's transparency issues and risk issues as a result of regulatory developments and changes. And we have discussed this. That is very much part of I see my job, the job of the other commissioners, and the staff at the Commission is to continue to look forward.

We are looking at things like the fixed income market. There have been developments in investment products that we are looking at. If we sat here and talked about ETFs, there would not be very many people who knew what we were talking about 7 years ago and now it is a fundamental product in the marketplace. And we are trying to anticipate whether there are areas where greater transparency would assist our mission and is necessary on virtually a continuous basis.

Senator CAPITO. And I think that is key element to the core of your mission and I am going to just ask a quick question. The budget that you have before us, you are satisfied, and I think you have stated this before, that the aim of transparency can be met for this year with the staffing levels and the budget level that you have requested.

Mr. CLAYTON. Yes, for this year. And I may be in a different position next year, but that is where I am this year.

Senator CAPITO. Yes. Thank you. The last question I had for you was it kind of piqued my interest. At the end you said that if the relocation dollars, if \$245 million were decided to not be unused that you would not be using those for other purposes and that you have mechanisms in place to be refunded to the fee payers. Is that unusual in your budget, that you would refund money back to the fee payers for certain aspects of a budget?

Mr. CLAYTON. I believe—this is the only circumstance where I know where that would be the case, but I think it is a result of the procurement process itself and how you have to set aside the funds now to go through the process.

Senator CAPITO. Right.

Mr. CLAYTON. And that is driving that result.
 Senator CAPITO. Okay. Thank you. Thank you both.

CYBERSECURITY

Senator COONS. Thank you, Madam Chair.

If I might just follow up, the Chair just asked about transparency. I want to ask about cyber security and I think they are related. Both of your predecessors talked about the critical role of further investments in cyber security. Your Inspector General in both cases have made it one of the top priorities for your agencies. So, Chairman Clayton and Chairman Giancarlo, you have undertaken efforts in previous years to strengthen the cyber defenses, both of market participants, and to improve your agencies' abilities to detect, contain, respond to, and recover from cyber attacks.

Do you share those concerns as articulated by your Inspectors General and your predecessors? Is it a clear necessity? What are your approaches to investing in cyber security? And what resources are you devoting to that now? Does that play some central role in your request for additional funding? And how would you continue to invest in these ongoing and important concerns with flat funding, if you would in order? Thank you.

Mr. GIANCARLO. Thank you for that question. Cyber is absolutely priority number one. I had the honor of giving a guest lecture at Harvard Law School 2 years ago to identify what were the major megatrends that we are seeing in our markets. And I identified cyber as the number one and most important. It is an enormously challenging threat because it is a threat that comes from so many different directions. Everything from rogue individuals all the way up increasingly to nation states using cyber as a threat tactic.

And so, therefore, our response must be as multifaceted as well. It comes down to—it ranges from individual firm defenses all the way up to public and private defenses. And Government certainly has a role to play in making our markets resilient and indeed durable in the face of an ongoing attack.

Since I have come into the CFTC, I have redoubled efforts in a number of areas. I now do a monthly meeting with our head cyber officer to walk me through the attacks we have seen in our space, not just on our own agency, but what we are seeing in the marketplace. We have resources built into our budget request and if we are not able to achieve that, we will still prioritize cyber in this new world. It will come at the expense of other things, but it is absolutely essential that it remain our first priority at the agency.

Senator COONS. Thank you, Mr. Chairman.

Chairman Clayton.

Mr. CLAYTON. Let me say I agree with Chairman Giancarlo on the importance of this issue. And I will incorporate and then supplement.

On supplementing, I do think it is a priority for me at the Commission to educate our investing community, particularly our main street investors on the risks, cyber risks and what they mean to them at an individual company across the market system and otherwise.

Turning to our own house at the SEC, we have some what I will call very important, perhaps critical functionality for the market-

place that we administer, our EDGAR system. It is important to me that that continues to function on a daily basis. I think I mentioned it gets 50 million downloads a day. Keeping that up and running in the face of the threats is very important. And more generally at the Commission, this is an area of intense focus because we recognize the consequences if the risks come to bear.

Senator COONS. I will just say both to you that, you know, we are best understood and defined as a democratic society also committed to capitalism. Given that a very capable state actor intentionally interfered in our last Presidential election, I just hope we are appropriately investing in cyber security for what are, in some ways, our most important regulatory oversight entities that keep our capital markets liquid and stable and secure.

If I could briefly, Chairman Clayton, just what reassurances can you give me that you will continue to enforce and uphold the conflict minerals statute and rule? It is an area of great interest and work for me and over a long period of time it has helped reduce conflict in the Democrat Republic of the Congo.

Mr. CLAYTON. So the conflict minerals rule, as you know, Senator, has been subject to court challenge and other, including a First Amendment holding. Where it stands today, it is on the books. I will try and summarize. There are three steps to it. Do you have conflict minerals in your products? If you have covered conflicts minerals do they come from covered countries? Those steps are enforced today based on staff guidance. The third step is the one that we are looking at as to whether the court action restricts it, and if so, to what extent, which is the audit function around conflict minerals disclosure. So that is where we stand.

