FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2020

WEDNESDAY, MAY 8, 2019

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

The subcommittee met at 11:30 a.m., in room SD–124, Dirksen Senate Office Building, Hon. John Kennedy (Chairman) presiding.

Present: Senators Kennedy, Coons, and Van Hollen.

SECURITIES AND EXCHANGE COMMISSION AND

COMMODITY FUTURES TRADING COMMISSION

OPENING STATEMENT OF SENATOR JOHN KENNEDY

Senator KENNEDY. I am going to call the subcommittee meeting to order. I want to apologize to everyone for our tardiness but as you know, we had votes on the Senate floor. Today, we have the Chairman of the Securities and Exchange Commission, the Honorable Jay Clayton. We also have the Chairman of the Commodity Futures Trading Commission, the Honorable Christopher Giancarlo. Thank you both for being here today. I am going to skip my opening statement in the interest of time, our objective today being to try and get through this by 1:00 p.m. given that we all have other commitments, including and especially our two Chairmen.

Before turning to Senator Coons though, I do want to thank Chairman Giancarlo for being here today, this will be your last hearing. I want to thank you for your service. I want to thank you for your hard work. I want to thank you for giving so much to the American people. And I know all of my colleagues join with me in that sentiment. Five years is a long time to give up your life, and I know it is not a job, it is sort of a lifestyle that you take on as Chairman, both of you. You know what I am talking about, and we are just very, very grateful, Mr. Chairman.

Senator Coons.

STATEMENT OF SENATOR CHRISTOPHER A. COONS

Senator COONS. Thank you, Chairman Kennedy. I too will be brief. Thank you to our key witnesses today, Chairman Jay Clayton and Chairman Chris Giancarlo. And to your wife Regina, if I might just would like to express our gratitude for your support for his service. And I will join with the Chairman in our thanks to you both for the time you have dedicated to our Nation in your role as chairmen of the SEC and CFTC.

I will be interested in hearing about how cryptocurrencies are challenging your oversight and your regulatory role. How cybersecurity is and remains a challenge both for the agencies you are responsible for and for financial markets more broadly. How you have invested the modest, but I think very responsible increased investments we have made, and then where you are in terms of the request you are making this year and how we could improve our service to the general public. By that, I will follow the Chairman's lead and conclude my opening remarks and say, let's get going with this hearing. Thank you, Mr. Chairman.

Senator KENNEDY. Thank you, Senator Coons. Let us start with opening statements. Chairman Clayton, who has been our chairman since May of 2017. He was previously a partner at the very prestigious law firm of Sullivan & Cromwell LLP. I will recognize him for his testimony.

STATEMENT OF HON. JAY CLAYTON, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Chairman CLAYTON. Thank you, Chairman Kennedy and Ranking Member Coons. It is nice to have the opportunity to testify before you today. I am pleased to be joined by Chairman Giancarlo. We have worked very closely together over the past 2 years and I echo your comments. He is a great public servant.

I am going to focus on a few high-level matters as my written testimony provides a detailed review of the Commission's work over the past year, as well as a discussion of how we will leverage the resources that you provide us to further the interests of our Main Street investors.

First, on behalf of my fellow Commissioners and the 4,500 women and men of the SEC, I want to thank you for your past support. Your funding has enabled us to make targeted hires in much-needed areas, including cybersecurity, enforcement, our examination program, market oversight, and small business capital formation. It has allowed us to lift our hiring freeze, make significant investments to modernize our information technology infrastructure, improve our cybersecurity, and more generally, continue to execute on our 2018–2022 Strategic Plan.

Turning to our fiscal year 2020 budget request, we are requesting $1.746 billion dollars, an approximately 4 percent increase over current levels. I will start with two points on that:

First the SEC budget request relies on the SEC having continued access to the Reserve Fund to invest in information technology improvements, including those related to cybersecurity. Second, and I want to emphasize this, the funding is deficit-neutral, and any amount appropriated to the agency will be offset by transaction fees.

Our operational funding has three principal components. The first is our people—our human capital. This funding, including compensation and benefits, is the largest portion of our budget, approximately 68 percent, and also our most important. My written testimony lays out a number of initiatives we have undertaken on behalf of our Main Street investors, and each of these was attained only through the hard work and professionalism of the SEC staff. Continued investment in our human capital is critical to our ability to recruit, retain, and develop top talent that is needed to effectively pursue our mission.

The second component, information technology, including again cybersecurity, makes up a significant and in recent past, increasing portion of our overall budget, approximately 14 percent. We have made meaningful progress in the past 2 years in upgrading our technical and staff capabilities in these areas with the resources provided by Congress. As we become more data dependent and cyber threats to the industry, investors, and governments continue to evolve, I expect investments in our information technology and cybersecurity capabilities to stay front of mind for the agency.

Finally, the third component is leasing. The SEC is engaged with the GSA currently for procurement process for both our Headquarters and our New York Regional Office. We expect GSA to announce contract awards for these leases in fiscal year 2019 and 2020 respectively.

In closing, I would like to again thank the subcommittee for its continued support of the SEC, its mission, and its people.

I look forward to working with each of you on our fiscal year 2020 request, and I am prepared to answer any questions you may have. Thank you very much.

[The statement follows:]

PREPARED STATEMENT OF HON. JAY CLAYTON

Chairman Kennedy, Ranking Member Coons and Senators of the subcommittee, thank you for the opportunity to testify today on the President's fiscal year 2020 budget request for the U.S. Securities and Exchange Commission (SEC).[1]

It is an honor to appear before this subcommittee again with my colleague, U.S. Commodity Futures Trading Commission (CFTC) Chairman Christopher Giancarlo. This is the fourth time we have testified together before Congress, and since he is planning on leaving the agency soon, I want to express my deep appreciation for his work on behalf of our markets, our investors and, importantly, our country. Over the past year, we and the staff of our respective agencies have collaborated on a number of issues to strengthen our markets, including developing and improving regulations for our swaps and security-based swap markets, preparing for the effects of Brexit and addressing issues raised by cryptocurrencies, initial coin offerings (ICOs) and similar products and technologies. In these and other matters on which we have worked together, Chairman Giancarlo has always had the interests of our country front of mind.

As a threshold matter, I would like to thank the members of this Committee for your support of the Commission's mission and its people. The funding Congress provided for the agency for fiscal year 2019 positions the SEC to maintain effective oversight of our changing securities markets and to continue to pursue policies to benefit long-term Main Street investors, American businesses and our markets. The fiscal year 2019 funding is allowing us to lift our hiring freeze, and we are in the process of improving our human capital, including through the targeted hiring discussed in our fiscal year 2019 budget request. Additionally, the fiscal year 2019 funding provides necessary resources to maintain and upgrade our information technology systems and enhance the agency's cybersecurity and risk management. I am committed to being a responsible and prudent steward of these resources and look forward to working with each of you on the agency's fiscal year 2020 request during the congressional appropriations process.

[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 other Commissioner.

FISCAL YEAR 2020 BUDGET REQUEST

To begin, I want to make it clear that our people—our human capital—are our most important resource. Over the past several years, they have moved the Commission forward in the face of ever-changing markets as well as well-known and emerging risks. A key principle of mine is to continue to invest in and upgrade our human capital. Staff compensation is the largest portion of our budget, and the most critical in order for the SEC to stay competitive in retaining and recruiting top talent whose skills and expertise provide them with many employment choices.

The SEC's workforce of about 4,500 staff, located in Washington and across our 11 regional offices, permits the SEC to oversee, among other things: (1) over $97 trillion in securities trading annually on U.S. equity markets; (2) the disclosures of approximately 4,400 exchange-listed public companies with an approximate aggregate market capitalization of $34 trillion; and (3) the activities of over 27,000 registered entities and self-regulatory organizations. These registered entities and registrants include, among others, investment advisers, broker-dealers, transfer agents, securities exchanges, clearing agencies, mutual funds and exchange-traded funds (ETFs), and employ almost one million people in the United States.

For fiscal year 2020, our request of $1.746 billion, a 4.2 percent increase over the fiscal year 2019 enacted levels, will allow the agency to carry out our mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation. This funding level would support 4,694 positions, including 34 new positions. Along with the funding provided for 100 additional positions in fiscal year 2019, the fiscal year 2020 request will enable the SEC to fill approximately one-third of the approximately 400 positions lost due to the hiring freeze. The fiscal year 2020 request also includes additional funding for information technology and cybersecurity upgrades to build on the agency's recent work to improve our systems and expertise. Finally, the fiscal year 2020 budget request relies on the SEC having continued access to the Commission's Reserve Fund to fund multi-year information technology improvements, including those related to cybersecurity.

It is important to note that the SEC's funding is deficit-neutral. Any amount appropriated to the agency will be offset by private sector transaction fees. The current transaction fee rate is just over two cents for every $1,000 in covered securities sales. In addition, the SEC has been a net contributor to the U.S. Treasury in 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 2019, the fee rate will be set at a level sufficient to collect $660 million. A portion of these collections will be put into the Reserve Fund, while the remaining funds will be deposited in the general fund of the U.S. Treasury.

For fiscal year 2020, the requested funding will enable the SEC to execute initiatives in our new 2018–2022 Strategic Plan, including continuing to invest in our human capital, modernizing key information technology systems and further strengthening our cybersecurity and enterprise risk management consistent with our multi-year information technology strategic roadmap. Our Strategic Plan for 2018–2022 outlines three goals that will guide the work of the SEC moving forward.[2] We have already made meaningful progress on each of these goals, and importantly, our fiscal year 2020 request is calibrated to further these initiatives in the coming year.

Our first goal, which has been a priority of mine since I became Chairman, is focusing on the interests of our long-term Main Street investors. The past year has presented many opportunities for me, my fellow Commissioners and SEC staff to interact directly with investors from across the country. Those discussions allowed us to better answer the question we ask ourselves every day: how does our work benefit the Main Street investor? Each proposal or action we take is guided by that principle.

Our second goal—to be innovative and responsive—reflects the changing nature of our markets. As technological advancements and commercial developments have changed how our securities markets operate, the SEC's ability to remain an effective regulator requires that we continually monitor the market environment and adapt our rules, regulations and oversight. This maxim applies to nearly every facet of what we do at the SEC. For example, since I arrived at the SEC, these principles have driven the establishment of a Cyber Unit in the Division of Enforcement (Enforcement or Division), a Fixed Income Market Structure Advisory Committee (FIMSAC), and more recently, our new Strategic Hub for Innovation and Financial Technology (FinHub).

[2] *See* U.S. Sec. and Exch. Comm'n Strategic Plan: fiscal years 2018–2022 (Oct. 2018), *available at* https://www.sec.gov/strategic-plan.

Our third goal—elevating the agency's performance through technology, data analytics and human capital—embodies our commitment to maintaining an effective and efficient operation. Maintaining a high level of staff engagement, performance and morale is critical to our ability to execute the SEC's mission on behalf of Main Street investors. Our staff represents top talent in our field, and when we recruit, we look for candidates who can match this high standard for professional qualification and experience. We also are using technology, analyzing data and promoting information-sharing and collaboration across the agency to strengthen our cybersecurity and enterprise risk profiles, while also maintaining the work environment that has resulted in consistent high levels of employee satisfaction. With the support of the Committee, we are committed to continued investment in both new technology and human capital.

FISCAL YEAR 2018 REVIEW

Before I discuss our fiscal year 2020 budget request in more detail, I would like to briefly provide an overview of our accomplishments over the prior fiscal year (fiscal year 2018). Last year, I noted that the near-term Regulatory Flexibility Act agenda would be streamlined to increase transparency and accountability to the public and Congress, as well as to provide greater clarity to our staff, by including initiatives the agency could reasonably expect to complete over the next 12 months. During fiscal year 2018, the Commission advanced 23 of the 26 rules on the near-term agenda, a good result on both a percentage basis (88 percent) and an absolute basis.[3]

In addition, the Commission responded to major events and changes in the broader regulatory landscape by advancing several other initiatives not in the original agenda. For example, we issued guidance to public companies about disclosures of cybersecurity risks and incidents.[4] During fiscal year 2018, the Commission also responded to a new congressional mandate from the Economic Growth, Regulatory Relief, and Consumer Protection Act by expanding a key registration exemption used by non-reporting companies to issue securities pursuant to compensatory arrangements[5] and provided proactive relief for those investors and companies affected by Hurricane Florence.[6] In addition, to facilitate more accurate, clear and timely communications between issuers and shareholders, the staff released guidance on how to approach near-term financial reporting questions resulting from tax law changes on the same day the bill was signed by the President.[7]

To be sure, statistics—such as an 88 percent completion rate—often fail to tell more than a narrow story. Main Street investors—the market participants we have at the forefront of our minds—will not assess our work by the number or percentage of rules and initiatives we complete, but rather will be looking at what our efforts substantively do for them.

While each of these regulatory initiatives is a key component of our agenda, I would be remiss if I did not note that a vast majority of the work of the SEC staff goes unheralded but is critical to the efficient functioning of our capital markets. From (1) reviewing tens of thousands of issuer filings and disclosures to (2) providing assistance, informal guidance and responding to daily questions from investors, issuers and other market participants to (3) collaborating with domestic and international counterparts to address issues related to events such as Brexit[8] and

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[3] Over the past 10 years, the Commission completed, on average, approximately one-third of the rules listed on the near-term agenda.

[4] *See* Press Release 2018–22, *SEC Adopts Statement and Interpretive Guidance on Public Company Cybersecurity Disclosures* (Feb. 21, 2018), *available at* https://www.sec.gov/news/press-release/2018-22.

[5] *See* Press Release 2018–135, *SEC Adopts Final Rules and Solicits Public Comment on Ways to Modernize Offerings Pursuant to Compensatory Arrangements* (Jul. 18, 2018), *available at* https://www.sec.gov/news/press-release/2018-135.

[6] *See* Press Release 2018–202, *SEC Provides Regulatory Relief and Assistance for Hurricane Victims* (Sept. 19, 2018), *available at* https://www.sec.gov/news/press-release/2018-202.

[7] *See* Press Release 2017–237, *Commission Staff Provides Regulatory Guidance for Accounting Impacts of the Tax Cuts and Jobs Act* (Dec. 22, 2017), *available at* https://www.sec.gov/news/press-release/2017-237.

[8] In addition to collaborating with domestic and international counterparts on Brexit-related issues, I directed the SEC staff to focus on the disclosures companies make about Brexit. We have seen a wide range of disclosures, even within the same industry. Some companies have fairly detailed disclosures about how Brexit may impact them, while others simply state that Brexit presents a risk. While many companies' disclosures improved in their most recent annual filing, I would like to see more companies providing robust disclosure about how management is considering Brexit, and the impact it may have on the company and its operations, particu-

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the pending phase out of LIBOR to (4) the daily, dogged efforts of our investigative, litigation and examination teams, much of the SEC's staff work is unseen by many but nonetheless a principal component to the success of America's capital markets.

With that in mind, and using the goals in our Strategic Plan as guideposts, I would like to provide additional detail on a few of our recent initiatives and how our fiscal year 2020 budget request will enable the SEC and its people to further the interests of our long-term Main Street investors.

Focusing on the Interests of Long-term Main Street Investors

I have noted that my touchstone when considering issues before the Commission is the interests of long-term Main Street investors. The importance of well-functioning capital markets to Main Street investors' financial goals—whether saving for retirement, a home, college or other endeavors—cannot be overstated. And perhaps more importantly, Main Street investors' continued participation provides the lifeblood for our capital markets, as at least 52 percent of U.S. households are invested directly or indirectly in the capital markets.[9] This represents tens of millions of Americans who are invested in our capital markets and make personal investment decisions—both direct investment decisions such as which stocks, bonds, mutual funds, ETFs and other securities to purchase or sell and indirect investment decisions such as whether to hire a broker-dealer or investment adviser. Many other Americans are also invested in or exposed to our markets through pension funds, insurance products and other intermediaries.

This level of retail investor participation stands out against other large industrialized countries. Other countries want to replicate it because such broad investor participation in our capital markets is a significant competitive advantage for our economy, and participation in our capital markets has made many Americans' lives better and their retirements more secure. But this level of investor participation—which has been a decades-long endeavor among investors, issuers, the SEC and other market participants—should not be taken for granted.

Standards of Conduct for Broker-Dealers and Investment Advisers

One of the more important ways in which we can further the interests of our long-term Main Street investors is by enhancing and clarifying the standards of conduct and mandated disclosures for our two principal types of financial professionals—broker-dealers and investment advisers. My view is these standards should reflect what retail investors would reasonably expect of these financial professionals, while preserving access and choice for investors who prefer the "pay as you go" model for advice from a broker-dealer or a fee-based model from an investment adviser (or a combination of both types of arrangements), as well as preserving retail customer choice of the level and types of advice provided and the products available. Our standards of conduct rulemaking is years—perhaps decades—overdue, and of significant importance to a vast number of retail investors.

In April 2018, the Commission proposed for public comment a significant set of rulemakings and interpretations designed to serve Main Street investors that would: (1) require broker-dealers to act in the best interest of their retail customers; (2) reaffirm, and in some cases clarify, the fiduciary duty owed by investment advisers to their clients; and (3) require both broker-dealers and investment advisers to state clearly key facts about their relationship, including their financial incentives.[10] This set of initiatives is intended to enhance investor protection by bringing the legal requirements and mandated disclosures of financial professionals in line with reasonable investor expectations.

Specifically, proposed Regulation Best Interest would enhance broker-dealer standards of conduct by establishing an overarching obligation requiring broker-dealers to act in the best interest of the retail customer when making recommendations of any securities transaction or investment strategy involving securities. Simply put, under proposed Regulation Best Interest, a broker-dealer cannot put her or his interests ahead of the retail customer's interests when making a recommenda-

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larly the impact of a so-called "hard Brexit." *See also* William Hinman, Applying a Principles-Based Approach to Disclosing Complex, Uncertain and Evolving Risks (Mar. 15, 2019), *available at* https://www.sec.gov/news/speech/hinman-applying-principles-based-approach-disclosure-031519

[9] *Data Source:* 2016 Survey of Consumer Finances (SCF). The SCF is a triennial interview survey of U.S. families sponsored by the Board of Governors of the Federal Reserve System with the cooperation of the U.S. Department of the Treasury. *See* https://www.Federalreserve.gov/econres/scfindex.htm.

[10] *See* Press Release 2018–68, *SEC Proposes to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Investment Professionals* (Apr. 18, 2018), *available at* https://www.sec.gov/news/press-release/2018-68.

tion. The proposal incorporates that key fiduciary principle and goes beyond and enhances the current suitability obligations applicable to broker-dealers under the Federal securities laws. To meet this new requirement, the broker-dealer would have to satisfy specific disclosure, care and conflict of interest obligations, including a requirement to adopt policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, certain conflicts of interest arising from financial incentives.

Proposed Regulation Best Interest and its "best interest" standard draw upon fiduciary principles applicable in other well-known contexts, including those underlying an investment adviser's fiduciary duty, recognizing that, while their client relationship models differ, both broker-dealers and investment advisers provide recommendations and advice in similar contexts and in the face of conflicts of interest. In another part of our reform efforts, we proposed an interpretation reaffirming—and, in some cases, clarifying—the fiduciary duty that investment advisers owe to their clients. This proposed interpretation is designed to provide advisers and their clients with a reference point for understanding the obligations of investment advisers to their clients and, specifically, reaffirms that an investment adviser also must act in the best interest of her or his client.

While proposed Regulation Best Interest draws on fiduciary principles, the obligations of a broker-dealer under Regulation Best Interest and the obligations of an investment adviser pursuant to its fiduciary duty under the Advisers Act would differ in certain respects, reflecting the differing scope of the services, payment forms and other relationship terms offered by broker-dealers and investment advisers, respectively. For instance, aspects of the obligations applicable to broker-dealers under proposed Regulation Best Interest are more specific than those applicable to investment advisers and reflect the characteristics of the generally applicable broker-dealer model—transaction-specific recommendations and compensation.[11]

While the generally applicable investment adviser model—ongoing, regular advice and services provided in the context of broad investment management with compensation based on the value of assets under management, a fixed fee or other arrangement—differs from the generally applicable broker-dealer model, in my view the key elements of the standard of conduct that would apply to broker-dealers under proposed Regulation Best Interest at the time that a recommendation is made would be substantially similar to key elements of the standard of conduct that applies to investment advisers pursuant to their fiduciary duty under the Advisers Act. It is my intention that, regardless of whether the retail customer chooses a broker-dealer or an investment adviser, the retail customer will receive recommendations (from a broker-dealer) or advice (from an investment adviser) that are in the best interest of the retail customer, and that do not place the financial professional's interests ahead of the interests of the retail customer.

Finally, under our proposed rulemaking package, firms would be required to provide retail investors with a new, succinct disclosure form referred to as the "relationship summary" or "Form CRS." As proposed, the relationship summary would highlight key aspects of broker-dealers and investment adviser relationships, including: (1) the principal types of services offered; (2) the legal standards of conduct that apply to each; (3) the fees the customer would pay; and (4) certain conflicts of interest that may exist. It also would include key questions for retail investors to ask their financial professional. I believe that the relationship summary will result not only in more informed retail investors, but also will drive competition by facilitating transparency and comparability of these key features of a relationship with a financial professional.

In order to hear first-hand from retail investors who will be directly impacted by our various rulemaking efforts, the SEC staff organized seven roundtables across the country to provide Main Street investors the opportunity to speak directly with me, my fellow Commissioners and senior SEC staff to tell us about their experiences and views on what they expect from their financial professionals. I had the opportunity to lead five of these discussions—in Houston, Atlanta, Miami, Denver and Baltimore—and attend another in Washington, D.C. These candid, experience-based conversations were incredibly valuable and are informing our work moving forward. The transcripts from these roundtables are included in our public comment file. We also invited investors to view samples of the proposed relationship summary to share their insights and feedback with the Commission by going to https://www.sec.gov/tell-us. In addition, our Office of the Investor Advocate engaged RAND Corporation to perform investor testing of the proposed relationship summary. The

[11] In these specific areas, the obligations of broker-dealers under proposed Regulation Best Interest are more prescriptive, consistent with the generally rules-based regulatory regime that applies to broker-dealers.

results of the investor testing were made available on the SEC's website in order to allow the public to consider and comment on this supplemental information.[12]

The staff of the Division of Trading and Markets (Trading and Markets) and the Division of Investment Management (Investment Management) are reviewing all of this information, and the more than 6,000 comment letters,[13] as they work diligently together to develop final rule recommendations.

Facilitating Capital Formation

Focusing on the interests of long-term Main Street investors also requires encouraging capital formation for emerging companies seeking to enter our public capital markets while maintaining, and in many cases enhancing, investor protections. Doing so provides greater investment opportunities for Main Street investors, as it is generally difficult and expensive for them to invest in private companies. As a result, Main Street investors may not have the opportunity to participate in the growth phase of these companies if the companies choose not to enter our public markets or do so only later in their life cycle. Additionally, it is my experience that companies that go through the SEC public registration and offering process often come out as better companies, providing net benefits to the company, investors and our capital markets.

Since 2017, the Division of Corporation Finance (Corporation Finance) has led a number of regulatory actions to benefit public company capital formation.[14] For example, Corporation Finance now accepts voluntary draft registration statement submissions for many securities offerings, including for initial public offerings (IPOs) and offerings within 1 year of an IPO, for review by the staff on a non-public basis, building on the successful confidential submission process established by the Jumpstart Our Business Startups (JOBS) Act.[15] Additionally, earlier this year the Commission issued a proposal to expand the ability of companies that are contemplating raising capital to "test-the-waters" by engaging in communications with certain potential investors prior to or following the filing of a registration statement for an IPO.[16] I have seen firsthand how this has benefitted emerging growth companies considering an IPO, as they are able to engage investors earlier to explain their business and obtain feedback in advance of a public offering. This also benefits investors and shareholders as companies are better able to determine the appropriate time for an offering and to more effectively size and price the offering.

Corporation Finance has several proposals on the horizon designed to encourage capital formation for emerging companies seeking to enter our public capital markets. These include amending the definition of "accelerated filer" that triggers Section 404(b) of the Sarbanes-Oxley Act of 2002, which requires registrants to provide an auditor attestation report on internal control over financial reporting. This proposal, which also builds on the success of the JOBS Act, should reduce the number of smaller companies that are required to provide the auditor attestation report while maintaining appropriate incentives and safeguards to ensure that such companies have appropriate controls over financial reporting.