WHISTLEBLOWER PROGRAMS

Senator COONS. Thank you. I have a last question if I might about whistleblowers. Both of you have programs that have demonstrated important benefits for taxpayers and the investing public. What have been the most important benefits of the enforcement work your agencies are doing of having well functioning whistleblower programs? And what additional steps have you taken to protect whistleblowers? And are there any other statutory or administrative impediments that prevent your agencies from doing more to combat fraud through whistleblowers?

Mr. GIANCARLO. We view whistleblowers as an important referral source for enforcement action. We have taken, under my leadership, steps just recently to enhance anti-retaliation protections for whistleblowers. We also abide by Federal statutes within our own agencies to protect whistleblowers. So we view whistle blowing protections as important. We view the process as important to our work.

Senator COONS. Thank you.

Mr. CLAYTON. I agree with Chairman Giancarlo. Actually, just yesterday, we have a matter that is going to the Supreme Court. I will not comment on that, but around whistleblower protection. And this is an area that is evolving and we are going to continue to pay attention to it to get the most out of it.

Senator COONS. It has generated thousands of tips, tens of millions of dollars of recovery, and I just commend you both for being attentive to that important tool.

Senator CAPITO. Thank you.

Senator Moran.

CFTC KANSAS CITY OFFICE

Senator MORAN. Chairman Giancarlo, first of all, I would complement you on your zero-based budgeting, whatever the rights words are for that process. I did not want your comments to go unresponded to. I think that that has merit and we ought to be all pursuing that to start and justify, not just to add to what we have.

Secondly, I just wanted to follow up on your comments about leased space. What is the status of the CFTC in Kansas City? With the merger that has occurred what presence does the CFTC now have and the same amount of space as you had before the merger?

Mr. GIANCARLO. It is, but I am so glad you asked about that because when I stepped into the role of acting chairman I took a look at our offices. And it was very clear to me, of course, why we are in Washington. It was very clear to me why we are in New York because the swaps market is centered in New York. It is clear to me why we are in Chicago because the futures market was centered in Chicago.

And I thought I would find the same logical connection in Kansas City because of our work in the agricultural area. And yet, our Kansas City office, at least in the last few years, has really become an important office where we conduct enforcement action across the country. It is really not a center of our work in agriculture. And I must say I think in the post-financial crisis area we have been so focused on the swaps area, to some degree we have forgotten about our core role, making sure that our commodity futures markets are there for our core users in agriculture, in manufacturing, and in other areas. Perfect timing for my talk about how important agriculture is to our mission.

Senator MORAN. Only my wife has that number, but this said Jamaica, so.

Senator CAPITO. That was last week with the FCC we had that, remember?

Mr. GIANCARLO. So we intend to reposition our Kansas City office as a real foothold in our mission to make sure that our markets serve and serve well our agriculture producers, our manufacturers are really the end users of our marketplace. And we have got a number of initiatives under way, some of which I look forward to announcing in the next few months, about how we are going to reposition Kansas City for our outreach into those communities.

Senator MORAN. We very much appreciate your presence in Kansas City and I am glad to hear that you as the chairman have discovered value. We would not want an office just for the sake of having an office, but appreciate the opportunity that Kansas City, Missourians, and Kansans may have to not only benefit as consumers, but provide employment to the CFTC and the mission that you have.

Thank you very much. I would look forward to working with you and hearing what your plans are.

Mr. GIANCARLO. Thank you, Senator.
 Senator CAPITO. Senator Boozman.

INTER AFFILIATE MARGIN REQUIREMENTS

Senator BOOZMAN. Thank you, Madam Chair, and thank both of you all for being here and again for your hard work.

I just have one other thing, Chairman Giancarlo. As you know, requiring margin for the over the counter derivatives was a key G20 reform aimed at reducing risk in the financial system. The authority to require margin is split in Dodd-Frank between the CFTC and the Prudential regulators, including the Fed, FDIC, OCC, et cetera. In the CFTC's final margin rules, the Agency took what I believe is a sound approach in distinguishing derivatives traded with external parties from those internal risk management transactions that occur between affiliates within the same corporate group.

You did not subject them to a much higher margin requirement. Unfortunately, the Prudential regulators did not follow suit with an initial margin exemption in their final rule. This is not only locking out billions of dollars of capital unnecessarily, but is also creating an unlevel playing field, and I think very importantly for U.S. companies is that both European and Asian regulators have, like the CFTC, provided for such exemptions. We have got kind of a common theme with a lot of this stuff dealing with our international partners, which you simply have to get it worked out.

Do you support a legislative exemption from initial margin for inter affiliate swaps to level the playing field for U.S. companies both in the U.S. and globally and do you think such an approach would be good for the markets overall?