Beyond our public markets, I expect the Commission to take a fresh look at the exempt offering framework to consider whether changes should be made to harmonize and streamline what can be fairly described as a patchwork approach. While Congress and the SEC have taken a number of steps to expand the options that small businesses have to raise capital, most notably in the bipartisan JOBS Act, there has not been a comprehensive review of our exemptive framework to ensure that the system, as a whole, is rational, accessible and effective. The staff is working on a concept release that I expect will bring to the forefront these and other topics on how we can better harmonize exempt offerings.[17] Receiving input from investors,

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[12] *See* Press Release 2018–257, *Investor Testing of the Proposed Relationship Summary for Investment Advisers and Broker-Dealers* (Nov. 7, 2018), *available at* https://www.sec.gov/news/press-release/2018-257.

[13] *See* Comments on Proposed Rule: Regulation Best Interest, *available at* https://www.sec.gov/comments/s7-07-18/s70718.htm. Of the more than 6,000 comment letters, approximately 3,000 were unique letters.

[14] *See* Remarks on Capital Formation at the Nashville 36|86 Entrepreneurship Festival (Aug. 29, 2018), *available at* https://www.sec.gov/news/speech/speech-clayton-082918; *see also* Press Release 2019–38, *SEC Adopts Rules to Implement FAST Act Mandate to Modernize and Simplify Disclosure* (Mar. 20, 2019), *available at* https://www.sec.gov/news/press-release/2019-38.

[15] *See* Press Release 2017–121, *SEC's Division of Corporation Finance Expands Popular JOBS Act Benefit to All Companies* (June 29, 2017), *available at* https://www.sec.gov/news/press-release/2017-121.

[16] *See* Press Release 2019–14, *SEC Proposes to Expand "Test-the-Waters" Modernization Reform to All Issuers* (Feb. 19, 2019), *available at* https://www.sec.gov/news/press-release/2019-14.

[17] As we embark on this project, I believe there are several things we should consider. We should evaluate the level of complexity of our current exemptive framework for issuers and in-

startups, entrepreneurs and other market participants who have firsthand experience with investing, raising capital and our regulatory framework is extremely important to make sure we get it right.

Another significant initiative for Corporation Finance and Investment Management is improving the proxy process. In November 2018, the SEC staff held a proxy roundtable to discuss: (1) the proxy solicitation and voting process; (2) shareholder engagement through the shareholder proposal process; and (3) the role of proxy advisory firms.[18] I was pleased with this largely solutions-oriented event, which included a diverse group of panelists representing the views of investors, companies and other market participants. While we heard a wide range of views, we saw more agreement than disagreement, and I believe that we should act to improve each of these areas with an initial focus on the matters where there was broad agreement action is appropriate. The staff is looking at a number of issues that were discussed at the roundtable and submitted for public comment, and I have asked them to formulate recommendations for the Commission's consideration. On timing, it is clear to me that these issues will not improve on their own with time, and I intend to move forward with the staff recommendations, prioritizing those initiatives that are most likely to improve the proxy process and our markets for our long-term Main Street investors.

Each of these initiatives is designed to ensure that American businesses continue to have the ability to effectively raise capital, while maintaining, and in some ways enhancing, investor protections. Our fiscal year 2020 request would provide resources to Corporation Finance to continue their efforts, including by adding a new position to Corporation Finance to assist with new capital formation policy and rulemaking initiatives. This would include the continuation of efforts to consider a scaled disclosure framework for smaller companies, disclosure modernization and simplification and anticipated recommendations arising out of our upcoming concept release on the exempt offering regulatory framework.

Beyond our policymaking divisions, the Commission recently acquired a powerful voice for small businesses and their investors—our first Advocate for Small Business Capital Formation, Martha Miller.[19] Martha brings a wealth of experience and passion to the role and will be a proponent for American businesses and their investors. Martha has hit the ground running in building the office and engaging with many small businesses and their investors, including participating in several panels on entrepreneurship and hosting her first public town hall in Kansas City, Missouri in April. She also released a business plan providing insight into her office's roadmap for serving small businesses, including traveling to areas that traditionally have received less attention from investors.[20]

Our fiscal year 2020 request will allow the SEC to expand the Office of the Advocate for Small Business Capital Formation (OASB), bringing its total staffing to nine positions so that it can pursue its mission and provide outreach, offer assistance, identify problems and unique challenges to raising capital for small businesses, including minority- and women-owned small businesses and small businesses affected by natural disasters, and give a stronger voice at the Commission to small businesses and small business investors. The request would also assist OASB in supporting the Advisory Committee on Small Business Capital Formation, which is designed to solicit ideas from a diverse group of professionals about ways to better facilitate small business capital formation. In this regard, I am very pleased to say that my fellow Commissioners and I recently announced the formation of that Committee, including its inaugural members, all highly accomplished

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vestors alike and consider whether changes should be made to rationalize and streamline the framework. For example, do we have overlapping exemptions that create confusion for companies trying to navigate the most efficient path to raise capital? Are there gaps in our framework that impact the ability of small businesses to raise capital at key stages of their business cycle? We also should consider whether current rules that limit who can invest in certain offerings should be expanded to focus on the sophistication of the investor, the amount of the investment, or other criteria rather than just the wealth of the investor. And we should take a look at whether more can be done to allow issuers to transition from one exemption to another and, ultimately, to a registered IPO, without undue friction.

[18] *See* November 15, 2018: Roundtable on the Proxy Process, *available at* https://www.sec.gov/proxy-roundtable-2018.

[19] *See* Press Release 2018–304, *Martha Miller Named Advocate for Small Business Capital Formation* (Dec. 21, 2018), *available at* https://www.sec.gov/news/press-release/2018-304.

[20] *See* Office of the Advocate for Small Business Capital Formation Foundational Business Plan (Apr. 2019), *available at* https://www.sec.gov/files/2019%20OASB%20Business%20Plan.pdf

individuals who are committed to entrepreneurship and growth and who, collectively, provide a wide range of expertise, experience and perspective.[21]

Enforcing the Federal Securities Laws

The interests of long-term Main Street investors require capital markets that are vigorously policed for fraud and other misconduct. The ongoing efforts by Enforcement to deter misconduct and punish securities law violators are critical to safeguarding millions of investors and instilling confidence in the integrity of our markets. The nature and quality of the SEC's enforcement actions during the last year speak volumes to the hard work of the women and men of the agency as they have made our capital markets a safer place for investors to put their hard-earned money to work.

As noted by Enforcement's Co-Directors, Stephanie Avakian and Steven Peikin, in the Division's Annual Report, our success is best judged both quantitatively and qualitatively and over various periods of time.[22] Based on such an evaluation—and in my opinion by any measure—Enforcement has been successful over the past year. I can assure you that the Division will continue its vigorous enforcement of the Federal securities laws and hold bad actors accountable, whether on Main Street or Wall Street.

To further our enforcement efforts on behalf of Main Street investors, in September 2017, the SEC announced the formation of a Retail Strategy Task Force (Task Force), which has two primary objectives: (1) to develop data-driven, analytical strategies for identifying practices in the securities markets that harm retail investors and generating enforcement matters in these areas; and (2) to collaborate within and beyond the SEC on retail investor advocacy and outreach.[23] Each of these objectives directly impacts the lives of Main Street investors and involves collaboration among many divisions and offices. We anticipate that new data-driven approaches will yield significant efficiencies in case generation and resource allocation by targeting enforcement efforts where the risks to Main Street investors are the most significant. Although it has been operative for less than 2 years, the Task Force has already undertaken a number of lead-generation initiatives built on the use of data analytics.

Additionally, in my view, protecting retail investors means, whenever possible, putting money back in their pockets when they are harmed by violations of the Federal securities laws. In fiscal year 2017 and fiscal year 2018, the Commission returned \$1.07 billion and \$794 million to harmed investors, respectively. Here, I will call out for commendation the Division's approach to the too-widespread practice of investment advisers placing retail investors in higher cost share classes of mutual funds when the same funds were available to those investors at lower or no cost, without adequately disclosing the practice or with disclosure that was inconsistent with the advisers' actual practices. In a little over a year, the Division's approach—which centered on self-reporting and cooperation—will result in the return of over \$125 million to retail investors.[24] Importantly, the resulting savings to retail investors from moving to the lower cost share classes will continue for years to come. We remain committed to this important Main Street investor-focused part of our work, and we will continue our efforts to return funds to harmed investors as promptly as practicable.

The fiscal year 2020 request will provide critical resources to Enforcement, allowing the Division to add six positions to expand our capability to investigate and prosecute alleged misconduct involving actions that affect Main Street investors. These positions will bolster our Task Force and also provide further support to Enforcement investigators and litigators.

Examining SEC-Registered Entities

Our examination program, executed by the Office of Compliance Inspections and Examinations (OCIE), is another key area where our work directly protects the in-

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[21] *See* Press Release 2019–61, *SEC Announces Members of Small Business Capital Formation Advisory Committee* (Apr. 25, 2019), *available at* https://www.sec.gov/news/press-release/2019-61.

[22] Relevant qualitative factors include, among other things, asking whether we are: bringing meaningful actions that target the most serious violations, pursuing individual sanctions in appropriate cases, obtaining punishments that deter unlawful conduct and returning money to harmed investors. *See* U.S. Sec. & Exch. Comm'n, Div. of Enforcement, Annual Report: A Look Back at fiscal year 2018 (Nov. 2, 2018), *available at* https://www.sec.gov/files/enforcement-annual-report-2018.pdf.

[23] *See* Press Release 2017–176, *SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors* (Sept. 25, 2017), *available at* https://www.sec.gov/news/press-release/2017-176.

[24] *See* Press Release 2019–28, *SEC Share Class Initiative Returning More Than \$125 Million to Investors* (Mar. 11, 2019), *available at* https://www.sec.gov/news/press-release/2019-28.

terests of Main Street investors. In December 2018, OCIE published its 2019 Examination Priorities, which reflect a continued focus on the SEC's commitment to protecting retail investors, including seniors and those saving for retirement.[25] In particular, OCIE has looked closely at products and services offered to retail investors, the disclosures they receive about those products and services and the financial services professionals who serve them. OCIE has also focused its attention on several other areas that present heightened risks, including: (1) compliance and risks in critical market infrastructure, such as exchanges and clearing agencies; (2) digital assets, including cryptocurrencies, coins and tokens; (3) cybersecurity; and (4) anti-money laundering programs.

OCIE conducts risk-based examinations of SEC-registered entities, including broker-dealers, investment advisers, investment companies, municipal advisors, national securities exchanges, clearing agencies, transfer agents and the Financial Industry Regulatory Authority (FINRA), among others.[26] During fiscal year 2018, OCIE conducted over 3,150 examinations, an overall increase of 11 percent from fiscal year 2017. This includes a 17 percent coverage ratio for SEC-registered investment advisers—which increased 13 percent from fiscal year 2017, even as the number of registered investment advisers increased by approximately 5 percent.[27] While OCIE will face challenges in sustaining this trajectory in fiscal year 2019, OCIE will continue to leverage data analysis to identify potentially problematic activities and firms as well as to determine how best to scope the examinations of those activities and firms.

The fiscal year 2020 request would allow us to restore five positions to OCIE, enabling it to bring on additional expertise of SEC-registered entities and continue its risk-based efforts to protect Main Street investors.

Investor Outreach and Education

The SEC promotes informed investment decisionmaking through education initiatives aimed at providing Main Street investors with a better understanding of our capital markets and the opportunities and risks associated with the array of investment choices presented to them. The Office of Investor Education and Advocacy (OIEA) spearheads these efforts and participation extends throughout our divisions and offices. In fiscal year 2018, the SEC conducted over 150 in-person investor education events focused on various segments of the investing population, including senior citizens, military personnel, younger investors and affinity groups. In addition to in-person education events, OIEA developed informative, innovative and accessible educational initiatives.

We use a variety of channels to deliver information to investors. For example, we created a website to educate the public about frauds involving ICOs and just how easy it is for bad actors to engineer this type of fraud—our HoweyCoins.com mock website promoted a fictional ICO.[28] The website was created in-house, very quickly and with few resources. It attracted over 100,000 people within its first week. We also published a variety of investor alerts and bulletins to warn Main Street investors about other possible schemes and risks for fraud, including certain investment schemes that use celebrity endorsements, self-directed individual retirement accounts, the risks in using credit cards to purchase an investment and the potential harm resulting from sharing their personal contact information with online investment promoters.

We also continued to promote our national public service campaign, "Before You Invest, Investor.gov," which encourages investors to research the background of

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[25] U.S. Sec. & Exch. Comm'n, Off. of Compliance Inspections and Examinations, 2019 Nat'l Exam Program Examination Priorities (Dec. 20, 2018), *available at* https://www.sec.gov/files/OCIE%202019%20Priorities.pdf.

[26] In conjunction with OCIE's examination activities, OCIE published a number of risk alerts to inform SEC-registered firms and investors of common compliance issues OCIE observed. Over the last year, OCIE risk alerts addressed topics ranging from transfer agent safeguarding of funds and securities to fee and expense compliance issues for investment advisers. These alerts provide OCIE's views on ways to sharpen the identification and correction of potentially deficient practices, maximize the impact of our examination program and better protect the interests of Main Street investors.

[27] The number of investment advisers has increased from approximately 9,000 in 2005 to over 13,000 in 2018. In addition, in response to the Department of Labor Fiduciary Rule adopted on April 8, 2016 (vacated by the Fifth Circuit Court of Appeals in March 2018) it was reported that the broker-dealer industry, among other things, reduced service and advice to small retirement accounts and encouraged retail customers to move towards self-directed accounts and advisory accounts, including robo-advisors. The SEC will continue to monitor the effects of this trend on investor protection and market integrity more generally.

[28] *See* Press Release 2018–88, *The SEC Has an Opportunity You Won't Want to Miss: Act Now!* (May 16, 2018), *available at* https://www.sec.gov/news/press-release/2018-88.

their financial professional. Our experience demonstrates that working with unlicensed promoters who have a history of misconduct greatly increases the risk of fraud and losses. In May 2018, we supplemented this information service with a new online search tool, the SEC Action Lookup for Individuals, or SALI.[29] This tool enables investors to find out if the individual he or she is dealing with has been sanctioned as a result of SEC action, for both registered and unregistered individuals. SALI continues to be updated on an ongoing basis, making it an ever better resource for Main Street investors. We are encouraged by the fact that unique page views on Investor.gov increased by 45 percent compared to fiscal year 2017.

Additionally, SEC regional offices engage in investor initiatives in their local communities. For example, the San Francisco Regional Office has conducted extensive outreach to California teachers through its Teacher Investment Outreach Initiative. This project seeks to help teachers make informed decisions on investment portfolio options, fees and risk. Regional staff, many of whom have personal connections to the teaching community, created this initiative in response to learning about the limitations of the investment options (and related high fees and costs) offered to public school teachers under the defined contribution portion of their retirement plans.

More recently, as part of National Financial Capability Month, I released several videos in a new series, "Notes from the Chairman."[30] These videos are based on my experiences traveling the country and meeting with Main Street investors. In these meetings, two common and related themes emerged, regardless of demographics and geography. Investors wished they (1) started investing in our markets earlier and (2) had known more about investing and financial affairs more generally earlier. These views were universal and deeply held and, while not entirely within the purview of the Commission to address, will continue to resonate with me—and I will continue to work to address them—during my tenure at the Commission.[31]

The fiscal year 2020 request would permit expanded outreach to Main Street investors through the work of OIEA and the Office of the Investor Advocate, and to small business owners and investors through OASB. Further, SEC staff plans to conduct additional research to gain deeper insight into how different types of investors participate in our capital markets to benefit both our policymaking and investor education efforts.

Recognize Significant Developments and Trends in Our Evolving Capital Markets and Adjust Our Efforts to Ensure We Are Effectively Allocating Our Resources

Overseeing the Capital Markets

As our markets continue to evolve through technological advancements and other developments, the SEC staff must stay abreast of these changes to ensure that all investors, including our Main Street investors, have access to fair and efficient capital markets. Many of our trading markets have become data and algorithm driven and are populated by firms with extensive resources and expertise. Transparency is a bedrock of healthy and vibrant markets. It enhances monitoring and can energize competitive forces to benefit investors. Transparency is a key part of our efforts to ensure fair and efficient markets, particularly those with significant Main Street investor participation. We have taken significant steps over the past year to make our markets more transparent.

For example, in July 2018, the Commission adopted amendments to Regulation ATS that enhance the transparency requirements governing alternative trading systems, commonly known as "ATSs."[32] These amendments provide investors, brokers and other market participants—as well as the Commission—with increased visibility into the operations of these important markets for equity trading. Additionally, in November 2018, the Commission adopted amendments to Regulation NMS to provide investors with greater transparency concerning how brokers handle and execute customer orders.[33] Both of these sets of amendments will provide investors

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[29] *See* Press Release 2018–78, *SEC Launches Additional Investor Protection Search Tool* (May 2, 2018), *available at* https://www.sec.gov/news/press-release/2018-78.

[30] *See* Tips for Main Street Investors from Chairman Jay Clayton (Apr. 2019), *available at* https://www.sec.gov/page/investment-tips-chairman-jay-clayton.

[31] *See* CNBC, SEC chair Jay Clayton weighs in on America's retirement crisis (Apr. 26, 2019), *available at* https://www.cnbc.com/video/2019/04/26/sec-chair-jay-clayton-weighs-in-on-the-americas-retirement-crisis.html (last visited Apr. 29, 2019).

[32] *See* Press Release 2018–136, *SEC Adopts Rules to Enhance Transparency and Oversight of Alternative Trading Systems* (July 18, 2018), *available at* https://www.sec.gov/news/press-release/2018-136.

[33] *See* Press Release 2018–253, *SEC Adopts Rules That Increase Information Brokers Must Provide to Investors on Order Handling* (Nov. 2, 2018), *available at* https://www.sec.gov/news/press-release/2018-253.

with significantly enhanced disclosures that will impact their ability to ensure best execution for their orders to buy and sell securities.

Further, in December 2018, the Commission adopted a transaction fee pilot for NMS stocks, which will provide the Commission with data to help us analyze the effects of exchange fees and rebates on order routing behavior, execution quality and our market structure generally.[34] In my view, this pilot will lead to a more thorough understanding of these issues, which will help the Commission make more informed and effective policy decisions in the future.

Our fixed income markets are also critical to our economy and Main Street investors, though, historically, less attention has been focused on these relative to the equity markets. With large numbers of Americans retiring every month and needing investment options, fixed income products attract more and more Main Street investors. Yet, many of those investors may not appreciate that fixed income products are part of markets that differ significantly from the equity markets. In November 2017, the Commission established the FIMSAC to provide diverse perspectives on the structure and operations of the U.S. fixed income markets, as well as advice and recommendations on fixed income market structure. The Committee has held five public meetings and dozens of subcommittee meetings and has provided the Commission with six thoughtful recommendations on ways to improve our fixed income markets.[35]

Turning back to the principle of transparency, in May 2018, new FINRA and Municipal Securities Rulemaking Board (MSRB) requirements regarding the disclosure of mark-ups and mark-downs on certain corporate and municipal bond trades with retail investors went into effect, and I am pleased that investors now have substantially greater transparency into the costs of participating in those markets. I believe this transparency will increase competition and reduce trading costs, all to the benefit of investors, including our Main Street investors who directly or indirectly hold approximately two-thirds of this market.

With respect to our security-based swap regime, the Commission has finalized many, but not all, of the security-based swap rules mandated by Title VII of the Dodd-Frank Act. The Commission has continued our efforts to lay out a coherent package of rules to finalize our statutory security-based swap rulemaking obligations, and I anticipate making significant progress in completing this work in 2019. As part of this effort, our staff has been actively engaged with our counterparts at the CFTC to explore ways to further harmonize our respective security-based swap rules with the swap rules developed by the CFTC to increase effectiveness and reduce complexity and costs. An important milestone of this work occurred in June 2018 when CFTC Chairman Giancarlo and I executed a memorandum of understanding (MOU) between our two agencies.[36] The MOU explicitly acknowledges where we have shared regulatory interests, including but not limited to Title VII, and reconfirms our commitment to work together to facilitate efficient markets for the benefit of all market participants.

Staying current with market trends and developments is essential to the SEC's ability to remain an effective regulator of our capital markets. The fiscal year 2020 request would add four additional positions to Trading and Markets, which regulates the major securities market participants such as broker-dealers, transfer agents, securities information processors, securities exchanges and clearing agencies and oversees self-regulatory organizations such as FINRA. In particular, these positions would enable Trading and Markets to expand its expertise relating to fixed-income markets, Treasury markets, digital asset markets and other asset classes, as well as provide additional insight into trading firm operations. The request also

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[34] *See* Press Release 2018–298, *SEC Adopts Transaction Fee Pilot for NMS Stocks* (Dec. 19, 2018), *available at* https://www.sec.gov/news/press-release/2018-298.

[35] *See* Fixed Income Market Structure Advisory Committee, *available at* https://www.sec.gov/spotlight/fixed-income-advisory-committee. FIMSAC's recommendations include the following: (1) the development of a pilot program to delay public dissemination for 48 hours of trades in any investment grade corporate bond above $10 million and any high-yield corporate bond above $5 million (requires FINRA rulemaking); (2) the formation of a joint SEC, FINRA and MSRB working group to review the regulatory framework for electronic trading platforms in corporate and municipal bonds; (3) the adoption of a comprehensive classification scheme for exchange traded products; (4) for the SEC to encourage the formation of an industry group to promote investor education and work towards the establishment of a centralized and widely accessible database of key ETF data; (5) that the SEC, in conjunction with FINRA, establish a new issue reference data service for corporate bonds that would be widely accessible on commercially reasonable terms; and (6) to permit principal trading with advisory clients in negotiated municipal securities offerings.

[36] *See* Press Release 2018–114, *SEC and CFTC Announce Approval of New MOU* (June 28, 2018), *available at* https://www.sec.gov/news/press-release/2018-114.

includes one position for the Office of Municipal Securities to address municipal market transparency, including recommendations provided by the FIMSAC.

Finally, one of my most significant responsibilities is to participate in the Financial Stability Oversight Council (FSOC), which is tasked with identifying risks to the U.S. financial system. The Commission and its leadership also participate in the Financial Stability Board (FSB) and other international bodies. We rely significantly on SEC staff in these efforts, and in fiscal years 2019 and 2020 I intend to add additional structure to our efforts in these areas so that the expertise of the Commission, across our various divisions and offices, is more effectively brought to bear in these fora, particularly in the areas of market risk, market fragmentation, disclosure effectiveness, audit quality and enforcement.

Improving the Investor Experience and Modernizing Our Framework

Main Street investors have significant holdings in mutual funds and other investment companies. In 2018, over 100 million individuals representing over 57 million households, or almost 45 percent of U.S. households, owned funds (generally ETFs or open ended mutual funds).[37] Fund disclosures are especially important to these millions of Americans who invest in funds to help them reach personal financial goals, such as saving for retirement and their children's educations. Investment Management is leading a long-term project to explore modernization of the design, delivery and content of fund disclosures and other information for the benefit of investors. These initiatives are an important part of how the Commission can serve investors in the 21st century.

In June 2018, the Commission issued a request for comment on enhancing disclosures by mutual funds, ETFs and other types of investment companies to improve the investor experience and to help investors make more informed investment decisions (Fund Disclosure RFC).[38] The Fund Disclosure RFC seeks input from retail investors and others on how they use fund disclosures and how they believe funds can improve disclosures to aid investment decision-making. In order to facilitate retail investor engagement and comment on improving fund disclosure, the Commission has provided a short Feedback Flier on Improving Fund Disclosure, which can be viewed and submitted at www.sec.gov/tell-us.

Investment Management also led work on the Commission's recent proposal on offering reforms for business development companies and registered closed-end funds.[39] The proposed rule amendments would implement certain provisions of the Small Business Credit Availability Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act. By making available to these funds the communications and prospectus delivery rules currently available to operating companies, the proposal would improve access to capital and facilitate investor communications by these funds.

The fiscal year 2020 request would allow Investment Management to build on these initiatives, including by providing four additional positions to bolster their expertise and oversight of products that receive significant investments from Main Street investors such as mutual funds, variable insurance products and ETFs, among other products.

Economic Analysis and Retrospective Review of Commission Rules

None of the efforts by our policymaking divisions and offices discussed above, including our work with the FSOC and the FSB, would be possible without the efforts of the economists in the Division of Economic and Risk Analysis (DERA). I have noted that the SEC is committed to performing rigorous economic analysis of our rules and has done so in each of the rulemaking initiatives I have described in this testimony and for each other major rule enacted in fiscal year 2018. However, effective rulemaking does not end with rule adoption. Our Strategic Plan calls for reviewing Commission rules retrospectively to identify outdated rules that might not be functioning as intended in modern markets.

Our fiscal year 2020 request would provide resources to hire two additional positions in DERA to enable further robust economic analysis and retrospective review of Commission rulemaking and allow DERA to fully support other divisions and offices in their regulatory and oversight responsibilities.

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[37] *See* ICI Research Perspective (Nov. 2018), *available at* https://www.ici.org/pdf/per24-08.pdf.