Mr. GIANCARLO. Thank you for that question.

Some of this can get a little bit complicated in terms of how those margin rules work, but at its heart, the issue is whether American firms can enter global swaps markets on the same level playing field as some of their foreign competitors. And I believe that some of the banking regulators approaches to inter affiliate margin, which was not at issue in the financial crisis, has been an effort to solve for bankruptcy insolvency risk of financial firms at the expense of American firms access to global capital and the ability to act in global markets. And as a market regulator, we are sensitive to that concern in a way that I think sometimes the banking regulators have not been.

So this is something that, working with Treasury Secretary Mnuchin, I will look to try to make banking regulators a little more sensitive to regarding the concerns of our American firms that at the end of the day are trying to access global capital and global risk catching markets and this inter affiliate margin area in some of its application, not all of it, has been preventative of that. And I think we need to take another look at that.

Senator BOOZMAN. Okay. Thank you, Madam Chair. And again, thank both of you so much. Yes, sir. Thank you so much for being here. We appreciate all you do.

ADDITIONAL COMMITTEE QUESTIONS

Senator CAPITO. Thank you. I want to again thank the witnesses for testifying today. If there are further questions, the hearing record will remain open until Wednesday, July 5, 2017, at noon for subcommittee Members to submit any statements or questions to the witnesses on the record.

[The following questions were not asked at the hearing, but were submitted to the Commissions for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO HON. JAY CLAYTON

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER A. COONS

REGULATORY REVIEW AND EXECUTIVE ORDER

Question. On February 3, President Trump issued an Executive Order on Core Principles for Regulating the U.S. Financial System. In response to that issuance, CFTC Acting Chair Giancarlo announced Project KISS—Keep It Simple, Stupid, as an agency-wide internal review focused on simplifying and modernizing CFTC rules, regulations and practices to ease regulatory burdens in the spirit of job creation and economic growth. It is reported that Project KISS's primary focus is on streamlining the implementation of existing regulations and practices, rather than on re-writing or repealing those rules and regulations.

—Chairman Clayton, to what extent is the SEC exploring a similar initiative to conduct a review of its body of regulations and practices?

Answer. In a speech before the Economic Club of New York on July 12, 2017, I outlined eight principles that will guide my SEC Chairmanship. Several of the principles that I articulated focus specifically on our rulemaking process. I emphasized that the Commission must write rules clearly so that those subject to them can ascertain how to comply and how to demonstrate that compliance. This principle of effective rulemaking should, in my view, not end with rule adoption but also should include retrospective reviews of Commission rules based on input from investors and others about where the rules are, or are not, functioning as intended and can be made more effective.

In addition to these principles, the Commission and its staff have formal and informal processes for identifying existing rules for review and for conducting those reviews to assess the rules' continued utility and effectiveness in light of the evolution of the securities markets and changes in the securities laws and regulatory priorities. For example, in accordance with current statutory requirements, we conduct 10-year retrospective rule reviews under the Regulatory Flexibility Act (RFA) on an annual basis. In addition, an agenda of anticipated rulemaking actions pursuant to section 602(a) of the RFA is published semi-annually. The agenda includes both potential changes to existing rules and new rulemaking actions. Along with these formal processes, the Commission and its staff frequently receive and consider suggestions to review existing rules through various types of communications from a wide variety of constituencies. Likewise, the Commission and staff frequently discuss the need to revisit existing rules through formal and informal public engagement, including advisory committees, roundtables, town hall meetings, speeches, conferences and other meetings.

ORGANIZATIONAL CHALLENGES: INTERNAL COMMUNICATION SHORTFALLS

Question. The Dodd-Frank Act requires that the GAO report triennially on SEC's personnel management. GAO's first report in 2013 identified a number of challenges and included seven recommendations. In the most recent report published in late December 2016, GAO found that employee views on the SEC's organizational culture have generally improved since 2013, particularly citing higher levels of morale and trust and that the SEC was less hierarchical and risk-averse. However, GAO's survey reflected that the SEC still operates in a compartmentalized way with little communication and collaboration between divisions and has not set expectations for staff to collaborate across divisions as needed or adopted best practices to break down existing silos. SEC staff still report that divisions operate in isolation. GAO noted that other organizations rely on their Chief Operating Officer to make such changes. Because SEC's COO lacks such authority, GAO contends that the agency will likely continue to face challenges.

—Recently, the GAO determined that the SEC has made little progress to address earlier recommendations related to improving cross-divisional collaboration. GAO found that the SEC operates in a compartmentalized way with little communication and collaboration among divisions. SEC officials disagreed with GAO's recommendation that enhancing the role of the Chief Operating Officer would be the optimal means to help improve cross-divisional communication and collaboration.

—Chairman Clayton, what are your plans for addressing the recommendations of GAO? Are you willing to reassess the SEC's prior disagreement with GAO's recommendation about enhancing the Chief Operating Officer's role?

Answer. The GAO report, *Securities and Exchange Commission: Actions Needed to Address Limited Progress in Resolving Long Standing Personnel Management Challenges* (GAO-17-65), contained a number of recommendations for the agency to help strengthen personnel management. We appreciated GAO's acknowledgment of the agency's significant progress in improving employee morale and organizational culture. As the report states, the SEC was named in December by the Partnership for Public Service as the Most Improved Mid-Sized Federal Agency in the 2016 Federal Employee Viewpoint Survey, and currently ranks sixth overall in that category.

However, the response noted disagreement with certain aspects of the report. For example, it discusses that the amount of interoffice communication and collaboration is much greater than portrayed in the GAO report. This has long been a key focus area for the agency, and the response pointed to a number of factors indicating there has been significant progress. There is extensive, productive interaction among division and offices for nearly every significant action the SEC undertakes, including rulemakings, enforcement actions, and other policy initiatives. The response also pointed to numerous formal and informal mechanisms for cross-agency coordination, such as intra-agency governance committees and working groups related to operational issues, identification of key risks, technology and data, and more. To help promote communications and collaboration at the staff level, under the SEC's performance management system every employee in the agency is evaluated on "Teamwork and Collaboration," and the SEC has continued to train its staff on team effectiveness and collaboration-related topics.

My predecessor, Chair White, disagreed with the report's recommendation to have all divisions and offices report to the agency's Chief Operating Officer (COO). She contended that this proposal would not fit with the legal and management structure of the SEC, and neglects the important role that the Office of the Chairman plays in overseeing and coordinating the various SEC programs. I have a great regard for Chair White's judgment and knowledge of our agency, and her opinion on these matters carries great weight with me. While I and my staff have devoted considerable time in my first few months at the SEC to operational issues and ensuring greater cross-divisional collaboration, I have not yet reached my own conclusion on whether significant organizational changes, such as expanding the COO role and materially changing lines of reporting and responsibility, would be, on balance, beneficial over the long term to the agency.

I believe that the SEC should always be exploring ways it can promote effective communication and collaboration across the agency. The agency is currently working on several additional initiatives to further these goals. I intend to continue to be focused on identifying operational improvements that will facilitate communication and collaboration, optimize our organizational structure, and generate efficiencies and cost savings.

RESPONSIVENESS TO TIPS, COMPLAINTS, AND REFERRALS—SECURITIES FRAUD PREVENTION

Question. The Madoff fraud scandal nearly a decade ago exposed disturbing ineptitude in the government's ability to promptly detect and prevent large-scale fraud on investors in the financial markets. In the wake of Madoff, the SEC addressed serious deficiencies in the agency's internal communication and coordination of incoming tips, complaints, and referrals (TCRs). Prior to reforms, the SEC had no centralized repository or searchable data management system to compile, interface, and manage the TCRs submitted to the agency about potential violations of securities laws. According to the SEC, it receives an average of 15,000 TCRs each year from multiple sources.

In March 2011, the SEC deployed the current system for receiving, recording, tracking, and acting on TCRs. Although the current TCR system is operational, SEC stakeholders determined that a more robust, flexible, and scalable system was needed to better support the SEC's evolving needs, mission, and policies. In September

2013, the SEC awarded a contract to elicit requirements, design, and deploy a redesigned TCR system.

Chairman Clayton, the SEC's Inspector General recently issued a management report about repeated delays and contract extensions related to the SEC's effort begun in 2013 to deploy a redesigned Tips, Complaints, and Referrals ("TCR") system. According to the IG, various factors, including unacceptable contractor performance and a lack of adequate contractor and Government resources to timely address concerns, have led to schedule delays and cost increases. The May 31, 2017 IG report says the TCR system will not "go live" until October 2, 2017 more than 3 years behind schedule and \$12.2 million dollars (170 percent) over budget.

—Can you please share your insights about the issues surrounding the redesigned TCR system and your plans to prioritize its deployment?

—What additional resources are required to further strengthen the SEC's capacity to acquire and manage an effective and functional automated tips, complaints, and referrals system?

Answer. It is important to me that the agency has a tips, complaints, and referrals (TCR) system in place that supports our investor protection efforts, and that there are sufficient resources for the system.

In 2009, the SEC began development of a comprehensive TCR system to allow agency staff to receive, triage, take action on, and search for TCRs quickly and accurately. The first iteration of the TCR system was deployed in March 2011 and has managed an increasing number of TCRs each year. Based on my discussions with the staff, I understand that by 2013, the SEC concluded that improvements were needed to make the initial TCR system more stable, flexible and efficient to maintain, among other things, and the agency began work to revise the system. I understand that the new TCR 3.0 system is designed to address the stability, flexibility, and efficiency issues in the initial system, while enhancing the usability of the underlying TCR data and improving security, workflow, search capabilities, and other important functionality.