[38] *See* Press Release 2018–103, *SEC Modernizes the Delivery of Fund Reports and Seeks Public Feedback on Improving Fund Disclosure* (June 5, 2018), *available at* https://www.sec.gov/news/press-release/2018-103.

[39] *See* Press Release 2019–39, *SEC Proposes Offering Reforms for Business Development Companies and Registered Closed-End Funds* (Mar. 20, 2019), *available at* https://www.sec.gov/news/press-release/2019-39.

Evaluate the SEC's Performance by Enhancing Our Analytical Capabilities and Human Capital Development

Cybersecurity and Information Technology

Cybersecurity and minimizing cyber risks at the SEC continue to be top priorities, and the additional resources Congress provided in fiscal year 2018 enabled us to upgrade our information technology infrastructure and strengthen our cybersecurity risk profile. The SEC and other agencies are frequent targets of attempts by threat actors who seek to penetrate our systems, and some of those actors may be backed by substantial resources. Recognizing the twin realities that electronic data systems are essential to our mission and that no system can ever be entirely safe from a cyber intrusion, it is incumbent upon us to continue to devote substantial resources and attention to cybersecurity, including the protection of personally identifiable information (PII). Over the past year, we have been focused on a number of areas for improvement, including with respect to information technology governance and oversight, security controls, risk awareness related to sensitive data, incident response and reliance on legacy systems—and much work remains to be done.

A key principle as a part of our review of our cybersecurity and enterprise risk profiles is to evaluate the data we take in, assess our regulatory and enforcement responsibilities, and limit the scope of that information to what is necessary to achieve those responsibilities. In particular, we are closely scrutinizing how we can reduce any potential exposure of PII contained in SEC systems, including EDGAR. In this regard, in April 2018, the Commission acted to eliminate the collection of social security numbers and dates of birth on a number of EDGAR forms where we concluded that the information was not necessary to our mission.[40] Moreover, return copies of test filings are no longer stored within the EDGAR system. Additionally, the Commission recently implemented modified submission deadlines for filing non-public reports for registered investment companies that will allow the agency to receive and analyze the data while meaningfully reducing the sensitivity of that data at the time it is transmitted.[41]

The agency has also focused closely on its cybersecurity risk governance structure. We recently hired a Chief Risk Officer, Gabriel Benincasa, who will help coordinate our enterprise risk management efforts across the agency.[42] We have worked to promote a culture that emphasizes the importance of data security and operational resilience throughout our divisions and offices. The staff has also been engaging with outside experts to assess and improve our security controls. For example, on a technical level, these efforts include the deployment of enhanced security capabilities, additional penetration testing and code reviews, investment in new technologies and experienced cybersecurity personnel and acceleration of the transition of certain legacy information technology systems to modern platforms. We will be taking additional actions in fiscal year 2020 to further strengthen our cybersecurity posture. We will also continue to coordinate and partner with other Federal agencies to identify and mitigate risks to our information technology environment and assets.

To date, the additional information technology and cybersecurity resources Congress has provided have allowed the SEC to make significant strides in our cybersecurity expertise and defenses. But these challenges are continuing to evolve, as the threat actors find new, innovative ways to carry out their attacks. As such, fiscal year 2020 will be a critical year for the agency to follow through on strategic technology priorities, including a number of multi-year initiatives. The fiscal year 2020 request seeks funding for information technology and cybersecurity, including funding to hire three additional staff positions to the Office of Information Technology to strengthen its expertise in new technologies and expand our security efforts against attacks by threat actors. The funding, including use of the Reserve Fund, will also enable the SEC to continue investments to strengthen the security of our systems and data, retire outdated legacy systems and develop new information technology systems and analytic tools to increase our effectiveness.

Human Capital

Returning to where I started, a critical part of our Strategic Plan, and inherent in our fiscal year 2020 request, is investing in our current workforce and ensuring

[40] Amendments to Forms and Schedules To Remove Provision of Certain Personally Identifiable Information, Rel. Nos. 33–10486, 34–83097, IC–33077 (Apr. 24, 2018), *available at* https://www.sec.gov/rules/final/2018/33-10486.pdf.

[41] *See* Press Release 2019–23, *SEC Modifies Timing for Filing Non-Public Form N–PORT Data to Align with Its Approach to Data Management and Cybersecurity* (Feb. 27, 2019), *available at* https://www.sec.gov/news/press-release/2019-23.

[42] *See* Press Release 2019–24, *SEC Names Gabriel Benincasa as Its First Chief Risk Officer* (Feb. 28, 2019), *available at* https://www.sec.gov/news/press-release/2019-24.

that the SEC can continue to build expertise in the areas most important to Main Street investors. The quality and character of the women and men who serve American investors in our headquarters and our 11 regional offices are the reason I am confident that the resources Congress has provided to the SEC are well spent. They have faced new challenges head-on with professionalism and commitment to our shared cause. I often say that our people are our greatest assets—this is not simply a cliché but a recognition that without our skilled, dedicated staff, the SEC could not advance our tripartite mission to the benefit of our Main Street investors. I believe our fiscal year 2020 request will ensure that the SEC continues to have a workforce known for its expertise and motivation to work for the benefit of Main Street investors and our markets.

Leasing

One final, important component of our fiscal year 2020 budget request is support for the leasing of office space. The SEC is currently participating in the General Services Administration's (GSA) competitive procurement process for a successor lease for the SEC's New York Regional Office (NYRO) and our Washington, DC headquarters. Currently, the GSA expects to announce a contract award for the headquarters lease by the end of fiscal year 2019, and an announcement for the NYRO lease award is expected in fiscal year 2020. Working through GSA, the SEC extended the terms of the current headquarters leases to align with the anticipated fiscal year 2024 start of the new headquarters lease. Additionally, as the outcome of GSA's competitive acquisition for NYRO may require moving to a new space, the fiscal year 2020 request includes funding for the planning and execution of the movement of files, equipment and personnel from NYRO. None of these funds would be used for the operations of the SEC, and we have proposed appropriations language that provides a mechanism whereby any unused portion of these funds would be refunded to fee payers, or the Treasury general fund, depending on the source.

CONCLUSION

Thank you again for the opportunity to testify today on our fiscal year 2020 budget request. I greatly appreciate this Committee's support of the SEC and stand ready to work with each of you this year to ensure that the SEC has the resources necessary to fulfill our mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation. I look forward to answering any of your questions.

Senator KENNEY. Thank you, Mr. Chairman. Chairman Giancarlo.

STATEMENT OF J. CHRISTOPHER GIANCARLO, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

Mr. GIANCARLO. Thank you, Chairman Kennedy, and Ranking Member Coons, and Members of this subcommittee. Thank you for your kind words as well.

There is indeed a strong partnership today between the SEC and the CFTC. Early on, Chairman Clayton and I committed our agencies to work more closely together, and it set a tone from the top. And you can see that cooperation today in matters of regulatory enforcement, crypto asset regulation, Dodd-Frank rule harmonization, Clearing House oversight, disaster recovery testing and planning, and so much more.

In fact, it is a privilege, a pleasure, and honor for the CFTC to work alongside the dedicated professionals of the SEC. And thank you my friend for our close cooperation and our work on behalf of American markets. And I want to thank this committee, the subcommittee, for its fiscal year 2019 budget increase that you provided and for your constant support for our agency. You know, when people think of the SEC, they think of American markets for capital formation and investment trends, they think of markets where investors with capital find investors with new ideas and new products that together produce prosperity and create jobs.

Well when people think of the CFTC, they think of futures, options, and swaps markets known as derivatives. These are the markets not for capital formation and capital transfer, but for risk mitigation. They enable the transfer of business risks of variable prices such as commodities, energy, foreign currency, and interest rates, from those who cannot bear that risk to those who can. And they serve the social good of moderating price, supply, and other commercial risks that then free up capital for job creation and economic growth. Now most Americans do not trade in these markets, yet these markets are the reason why consumers enjoy stable prices, not only in the supermarkets, but in all manner of consumer finance from auto loans to household purchases. Derivative markets are where the price of heating in American homes is found, energy used in factories, interest rates that borrowers pay on home mortgages, and the returns that workers earn on their retirement savings.

American derivative markets are the world's largest, most developed, and most influential, and they are relatively unmatched in their depth and breadth, providing deep pools of trading liquidity, low transaction costs, and participation by a diverse array of global counter-parties. And while American markets are some of the world's oldest, they are also some of the world's fastest growing and most technologically innovative. American markets are known to be the world's best regulated, and the United States is the only major country in the Organization for Economic Cooperation and Development to have a regulatory agency specifically dedicated to derivatives market regulation. And I believe there is a connection between having the world's largest and most competitive derivative markets and independent Federal regulation.

For over 40 years, the CFTC has been recognized for its principles-based regulatory framework, and econometric-driven analysis, and it is recognized around the world for its depth of expertise and depth of capabilities. And I truly believe that America's well regulated, independently regulated derivative markets are a national advantage in global economic competition. But to remain the best regulated U.S. derivatives markets must have an adequately funded regulator. The CFTC must have adequate resources to continue to serve its mission to foster open, transparent, competitive, and financially sound U.S. derivatives markets that are the envy of the world.

Turning to our budget, the Commission requests a total of $315 million for fiscal year 2020. This consists of two separate requests, the annual Commission operational funding of $284 million, and a new request to support the relocation of three regional offices of $31 million. The annual operational request of $284 million will provide 707 FTEs in fiscal year 2020. And it is a $2.5 million amount above the fiscal year 2019 President's budget request and reflects an inflation rate adjustment of less than 1 percent. This request seeks an annual increase of $35 million above the fiscal year 2019 continuing resolution funding level and is in line with fiscal year 2019 President's budget. The budget request of $284 million is the level of funding necessary, I am certain, to fulfill our statutory mission.

In closing, I am grateful for your consideration of this budget request that we will discuss today. As it is likely my last appearance before you, I want to say that it really has been a pleasure and privilege to have served under this subcommittee, and it is an honor to have been of service to the American people and to have led the extraordinary men and women of the U.S. Commodity Futures Trading Commission. Thank you.

[The statement follows:]

PREPARED STATEMENT OF HON. J. CHRISTOPHER GIANCARLO

INTRODUCTION

Thank you, Chairman Kennedy, Ranking Member Coons, and Members of the subcommittee. I appreciate the opportunity to appear before you today, along with my fellow colleague from the Securities Exchange Commission (SEC), Chairman Jay Clayton.

I want to start by saying thank you to all the members of this subcommittee for supporting the work of the Commodity Futures Trading Commission (CFTC), and for the budget increase you provided with the enactment of the fiscal year 2019 budget.[1]

I would also like to acknowledge the strong working relationship that exists today between the SEC and CFTC. From the outset Chairman Clayton and I recognized the need for our agencies to work more closely together. We are doing that today in the areas of regulatory enforcement, cyrptoasset regulation, Dodd-Frank rule harmonization, clearinghouse oversight, disaster recovery testing and resolution planning and so much more. It has been a privilege, a pleasure and an honor to work alongside him and the fine men and women of the SEC. I thank Chairman Clayton for being a good partner and trusted colleague in the challenging roles that we serve.

As you know, the CFTC oversees the futures, options and swaps markets. While most Americans do not actively participate in these markets, businesses of all sizes use the derivatives markets to manage commercial and market risk. These markets are one reason why American consumers enjoy stable prices, not only in the supermarket, but in all manner of consumer finance from auto loans to household purchases. Derivatives markets 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.

Today, American derivatives markets are the world's largest, most developed, and most influential. They are relatively unmatched in their depth and breadth, providing deep pools of trading liquidity, low transaction costs and friction and participation by a diverse array of global counterparties. They are also some of the world's fastest growing and technologically innovative.

American derivatives markets are also the world's best regulated. The United States is the only major country in the Organization for Economic Co-operation and Development to have a regulatory agency specifically dedicated to derivatives market regulation: the CFTC. There is a connection between having the world's most competitive derivatives markets and independent Federal regulation. For over 40 years, the CFTC has been recognized for its principles-based regulatory framework and econometrically-driven analysis. The CFTC is respected around the world for its depth of expertise and breadth of capability.

The combination of regulatory expertise and competency is one of the reasons why derivatives markets continue to serve the global need to hedge price and supply risk safely and efficiently. It is why well-regulated U.S. derivatives markets, by allowing low-cost and effective hedging, are of great benefit to American producers and consumers and to the rest of the world.