However, as you point out, the TCR modernization effort has experienced delays as we have worked through technical issues and attempted to improve usability and functionality prior to going live. The staff has assured me that they have taken seriously the findings of the Inspector General and worked to implement improvements in the project. I and the staff will be mindful of this experience as we pursue similar projects in the future. With regard to the current status of the TCR system, the staff is currently conducting testing, staff training, and other final checks of the modernized system.

SEC RULEMAKING RELATING TO CORPORATE EXECUTIVE COMPENSATION

Question. In August 2015 the SEC finalized a rule to implement Section 953(b) of Dodd-Frank that requires enhanced disclosure of executive compensation by public companies. The "Pay Ratio Disclosure" rule requires that public companies disclose the ratio of the CEO's total compensation to the total median compensation of all other employees. The first disclosure is expected for fiscal year 2017 and will first be reflected in proxy statements filed in 2018.

In February of this year, SEC Commissioner Michael Piwowar, who was at that time serving temporarily as Acting Chairman, issued a statement suggesting that some issuers may be encountering unanticipated compliance difficulties that may hinder them in meeting the reporting deadline.

Commissioner Piwowar's statement solicited public input on any unexpected challenges and asked for comments within 45 days. It also directed SEC staff to reconsider the implementation of the rule based on any comments submitted and to determine as promptly as possible whether additional guidance or relief may be appropriate.

—What is the present status of SEC's work on the Pay Ratio Disclosure rule and guidance?

—Is there any basis upon which the SEC would reverse course or delay the effective date of public company compliance with this critical disclosure requirement?

—What outreach and education is the SEC making available to ensure corporate compliance with this requirement?

—What additional resources will be required to monitor adherence to this new mandate?

Answer. I believe that the SEC is required to implement rulemakings mandated by statute in accordance with applicable law. The SEC adopted the pay ratio disclosure rule on August 5, 2015, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

At this time, the current rule remains in effect. As such, the disclosures provided in response to the new pay ratio disclosure rule would be subject to review by staff of the Division of Corporation Finance, which reviews filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934 to evaluate compliance with the applicable disclosure requirements. With respect to outreach and education, the Division of Corporation Finance has published “Compliance and Disclosure Interpretations” on the SEC’s website to assist companies and their advisers in the preparation of pay ratio disclosures.

In response to Acting Chairman Piwowar’s request, the Commission received over 180 unique comment letters and over 13,700 form letters. The staff is reviewing all of the comment letters and will consider them in any recommendations that it may provide to the Commission regarding the pay ratio disclosure rule in the future.

EMERGING TRENDS IN HIGH-FREQUENCY TRADING

Question. High-frequency trading generally refers to trading in financial instruments, such as securities and derivatives, transacted through supercomputers executing trades within microseconds or milliseconds. By most accounts, high frequency trading has grown substantially over the past decade. The SEC has taken steps to bring some high-frequency trading under closer scrutiny, through recent regulatory proposals and enforcement actions such as a proposal to require certain high-frequency trading broker-dealers to register with the Financial Industry Regulatory Authority (FINRA), which oversees broker-dealers.

—How has the SEC adapted to the growth in high frequency trading?

—What are your current and planned initiatives in this area?

—Do you have adequate in-house expertise and resources to effectively monitor this trading?

Answer. The SEC has taken a series of steps in recent years to help assure that its regulatory program appropriately takes into account evolutions in our markets, including in respect of algorithmic trading. High frequency trading is one type of the computer-driven, algorithmic trading that is now prevalent in the U.S. equity markets, as well as in other active financial markets around the world. The technologies deployed by algorithmic traders are capable of generating a large volume of orders and trades in short timeframes. The SEC adopted Rule 15c3–5, the Market Access Rule, which requires broker-dealers that provide access to trading venues to implement procedures that reasonably address the risks of access, such as the risk of malfunctioning algorithms. With respect to trading venues, in turn, the SEC has adopted Regulation Systems Compliance and Integrity, which requires, among other things, that significant trading venues implement procedures reasonably designed to assure that their systems have the capacity, integrity, resiliency, availability and security adequate to maintain their operational capability.

Another important SEC initiative is the Consolidated Audit Trail (CAT), which is intended to enhance the ability of the Commission and other regulators to access the data needed to surveil trading and enforce rules in today’s high-speed, high-volume markets. The design of the CAT system is being led by the self-regulatory organizations with Commission oversight. Additionally, the self-regulatory organizations have implemented a plan to address the risk of extraordinary volatility potentially raised by high-speed trading by establishing limits when prices move too far too fast.

We also are aware of industry initiatives that would deemphasize speed as an element of trading, and we are conscious of the need for such initiatives to be consistent with statutory requirements. A variety of other initiatives relating to algorithmic trading have been considered by the SEC and SEC staff in recent years, including the proposal relating to FINRA membership for broker-dealers active in the off-exchange market. I intend to continue to review these initiatives with staff as we assess the appropriateness of further action.

In addition to rulemaking initiatives, the SEC has expanded its quantitative capabilities throughout the agency, both by deploying new quantitative tools and hiring personnel with the quantitative expertise to use the new tools. I anticipate this trend will continue in the future to help assure that SEC capabilities remain up to the task of effectively monitoring high frequency and other types of algorithmic trading.

QUESTIONS SUBMITTED BY SENATOR JAMES LANKFORD

Question. The SEC is seeking public comment on standards of conduct for investment advisors and brokers and this regulatory initiative is running parallel to the Department of Labor's request for additional public input on the Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice regulation published by DOL in the Federal Register on April 8, 2016 (81 Fed. Reg. 20946 et seq.).

Can you elaborate on how the SEC will evaluate and define "Fiduciary" standards?

Answer. The SEC has been reviewing this area for some time, which is an illustration of both the complexity of these issues and the fast-changing nature of our markets, including the evolving manner in which investment advice is provided. Much has happened since the SEC last solicited information on this issue 4 years ago. In recognition of this, on June 1, 2017, I issued a statement (June Statement) seeking public input on standards of conduct for investment advisers and broker-dealers. I believe that robust public comment can help us evaluate potential regulatory actions in light of the current market for investment advice and risks to investors, and am encouraging the public to send us feedback and any data that may be helpful to us. We are beginning to receive and review public input on the various issues raised in my June Statement, including what future action, if any, the SEC should take in this area. I am looking forward to continuing to work with my fellow Commissioners and the SEC staff, as well as the Department of Labor and the self-regulatory organizations, as we evaluate our next steps, with the goal of making sure that main street investors are appropriately protected and continue to have access to affordable investment advice and products.

Question. Is there a timeline for this initiative?

Answer. I and the staff are focused on addressing this important issue. As noted, there have been significant developments in the industry since the SEC in 2013 issued a public request for data and other information related to the current standards of conduct for broker-dealers and investment advisers, including financial innovations, changes to investment adviser and broker-dealer business models, and regulatory developments—including the issuance and pending applicability of the Department of Labor's fiduciary rule. We continue to receive public comments and information in response to the June Statement, and we are hopeful that these comments will provide us with important input into understanding the current market and analyzing how any potential regulatory action could affect it. These are complex issues, however, and there is a lot of work to do, including coordinating with the self-regulatory organizations and other agencies. Any action should be carefully constructed, so that it provides clear, appropriate and meaningful protections but does not result in retail investors being deprived of affordable investment advice or products, or a multiplicity of standards that could cause confusion or otherwise weaken investor protection.

Question. Will you be coordinating with the Department of Labor as you evaluate and define these standards?

Answer. Any actions taken by the SEC or the Department of Labor in this space are going to have an effect on the areas overseen by the other agency, and it is my intent that we continue to coordinate with our colleagues at the Department of Labor.

Question. Do you foresee the SEC and DOL reaching a definition that will be a unified industry standard?

Answer. At this stage, the range of potential actions suggested to the SEC is broad. We are still evaluating potential options in this area and have not yet reached a particular conclusion. I am hopeful that the public comments submitted in response to the June Statement can help us evaluate potential regulatory actions in light of current market activities and risks. As I stated in the June Statement, clarity and consistency—and, in areas overseen by more than one regulatory body, coordination—are, in my view, of vital importance.

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. On May 12, 2015, the Securities and Exchange Commission filed suit against ITT Educational Services, Inc., Kevin Modany, and Daniel Fitzpatrick for securities fraud. In 2016, the company collapsed under the weight of its own misconduct and subsequently filed bankruptcy. While ITT students were left with tens of thousands of dollars in student loan debt, company executives, including Mr. Modany and Mr. Fitzpatrick, absconded with millions of dollars in compensation

and bonuses despite orchestrating one of the largest frauds in U.S. higher education history.

- Please provide an update on what steps the SEC is taking to hold ITT executives accountable.
- How many attorneys are currently assigned to the ITT matter?
- Has the SEC determined whether or not a criminal referral is appropriate in this matter?
- Is the SEC working with the Department of Justice and State Attorneys General to share investigative information to determine whether additional charges are warranted?

Answer. The SEC is committed to rooting out fraud and shady practices in our markets wherever they exist and to holding wrongdoers accountable where appropriate. The SEC's case against ITT Educational Services, Inc.'s (ITT's) CEO, Kevin Modany, and its CFO, Daniel Fitzpatrick, is ongoing. As a general matter, the SEC does not comment on ongoing litigation, so the information provided below is based on publicly filed documents in the SEC's litigation against ITT, Modany and Fitzpatrick.