In short, America's well-regulated derivatives markets are a national advantage in global economic competition. However, we must not take this advantage for granted. In order for U.S. derivatives markets to remain the world's best, U.S. markets must remain the world's best regulated. To be the best regulated, U.S. derivatives markets must have an adequately funded regulator. The CFTC must have adequate resources to continue to serve its mission to foster open, transparent, competi-

[1] Consolidated Appropriations Act, 2019, PL 116–6 at https://www.congress.gov/bill/116th-congress/house-joint-resolution/31

tive, and financially sound U.S. derivatives markets that remain the envy of the world.

It was 5 years ago this month that I first testified before the Senate Agriculture Committee concerning my nomination to serve on the Commission. I knew that if confirmed, I would bridge the last years of the Obama administration and the early years of the new administration. In 2017, as Chairman of the Commission, I set out my agenda for moving the Agency forward. I pledged to make sure that our derivatives markets performed their essential role moderating price, supply and other commercial risks—shifting risk to those who can best bear it from those who cannot. I said that our markets should be neither the least nor the most prescriptively regulated—but the BEST regulated—balancing market oversight, health and vitality. To do that, we would follow a three-part agenda: completing unfinished business of the past, improving current operations, and preparing for the future, what I call becoming a 21st Century digital regulator.

I believe the budget request for fiscal year 2020 supports this agenda.

BUDGET REQUEST

The Commission is requesting a total of $315.0 million for fiscal year 2020. This budget request consists of two separate requests, the annual Commission operational funding of $284.0 million and a new request to support the relocation of three regional offices of $31.0 million. The annual operational request of $284.0 million will provide 707 FTE in fiscal year 2020; this request is $2.5 million above the fiscal year 2019 President's Budget Request [2] and represents an inflationary adjustment of less than 1 percent. This request seeks an annual increase of $35.0 million above the fiscal year 2019 Continuing Resolution funding level and is in line with the fiscal year 2019 President's Budget.

The budget request of $284 million is the level of funding necessary to fulfill the CFTC's statutory mission.

21ST CENTURY REGULATOR

I have frequently talked about transforming the CFTC into a 21st Century regulator amidst today's increasingly digital and algorithmic markets. I recently identified several factors that are challenging the work of regulators: the extraordinary pace of exponential technological change, the disintermediation of traditional actors and business models, and the need for technological literacy and big data capability.

I said that the CFTC's response to rapidly changing markets and technological developments, including blockchain technology and cryptocurrencies, is built upon the following four cornerstones:

—Adopting an "exponential growth mindset" that anticipates the rapid pace of technological innovation and the need for appropriate regulatory response;
—Becoming a "quantitative regulator" able to conduct independent market data analysis across different data sources, including decentralized blockchains and networks, without being reliant on self-regulatory organizations and market intermediaries;
—Embracing "market-based solutions" to determine the value of technological innovations, as we witnessed with the launch of crypto-asset-based futures products; and
—Establishing an internal FinTech Stakeholder to address the opportunities and challenges that FinTech presents and manage the ever-present tension between innovation and regulation.

For us, that stakeholder is LabCFTC, which was launched almost 2 years ago. In that time, it has had over 250 separate interactions with innovators big and small. It has offices in New York City. It conducts "lab hours" in places where innovators work: from Silicon Valley, California to Silicon Hills, Texas and from the South Bank of London to Singapore Center. LabCFTC is not a "sandbox." It does not try to pick winners from losers, nor does it exempt firms from CFTC rules.

Instead, LabCFTC provides us both an internal and external technological focus. Internally, it means explaining technology innovation to agency staff and other regulators and advocating for technology adoption. Externally, that means reaching out and learning about technological change and market evolution, while providing a dedicated liaison to innovators. It has entered into FinTech cooperation agreements with regulators in London, Singapore and Australia. It has published well-regarded technology primers and requests for comments. I am proud to say that LabCFTC

[2] Commodity Futures Trading Commission, fiscal year 2019 President's Budget, February 2018, at: https://www.cftc.gov/About/CFTCReports/cftcreports__historical.html

has become a category leader. Every U.S. Federal financial regulator has either created or is creating a program similar to LabCFTC.

ECONOMIC MODELING AND ECONOMETRIC CAPABILITIES

The fiscal year 2020 budget request will continue to allow the agency to expand its core economic expertise in order to conduct in-depth analytical and empirical studies of issues affecting all areas of Commission and regulatory interest. It will allow the Commission to address the large volumes of data collected as a result of the Dodd-Frank Act. The resulting work will further enhance the Commission's understanding of market risk or systemic risk and derivatives market structure and participants, including end users, intermediaries, and traders, and connections between futures, cleared swaps, and uncleared swaps.

Improved economic and econometric analysis will improve the analytical and empirical foundations of the Commission's policies and rules and better inform its cost-benefit considerations. Furthermore, this request will enable the Commission to provide more of its analysis to the public in the form of white papers on topics of current interest, as well as recurring reports on aggregate market trends, trading activity, and positions, and high-quality research papers on fundamental properties of relevant markets and sectors of market participants.

CYBER SECURITY

As market leaders and regulators, we must continue to take every step possible to thwart cyber-attacks that have become a continuous threat to U.S. financial markets. With the fiscal year 2020 budget request, the Commission plans to strength cybersecurity and network defenses, support the LabCFTC 2.0 initiative, and invest in the agency's multi-year cloud strategy.

The Commission seeks new IT security resources to continue progress towards achieving compliance with Federal Information Security Management Act (FISMA) and related Office of Management and Budget (OMB) security mandates and ensuring the protection of sensitive market participant data.

The same vulnerabilities hold true in the case of futures commission merchants where customer accounts hold records and information that requires protection. We as an agency will work hard to ensure that regulated entities live up to their responsibility to ensure their IT systems are adequately protected from attacks and customers are protected.

AGENCY REFORM AND THE KISS PROJECT

Two years ago, I announced the launch of Project KISS. It stands for "Keep It Simple Stupid." It is an agency-wide review of CFTC rules, regulations and practices to make them simpler, less burdensome and less costly. It has resulted in a range of rule and process improvements that are reducing regulatory costs and burdens.[3] Many KISS initiatives were recommended by market participants, but many were also initiated by our own agency staff that saw ways to reduce undue obligations on registrants and market participants. There are still more Project KISS initiatives in the pipeline. It is my belief that this effort should continue upon my departure and be a regular part of the agency's mission.

DODD FRANK RULEMAKING

The Commission has made progress on completion of its critical Dodd-Frank Act rule making. On November 5, 2018 a five-Member Commission voted unanimously on the threshold for swap dealer de minimis to provide the market with certainty that the threshold will not fall from $8 billion to $3 billion.[4]

In addition, all five Commissioners have committed to Congress to move forward with a final position limits rule. I believe the final rule must be responsive to the public comments and ensure that regulatory barriers do not stand in the way of long standing hedging practices of American farmers, ranchers, producers and manufacturers, who depend on our markets. I intend to put forth such a position limits rule proposal before I leave the Commission.

[3] Michael Gill, Chief of Staff, U.S. Comm. Fut. Trading Comm'n, Remarks at the National Press Club, CFTC KISS Policy Forum, Washington, D.C. (Feb. 12, 2018), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/opagill2.

[4] "Commission Approves a Final Rule on Swap Dealer De Minimis Exception", November 5, 2018, at: https://www.cftc.gov/PressRoom/Events/opaeventstaffmeeting110518.

SEF REFORMS

The CFTC's implementation of its swaps trading rules has long been a concern of mine. I believe the current framework is inconsistent with the Dodd-Frank Act by being too prescriptive, too burdensome and too modeled on futures markets. The framework is also highly subjective and overly reliant on a series of no-action letters, staff interpretations and temporary regulatory forbearance that may change at any time.

That is why, last November, the Commission issued a proposed rule to amend the SEF regulations and the trade execution requirement and a request for comment on the practice of "post-trade name give-up." [5] I believe there are two crucial reasons to improve the SEF rules: risk and opportunity. The impermanence of the current SEF rule framework poses risk for market participants. At any time staff may well change or withdraw the numerous interpretations, guidance and compliance expectations that underpin the current framework. Moreover, the current restrictions on methods of execution may turn out to be, by themselves, a source of trading risk during a liquidity crisis—when swaps counterparties need to be found through less prescriptive and more flexible means of execution.

On the other hand, improving the SEF rules presents opportunity—opportunity for service innovation by existing and new market entrants that has waned under the current framework. It is the opportunity to boldly create a regulatory framework that actually fosters innovation, entrepreneurship, competition and increased market vibrancy rather than stifle it. Improving the SEF rules also increases the chance that the SEC will draw on the new framework in whole or in part for their security-based SEF regime. It would create a common U.S. regulatory approach for all swaps products, reducing operational and compliance costs and risks.

I do not support merely tinkering with the current SEF rules to fix their most glaring shortcomings or perpetuating the many no action letters and staff guidance on which they rely. Such a step would be unworthy of the regulator of the world's most vital derivatives markets. Instead, the agency must not be afraid to build a better and more durable regulatory framework for swaps execution that encourages the return of innovation and new service offerings and supports vibrant markets and broad-based prosperity for a generation or more.

INCREASED EXAMINATIONS OF CLEARINGHOUSES

Fully funding the CFTC at the fiscal year 2020 levels will support the agency's oversight of clearinghouses. The agency's work to conduct regular examinations, in concert with the Commission's surveillance and other functions, is a highly effective method to maintain market integrity so that American businesses can rely on these markets. The Commission leverages resources by conducting joint examinations across Commission divisions, and through coordinated examinations with the Federal Reserve and the Securities and Exchange Commission, where possible. This effort allows the Commission to be more efficient with its limited resources and at the same time, reduce burdens for dual registrants.

In addition, examinations of DCOs help the Commission identify issues that may affect a clearinghouse's ability to control and monitor its risks. These are among the most important examinations that the Commission conducts, as clearinghouses have become critical single points of risk in the global financial system. Furthermore, the number of clearinghouses, the scope and complexity of the examination issues and the importance of these examinations to overall financial stability are all increasing.

In addition to U.S. clearinghouses, the Commission regulates six registered non-U.S. clearinghouses, and has limited oversight of four non-U.S. clearinghouses exempt from registration. The Commission anticipates new applications for DCO registration resulting from the explosion of interest in crypto currencies; an area in which protection of the crypto currencies will be one of the highest risks.

The Commission has an active, data-driven daily risk surveillance function, and expects to continue investing additional resources on human capital, data, and technology to improve our current analytical capabilities to keep up with growth in both the scale and complexity of risk transmission in the derivatives markets.

Given the emphasis of G–20 and Dodd Frank reform efforts on central clearing as a critical tool to help mitigate systemic risk in the global financial markets, the Commission expects to grow our stress testing program to help ensure that the clearing eco-system continues to be resilient to absorb both market and systemic shocks.

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[5] Federal Register, November 30, 2018, at: https://www.Federalregister.gov/documents/2018/11/30/2018-24643/posttrade-name-give-up-on-swap-execution-facilities.

EFFECTIVE INTERNATIONAL ENGAGEMENT

Recently, the CFTC along with the Bank of England and the Financial Conduct Authority (FCA), with support from Her Majesty's Treasury, issued a joint statement providing assurances to market participants on the continuity of derivatives trading and clearing activities between the UK and U.S. regardless of the outcome of the UK's withdrawal from the EU.[6] Together, the four authorities are taking measures to avoid regulatory uncertainty about the continuation of derivatives market activity between the UK and U.S. These measures should give confidence to market participants about their ability to trade and manage risk across the Atlantic. It is a great credit to the decades-long cooperation between the CFTC and the Bank of England, FCA, and HM Treasury, that we are able to work together to take these steps.

It is critical that the CFTC continues to work positively with its overseas regulatory counterparts, not just in the UK, but in all financial centers. I am a firm believer that by working together with my regulatory counterparts across the globe, in a cooperative spirit, we can strengthen our economies while keeping our financial system resilient and stable. That is why the afternoon after the CFTC–UK announcement; I traveled to Brussels to meet with European Commission Vice President Valdis Dombrovskis and Director-General Olivier Guersent to discuss how to broaden cooperation between the CFTC and the EC.

In addition, I am proud to report that we achieved a significant milestone on March 13, 2019 as the CFTC and the Monetary Authority of Singapore announced the mutual recognition of swaps trading venues in our respective jurisdictions.[7] In this regard, the CFTC exempted certain Singapore trading venues from the SEF registration requirements. This exemption reduces the burdens associated with duplicative and overlapping regulations, mitigates market fragmentation, enables U.S. market participants to access Singaporean markets to manage risks effectively, and enhances cross-border business opportunities for both U.S. and Singaporean firms.

Recently, EU co-legislators reached a political agreement on the new amendments to the European Market Infrastructure Regulation (EMIR 2.2) pertaining to the regulation and supervision of central counterparties (CCPs). To mark this occasion, I issued two statements: a joint statement with Valdis Dombrovskis (Dombrovskis), the Vice-President of the European Commission (EC), and a separate statement as Chair of the CFTC. The statements publically affirm that the CFTC's concerns regarding the potential adverse impact EMIR 2.2 on U.S. CCPs and the broader U.S. financial markets remain a significant issue for the U.S. and it is our expectation, that EU authorities will address our concerns during the EMIR 2.2 legislative process.

The joint statement with Dombrovskis asserts that the CFTC will continue to engage with EU authorities on EMIR 2.2 through the next phase of the legislative process, the drafting of the implementation regulations (the Level 2 process), and that the EC will consider the CFTC's concerns during this Level 2 process. It also states that it is the expectation of the EC and the CFTC that the implementation of EMIR 2.2, along with the CFTC's on-going review of its cross-border regime, will result in a future transatlantic relationship between the EU and the CFTC, which will be based on greater deference than there is now.

In my separate statement, I reaffirm my understanding that although the application of EMIR 2.2 to U.S. CCPs is not likely to occur until 2020 or beyond, EU authorities, including the EC and the European Securities and Markets Authority (ESMA), will work with the CFTC to address U.S. concerns during the legislative process. Further, I state that the starting point for any future recognition assessment of U.S. CCPs must be the current 2016 Equivalence Decision.

These statements taken together are meant to provide market participants who transact in both U.S. and EU markets assures that the CFTC and the EC will continue to work through our differences to mitigate the impact of unnecessary regulatory and supervisory burdens, and to foster economic growth and stability for our global CCPs.

Six months ago, I released a White Paper on cross-border swaps regulation that proposed updating the agency's current cross-border application of its swaps regime with a rule-based framework based on regulatory deference to third-country regu-

[6] "Joint Statement by UK and US Authorities on Continuity of Derivatives Trading and Clearing Post-Brexit", February 25, 2019, at https://www.cftc.gov/PressRoom/PressReleases/7876-19.

[7] "Joint Statement of the CFTC and the Monetary Authority of Singapore Regarding the Mutual Recognition of Certain Derivatives Trading Venues in the United States and Singapore, March 13, 2019, at: https://www.cftc.gov/PressRoom/PressReleases/7887-19.

latory jurisdictions that have adopted the G–20 swaps reforms.[8] As our regulatory counterparts continue to implement swaps reforms in their markets, it is critical that we make sure our rules do not conflict and fragment the global marketplace. That is why I believe the CFTC should move to a flexible, outcomes-based approach for cross-border equivalence and substituted compliance and operate on the basis of comity, not uniformity, with overseas regulators.

Before I leave the Commission, I intend to put forward a rule proposal to address the registration of non-U.S. CCPs clearing swaps for U.S. persons. I also intend to put forth a rule proposal addressing the registration and regulation of non-U.S. swap dealers and major swap participants. In particular, the proposal will address the risk that non-U.S. swap dealing activity poses to the United States, but do so in a way that does not apply the swap dealer rules extraterritorially without sufficient consideration of whether the activity truly poses a "direct and significant" risk to the U.S. financial system, as Congress intended.

ENFORCEMENT

The fiscal year 2020 budget request will allow the Commission to continue its strong record on enforcement and oversight of the derivatives markets to ensure they operate free of fraud, manipulation, and other trading abuses.

Two years ago, I issued a warning to those who may seek to cheat or manipulate our markets that they would face aggressive and assertive enforcement action by the CFTC. I pledged there would be no pause, let up or reduction in our enforcement of the law and punishment of wrongdoing.

During my watch, the CFTC has been resolute in holding market participants to the highest standards of behavior. In fact, by any measure, enforcement has been among the most vigorous in the history of the CFTC, including more enforcement actions, more penalties, more large-scale matters, more accountability, more partnering with criminal law enforcement and more whistleblower awards than in prior years.highest standards of behavior. In fact, by any measure, enforcement has been among the most vigorous in the history of the CFTC, including more enforcement actions, more penalties, more large-scale matters, more accountability, more partnering with criminal law enforcement and more whistleblower awards than in prior years.highest standards of behavior. In fact, by any measure, enforcement has been among the most vigorous in the history of the CFTC, including more enforcement actions, more penalties, more large-scale matters, more accountability, more partnering with criminal law enforcement and more whistleblower awards than in prior years.[9]

The Commission has strengthened its rules and procedures to better protect whistleblowers, brought new impactful enforcement cases, and successfully resolved other important enforcement cases. In addition, enforcement resources have been enhanced through the internal realignment of the Market Surveillance Branch in 2017 to report directly to the Director of Enforcement. This is one of several actions the Commission has taken to better utilize resources across the Commission.

At the same time, I have strived to make sure CFTC enforcement staff is committed to providing incentives for companies and individuals to engage in ethical corporate behavior—to develop a true culture of compliance, to do the right thing. The cooperation and self-reporting policies issued by the Division make clear that companies and individuals could receive a recommendation for a Commission reduction in penalty if they fully cooperate with enforcement investigations, timely remediate, and, most importantly, self-report misconduct before the Commission learns about it.

To better encourage compliance, the Division recently issued an advisory on cooperation and self-reporting concerning foreign corrupt practices. As noted in remarks accompanying the advisory, James McDonald, the Commission's enforcement director, made clear that if a company or individual not registered (or required to be registered) with the CFTC timely self-reports a violation of the CEA involving foreign corrupt practices, fully cooperates, and appropriately remediates, the Division will apply a presumption, absent aggravating circumstances, that it will not recommend a civil monetary penalty.[10]

[8] "Chairman Giancarlo Releases Cross-Border White Paper", October 1, 2018 at: https://www.cftc.gov/PressRoom/PressReleases/7817-18.

[9] *See, generally,* "Regulatory Enforcement & Healthy Markets: Perfect Together!", Remarks of Chairman J. Christopher Giancarlo at Economic Club of Minnesota, October 2, 2018, Minneapolis, Minnesota, at: https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo56.

[10] "Speech of James McDonald, Director of the Division of Enforcement Commodity Futures Trading Commission Regarding Perspectives on Enforcement: Self-Reporting and Cooperation at

Continued

Before I entered government service, I spent a decade and a half working on Wall Street. My commitment to transparent examination practices and robust regulatory enforcement derives from that experience. It is the duty of government generally and the particular mission of the CFTC to fairly enforce market regulation and prosecute bad actors. We fulfill that mission so that America's financial markets are places for good people to fulfill their dreams, grow the economy and increase prosperity.

AGRICULTURAL COMMODITY FUTURES

Under my leadership at the Commission, we have refocused our attention on agricultural commodity futures, the agency's traditional foundation.

During almost 5 years on the Commission, I have travelled the country and visited agriculture producers in over two dozen States from Montana, Texas, Arkansas, Louisiana and Iowa to Minnesota, Missouri, New York, Georgia, Mississippi and Oklahoma. I have walked in wheat fields and harvested soybeans, tramped through rice farms and beneath pecan groves, milked dairy cows and toured feedlots, visited grain elevators and viewed cotton gins. I have also met with our energy producers, going 900 feet underground in a Kentucky coal mine and 90 feet in the air on a North Dakota oil rig. Throughout, I have been moved by the diverse beauty of this country. I have come to love its hard-working families producing food and energy from this abundant land. These visits have been a great privilege for me.

This year in Kansas, we held the CFTC's second annual agricultural futures conference along with Kansas State University.[11] Panelists discussed current macroeconomic trends and issues affecting our markets, such as market speculation, algorithmic trading, trade data transparency, novel hedging practices and market manipulation. Our common purpose was to hear from end users who use our markets to hedge risk and consider and address issues of emerging market structure and trading practices.

We also hosted a CFTC Agricultural Advisory Committee meeting in Kansas where panelists discussed the future of Futures Commission Merchants (FCM) and cash market innovations, as well as the evolution of electronic trading in agricultural markets, both very timely and important topics. I believe this was the first ever CFTC advisory committee meeting held outside of Washington with all five Commissioners in attendance.

CONCLUSION

Looking to the past, I will be pleased that I have furthered and confirmed much of the Dodd-Frank mandate for swaps. Where I have identified flaws in implementation, I have proposed comprehensive solutions. In my view, now is the time to create better frameworks that are more flexible, more durable and more supportive of deep and liquid markets, in good times and in bad.

As for the present, I have tried to do what my parents taught me—to leave any place I visit in a better condition than I found it: better run, better funded, more transparent, more accountable and more efficient in its vital mission overseeing American markets.

As for the future, I will be satisfied that I have raised the profile and reputation of the CFTC and set it on a course for the digital Twenty-First Century. So much is changing, and changing rapidly in our commodity derivatives markets. As market regulators, we are ready to listen, and we are working to understand. And, we will be dogged. The greater the pace of change, the greater must be our capacity to keep pace, understand and harness it.

The CFTC is well along the course of that new direction set 2 years ago—a course that is sustainable and true.

Thank you for a privilege to speak to you today. It has been my honor to serve you, our dynamic markets and the American people.

Senator KENNEDY. Thank you, Mr. Chairman. Let me begin with a request to each of you. I think you have to talk to your colleagues about this and put together the information, but I am interested in knowing, and I am going to ask this of all of the agencies and departments that we fund, if you have any vendors with which or

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the CFTC", September 25, 2017 at: https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald092517

[11] 2nd Annual Agriculture Commodity Futures Conference, April 11–12, 2019, at: https://www.k-state.edu/riskmanagement/conference1.html.

with whom you do business who have an unpaid final judgement against them for taxes. Could you check that for me? I am not saying we have a problem at your agencies, but we seem to have a problem across the Federal Government in that regard and I would like to look into it.

[The information follows:]

All of our payments to vendors are checked against a list maintained by Treasury of any company or vendor that owes the government funds, and if there is one, the amount paid to the vendor from CFTC funds is reduced by their liability to the Federal Government.

Let me start with Jay, Chairman Clayton. As you know, Mr. Chairman, Senator Warner and I have a bill that would allow the SEC to seek disgorgement as a remedy and create a new authority for restitution for violations of Securities laws. Tell me about the issue with respect to disgorgement and your ability to enforce the law.

Chairman CLAYTON. So, there was a recent Supreme Court case where the Supreme Court said that our current authority with regard to disgorgement was subject to a 5-year statute of limitations. Now, in a number of instances, that is probably correct. You know, statutes of limitations have value but there are some instances, in particular Ponzi schemes, well-concealed frauds where that type of statute of limitations, and we have the numbers that show this, impact our ability to get people their money back.

A cut-off of 5 years, you could say in some way, rewards a well-concealed fraud. I do not like that, and I very much would like us to have the power to get people their money back. In many cases, like one that we have talked about, the Stanford Ponzi scheme—these are ordinary people who need our help to get their money back.

Senator KENNEDY. Okay. So, you would be supportive of the legislation by Senator Warner and me?

Chairman CLAYTON. Let me be direct, yes.

Senator KENNEDY. Okay. Alright. Thank you for that. Let us talk about Stanford for a second. Last month we marked the 10th year anniversary of the Stanford Ponzi scheme, the second largest, unfortunately, that we have sustained. Most of the investors, as you know Mr. Chairman, were Mom-and-Pop investors that could not afford to lose the money. I know you have emphasized main street investors and protection of them in your work at the SEC. What role, if any, does the SEC have in overseeing the fees charged by the receiver? The fees are up to $224 million, and I do not want to begrudge anybody of a living wage, but they haven't recovered as much as I had hoped.

Chairman CLAYTON. Let me say this. We have a role here that I think is pretty broad. There are a lot of other cooks in the kitchen and responsible people including the court that is overseeing the receivership and how this takes place, but again, in the interest of being clear and perhaps too blunt, the outcome here is unacceptable. And you know, you have situations where people clearly take risks. I mentioned and maybe we will talk about ICOs. You use your credit card to buy some offshore ICO outside the United States on the back an Internet empty promise. Hopefully you know you are taking the risk.

The Stanford victims were not at all in that situation. There were all the indications of a well-thought-out, legitimate, secure investment, including lots of large institutions and government agencies in the mix, yet their recovery is anemic. We should learn from that at the very least.