The SEC filed its Complaint against ITT, Modany, and Fitzpatrick in the U.S. District Court for the Southern District of Indiana on May 12, 2015.¹ The Complaint alleged that ITT, Modany and Fitzpatrick engaged in a fraudulent scheme and made false and misleading statements to hide the magnitude of ITT's obligations related to two student loan programs from ITT's investors.² The Complaint included claims for violations of the anti-fraud, books and records, and reporting provisions of the Federal securities laws. The parties actively litigated the case and engaged in extensive discovery in the litigation, including taking dozens of fact and expert witness depositions. On September 12, 2016, ITT filed for bankruptcy under Chapter 7 of the bankruptcy code in the U.S. Bankruptcy Court for the Southern District of Indiana. On October 10, 2016, the bankruptcy trustee filed an adversary complaint in the Bankruptcy Court which sought to, among other things, stay the SEC's litigation against ITT. The SEC entered an appearance in the bankruptcy proceedings, and the SEC and ITT ultimately reached a settlement that was approved by the Bankruptcy Court and the District Court. As a result of the settlement, on June 30, 2017 the District Court entered a Final Judgment against ITT permanently enjoining it from violating the anti-fraud, books and records, and reporting provisions of the Federal securities laws charged in the Complaint.

While the settlement with ITT was being negotiated and approved, the SEC continued to litigate its case against Modany and Fitzpatrick. During a court-ordered settlement conference, Modany and Fitzpatrick made settlement offers in the case filed against them. If approved by the Commission, the settlements will be submitted to the District Court for approval and entry of final judgments against Modany and Fitzpatrick.

The SEC conducts investigations on a confidential basis and does not disclose whether or not it is working with other authorities or has made a criminal referral in a specific case. However, as a general matter, the SEC staff often works closely with other law enforcement authorities and agencies in our investigations and may refer matters to the criminal authorities in appropriate circumstances. This is an area in which I have taken a particular interest, as I am hopeful that working with criminal authorities can help keep bad actors, particularly recidivists, away from our markets and investors who rely on the integrity of our markets.

Question. In May 2016, Bridgepoint Education reported that it had received a second subpoena from the SEC, regarding the Company's scholarship and student loan programs, among other topics. Like the now-defunct ITT, Bridgepoint has been the subject of multiple Federal and State investigations and lawsuits for its student loan practices. In September 2016, the Consumer Financial Protection Bureau required Bridgepoint to pay more than \$30 million in student refunds and civil penalties for its predatory private student lending practices. To the extent that the facts revealed by the investigation allow, the SEC's pursuit of executive accountability is critical to preventing further abuses across the for-profit college industry.

- As part of its investigation, has the SEC interviewed or examined Mr. Robert Eitel, a former top compliance executive at Bridgepoint, who now serves in senior leadership at the U.S. Department of Education?
- Has Mr. Eitel communicated with any Commissioner or the SEC staff on behalf of himself or Bridgepoint since the SEC began its investigation?

¹ See Press Release 2015-86, SEC Announces Fraud Charges Against ITT Education Services (May 12, 2015), available at <https://www.sec.gov/news/pressrelease/2015-86.html>.

² A copy of the SEC's Complaint is available at <https://www.sec.gov/litigation/complaints/2015/comp-pr2015-86.pdf>.

- What mechanisms are in place to ensure that Mr. Eitel does not use his current government position to influence the SEC's investigation of his former employer?
- Is the SEC sharing information through a formal agreement with the U.S. Department of Education with respect to this investigation? Is the U.S. Department of Education providing any assistance to the SEC?
- When does the SEC expect to conclude its investigation and make a determination on whether to pursue charges?

Answer. As a matter of policy, the Commission conducts investigations on a confidential basis and generally does not acknowledge the existence or non-existence of any investigation unless or until charges are filed. We do so in order to protect the integrity of our investigations, safeguard the privacy of witnesses, and avoid damaging the reputation of persons who may not be charged. Similarly, as explained above, the SEC generally does not disclose whether or not it is working with other authorities or has made a criminal referral in a specific case. Accordingly, I cannot comment specifically on the matter raised in the question.

Question. Please provide a list of all publicly-traded for-profit institutions of higher education that are currently under investigation or facing current litigation by the SEC.

Answer. As explained above, the Commission conducts investigations on a confidential basis and does not acknowledge the existence or non-existence of any investigation unless or until charges are filed. Accordingly, I cannot comment on the existence of any SEC investigations related to publicly-traded for-profit institutions of higher education.

QUESTIONS SUBMITTED TO HON. J. CHRISTOPHER GIANCARLO

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER A. COONS

REGULATORY REVIEW AND TRUMP EXECUTIVE ORDER

Question. On February 3, 2017, President Trump issued an Executive Order on Core Principles for Regulating the U.S. Financial System. In response to that issuance, you announced Project KISS—Keep It Simple, Stupid, as an agency-wide internal review focused on simplifying and modernizing CFTC rules, regulations and practices to ease regulatory burdens in the spirit of job creation and economic growth. It is reported that Project KISS's primary focus is on streamlining the implementation of existing regulations and practices, rather than on re-writing or repealing those rules and regulations.

Chairman Giancarlo, what has been the CFTC's experience so far in conducting the internal regulatory review you have dubbed Project KISS?

Answer. Project KISS evolved out of an observation by Commissioner Giancarlo, while serving as the minority commissioner, that various existing agency rules were not up to date, inconsistent or required needlessly difficult compliance. Commissioner Giancarlo sought ways to make such rules simpler, less burdensome and easier to implement. After the election, Acting Chairman Giancarlo expanded the process to become Project KISS.

On February 24, 2017, President Trump issued an Executive Order on "Enforcing the Regulatory Reform Agenda." Although the CFTC as an independent agency is not strictly bound by President Trump's Executive Order, we believe the KISS effort is in line with the President's objectives.

Question. How are you soliciting public input in the process? What is your timetable for completing the assessment?

Answer. Through a Commission vote, the agency has requested public comments, outside the rulemaking process, for ways in which the CFTC can improve, streamline, or modernize our work. We have also launched on the CFTC's website a KISS portal through which interested parties may submit proposals. We will treat submissions to KISS like we treat other correspondence that we receive. Submission of a suggestion may not result in Commission action. The ideas received are kept on a separate page from our rulemaking comments page of the website. It is our hope that the Commission will receive submissions from a diversity of parties—market participants, scholars, economists, current and former regulators, and all members of the public who feel they have something of value to contribute to this rule review.

EMERGING TRENDS IN HIGH-FREQUENCY TRADING

Question. High-frequency trading generally refers to trading in financial instruments, such as securities and derivatives, transacted through supercomputers exe-

cutting trades within microseconds or milliseconds. By most accounts, high frequency trading has grown substantially over the past decade. The CFTC has taken steps to bring some high-frequency trading under closer scrutiny, through recent regulatory proposals and enforcement actions. In a number of enforcement actions involving algorithmic trading, the CFTC has cracked down on spoofing, the illegal practice of bidding or offering with intent to cancel before execution, using the anti-spoofing authority granted under Dodd-Frank.

How has the CFTC adapted to the growth in high frequency trading?

Answer. For many markets, automated trading brings trading liquidity, broader market access, enhanced transparency and greater competition. At the same time, automated trading presents a host of potential new challenges. How markets and market regulators adjust to this change from human to automated trading is extremely important. It requires delicate balancing. To ensure vibrant, accessible and durable markets, we must cultivate and embrace new technologies without harming innovation. Without a doubt, there must be effective safeguards of market integrity and credibility, but those safeguards should not bar promising innovation and continuous market development.

In November of 2015, the CFTC published a proposed rule to tackle some of the challenges of automated trading and a year later issued a supplemental proposal. While I believe it is time to formulate and establish well-considered policy responses to the digitization of contemporary markets, I have publically expressed concerns that the proposal is often times an analog solution to a digital problem. However, I maintain an open mind to a number of their elements and I look forward to reviewing the public's comments on the proposal and working with a full Commission to establish a final rule.

Question. What are your current and planned initiatives in this area?

Answer. The Commission recently undertook an effort to review certain portions of its organizational structure and concluded that it could create efficiencies and at the same time enhance its capabilities if some of its resources were reorganized internally. Specifically, elements of the market surveillance branch housed in the Division of Market Oversight (DMO) moved to the Division of Enforcement (DOE). This realignment will strengthen our mission to identify and prosecute violations of law and regulation, such as spoofing, manipulation and fraud. It will foster increased efficiencies through knowledge-sharing and cross-training under unified leadership; thus benefitting the Commission's surveillance mission and enforcement responsibilities.

In addition, we established a new Market Intelligence Branch within the Division of Market Oversight, the function of which is to understand, analyze and communicate current and emerging derivatives market dynamics, developments and trends—such as the impact of new technologies and trading methodologies, including high frequency trading.

By separating the two units—surveillance within DOE and market intelligence within DMO—we will sharpen our surveillance capability while increasing our knowledge of evolving market structures and practices to promote efficient and sound markets. The overall goal is to make the CFTC more adept in each of the two disciplines.

Question. Do you have adequate in-house expertise and resources to effectively monitor this trading? If not, please explain.

Answer. The pace of investment in new and innovative technologies, such as algorithmic trading, and in FinTech more broadly, has accelerated in recent years. The costs of launching new ventures and applying new technologies have dropped enormously, while the speed and scalability with which they can be brought to market have increased dramatically.

In order for the CFTC to remain an effective regulator, it must keep pace with these changes or our regulations will become outdated and ineffective. The CFTC's fiscal year 2018 budget request of \$281.5 million will allow us to continue to fulfill our mission and make the investments necessary to keep pace with 21st century digital markets.

SUBCOMMITTEE RECESS

The subcommittee hearing is hereby adjourned. Thank you both.
[Whereupon, at 11:12 a.m., Tuesday, June 27, the subcommittee was recessed, to reconvene subject to the call of the Chair.]