Senator KENNEDY. Well, I know the SEC has been very supportive. We had hoped that the SPSC would cover these losses. I know the SEC filed a suit to try to get a judgment to that effect. You lost, we lost. I don't want to imply that the SEC has not been very cooperative. You have, but I will be having some conversations with you about what we can do to review some of the fees being charged and to help us recover as much of this money as we can. I did not mean to imply by my question that the SEC had not been with us all the way because I know we have talked about it and you have been very supportive.

Senator Coons.

Senator COONS. Thank you, Chairman Kennedy. Let me ask a couple of questions about some broader issues, if I might. Chairman Clayton, FASB, the Financial Accounting Standards Board, has issued a new accounting standard for calculating expected losses, commonly referred to as the CECL (Current Expected Credit Loss) standard. Has the SEC analyzed the potential impact of the standard more broadly on the financial sector and then more specifically for small businesses and consumers? And if not, do you think you have the relevant expertise and jurisdiction to conduct an informative study about the potential impact of the CECL standard?

Chairman CLAYTON. So the CECL standard has been particularly a recent subject of a fair amount of debate and I have met with a number of people who have concerns. I think the principal concerns of the standard are the potential economic and other impacts of it and the cost of implementing it. To our larger banks, I think that cost is not material given the way they already run their systems and the like. For our less large, and mid-sized, and smaller banks that is an issue.

The second issue is whether implementing CECL, an accounting standard, is going to increase capital requirements which is often a bank's regulatory standard and whether that will have an impact on the ability of banks to lend and otherwise affect their balance. And the third is a dynamic effect, and that, is given that this is an adjustment you do about expected losses, as economic conditions worsen you generally want people to continue to lend. And will this type of accounting treatment cause people to actually pull back from lending at the very time when we might want them to lend?

So, we have analyzed that, but I should say that, unlike some of the other self-regulatory organizations, our oversight of FASB does not include reviewing and approving their rules. But what I will say is I have encouraged the FASB and I have encouraged the participants to continue to engage in those type of topics that I just outlined, and to think about ways that we can make sure that larger banks, mid-sized banks, smaller banks, we are taking into account those size considerations as we implement and analyze the rule. And continued engagement around this is important.

Senator COONS. Thank you, Mr. Chairman. I think sharing that analysis, the points, some of the SEC's significant analytical capabilities around the implementation of this will be important because I think there is a lot of concern about exactly the impacts you discussed. Let me turn if I could to Chairman Giancarlo about cryptocurrencies, and you may both want to speak to this. But your budget request includes $4.2 million for the Division of Clearing and Risk to expand examination, specifically into virtual currencies. Could you talk about the unique challenges of regulating an emerging market like virtual currencies, and the potential risks CFTC will be working to mitigate?

VIRTUAL CURRENCY REGULATION

Mr. GIANCARLO. Let me clarify that amount. Our Division of Clearing and Risk goes beyond just—they monitor all clearing houses. So, clearing house supervision is an important part of putting the swaps market into a cleared infrastructure under the Dodd-Frank Act. The demands on us as a derivatives clearing house regulator have grown, and so we are looking for resources to make sure that our capabilities, what I call our preventive approach, which is to make sure that if there is a problem in a clearing house, we see it before it becomes a market-based problem, is an important component there and in all areas.

The challenge of cryptos is that for the cash-end of that market—it is the wrong word to use cash, right—the spot-end of that market, we do not have jurisdiction over that except for fraud and manipulation. So, our standards by which derivatives clearing houses must operate, the reporting requirements, the oversight, and the very thing you mentioned, the examinations, we do not get to do in these spot crypto exchanges, only if there is fraud and manipulation that results an impact to the derivatives market, of which as you know there is now a Bitcoin future. And so, for those exchanges, their price point determines the future's price point. We watch that very closely for fraud and manipulation, but neither the CFTC nor the SEC for non ICOs have actual exchange authority.

And so, as Chairman Clayton noted, it is very much a buyer beware situation, and we work very hard individually and collectively. In fact, our two agencies 10 days ago issued a joint warning to investors to beware of the siren song of spot exchanges for cryptos and promises so that we make market participants aware because we are not there managing them and setting our regulations around how those exchange, those spot exchanges operate.

Senator COONS. Chairman Clayton, do you want to add anything to the question of cryptocurrency regulation?

Chairman CLAYTON. If you don't mind because I never miss an opportunity to say this, if you are looking at the quotes of stocks on one of our major exchanges and then you are looking at the quotes of a cryptocurrency on an offshore exchange, if you think those two are anything similar, you are wrong. We have all sorts of protections on trading. We have all sorts of abilities to audit and look into forensic analysis about whether somebody was manipulating or not and they have to have capital, they have to have—over there, nothing. Those trades could be fictitious. We would not know, and we can't do anything about it.

Senator COONS. Thank you. Mr. Chairman.

Senator KENNEDY. Chairman Giancarlo, you are going to be you are asking for $31 million for relocation costs. You are moving some of your regional offices. Tell me about that.

LEASING ISSUE

Mr. GIANCARLO. Yes. So, we have to relocate our offices in Kansas City, Chicago, and New York. Those offices, their term lease, is coming to an end, but they were also opened, several chairmen ago by the CFTC acting unilaterally and not through the GSA. And subsequent to that was a determination that that was a violation and that we must work through the GSA. I have decided to embrace that new relationship, which we have with the GSA and work very closely with them.

In fact, I have instructed my team, we are not only going to work well with the GSA, we are going to be their number one client. And we have been, and it is working very well. We have now identified space in New York and in Chicago, which are in the GSA buildings, within a short distance of our existing offices. First-class, A level space. And the $31 million is to do interior design work, fittings, relocation costs, all of the prep work we need to have in place so that in 2021 and 2022, when we make those office moves, we will be well positioned to do it.

Senator KENNEDY. You are reducing your square footage?

Mr. GIANCARLO. Right now, we have excess capacity on a blended basis where we are four offices. We have about 82 percent occupancy, 18 percent unused space, and with the budget we put forward, our headcount is not going to be raised significantly in any way to make-up that lost space. We have worked hard to try to return some of that. We were able to sublet some of our space in Kansas City and we have been working with a landlord in New York to try to do that. But with our leases coming to an end, it is very hard and unlikely that we will be successful, at least in the next 2 years.

But in our new space, we will be much closer to full occupancy with a little bit of swing space. But I think our leasing costs, or at least our square footage will go down. Rents go up, but I think net, we are going to save some money all the way around for the U.S. taxpayer.

Senator KENNEDY. Well good for you. Good for you. We appreciate that. I want to ask you about your fee proposal. You are the only Federal financial regulator that relies exclusively on appropriated funding. Do you think that ought to change?

FEES

Mr. GIANCARLO. Well it has been the position of, I think, four of the five last Presidents that the CFTC should have some sort of market participation in fees. Ultimately that is a decision for Congress to make, not a decision for us to make.

Senator KENNEDY. Right. Okay. Fair enough. Chairman Clayton, let me ask you a couple of other questions here. I want to talk to you about the Consolidated Audit Trail, I think you call CAT. CAT is going to compile information on every Securities trade known to humankind. So, a lot of data. Obviously, you are looking for fraud and securities violation.

The concern is I am not suggesting that you should not, but with algorithms and artificial intelligence, there is a lot of potential there to help you and your people do an even better job. But, tell me about the data security issues and what you have done. I know you are not going to collect social security numbers but how are you going to make sure that data stays secure?

Chairman CLAYTON. Yes. So, let me say this, I think we, broadly speaking, we need the CAT for what I would say is those kind of enforcement, surveillance issues but also to understand our market structure and understand the, you mentioned, electronic trading, speed of trading, to understand the vulnerabilities that may exist as a result of the changing market structure. We had a flash crash a number of years ago and it took us a long time to unpack and find out what happened. So, we need——

Senator KENNEDY. With EDGAR (Electronic Data Gathering, Analysis, and Retrieval system)?

Chairman CLAYTON. No, this is when stocks dropped——

Senator KENNEDY. Oh, okay. No, I know what you are talking about now.

Chairman CLAYTON [continuing]. Why did that happen?

Senator KENNEDY. Yes.

Chairman CLAYTON. Why all of a sudden did liquidity dry up. We need to understand that. But your concerns are concerns of mine. Are we collecting two types of data. One is proprietary data of people who participate in our market that they have a right to keep secure and then the personally identifiable information of what I call our Main Street investors. Both of those need to be addressed in any final CAT plan.

I would like to say that the discussions around that when I first got to the SEC, I was unsatisfied with. They had a lot of things that were, we cannot do that, we cannot do this, but not really constructive. I feel better about where we are now. We are actually talking about not taking social security numbers, only using CAT specific IDs. Thus, limiting the fields that would have any kind of personal information, so it is difficult to use the information for any kind of nefarious purpose, and then of course, protecting that data by segregating trading data and trader data in different databases and those types of things.

All that said, my message is we are not taking information unless we need it, and particular, in the area of personally identifiable information, unless we reasonably believe we can protect it. And that is how we are proceeding. This is a multi-staged—it is not like you flip the switch and the CAT goes on. It has got about, you know, almost enumerate milestones, but as we work through those, that is going to be in my mind.

Senator KENNEDY. Okay. Senator Van Hollen.

Senator VAN HOLLEN. Thank you, Mr. Chairman. Thanks both of you for being here and for your service. Chairman Clayton, I always have an opportunity also to talk about issues with you on the Banking Committee and I want to follow up on a couple of those issues, but first though relates to the mandatory arbitration question, because as I think you know, 21 Senators sent a letter to you urging you to continue to allow investors to have their day in court and that is supported by a Supreme Court decision way back in the day. There has been some talk that the SEC would try to eliminate those provisions and require mandatory arbitrations.

So, can you just talk a little bit about where you see the SEC heading on this question.

Chairman CLAYTON. So, I think I was first asked this question in the Banking Committee maybe as many as 2 years ago, and I am in the same position today that I was then. I have given some lengthy feedback on this and that is, if this issue were to be presented to the Commission, I would do everything I reasonably could to ensure that it was analyzed, discussed, and decided in an open way where the public and people who have different views, have an ability to weigh in. All that said, you know, there is the law and we are not the only, as recent developments have shown, we are not the only cook in this kitchen.

Senator VAN HOLLEN. Right. Do you have—are you personally in the position where you are still listening to arguments or have you reached any conclusions of your own on this issue?

Chairman CLAYTON. I am in the same place I was 2 years ago which is I am not anxious to see—you know, this is not an issue that I want to use up the commission's bandwidth dealing with——

Senator VAN HOLLEN. Got it.

Chairman CLAYTON [continuing]. But if I have to, I will.

Senator VAN HOLLEN. Got it. On the stock buyback issue and we have had a number of conversations there as well. We have Commissioner Jackson's findings. There are also questions about whether or not stock buybacks are being used for compensation purposes for, you know, executives of different companies. What is your sense of whether or not we should move ahead? As you know, I think this is something that warrants a deeper dive and a more formal study. What is your latest thinking on this?

Chairman CLAYTON. So, to be clear, we do not regulate stock buybacks. Companies don't come to us and say, "can I buy back a hundred shares or thousand shares?" What we do regulate is if a company decides to buy back stocks as a means of returning capital, whether they are doing so in compliance with our anti-manipulation and our insider trading laws. And we also require them to report, on a quarterly basis, how much stock they do buy back, and we require executives to report within a very brief time, two days, if they are making any sales for purchases generally, including during a buyback.

You and I have had discussions on this, and there is an issue here that has been—I could say that this issue has been on my mind for many years, and that is, when a company decides to do a stock buyback, they are not just deciding in the abstract. There are other things going on including equity-based compensations and the holdings of their executives. We do require disclosure of their sales, but it has always concerned me that the Compensation Committee of the Board of Directors, the Board of Directors generally, is looking at that compensation structure and analyzing whether the buyback is consistent with being appropriate stewards and setting appropriate compensation levels. But we have discussed that.

Senator VAN HOLLEN. Right, and I look forward to continuing that conversation. I mean, I know you do not, you know, tell companies can and cannot do buybacks, but as you know, we put in place, not you personally, but many years ago the Safe Harbor rule which is what has allowed companies to engage in stock buyback activity.

So, it seems to me we should be very vigilant about whether or not they are doing it in the interests of their stockholders as opposed to just fattening the wallets of returns for the executives. So, we will continue that conversation, but you know it goes to what is prioritized as the SEC, right. You know as the Chairman, I mean you have got a lot of discretion and so I think you know, you send signals based on what you decide to focus on. Yes. Do I have a——

Senator KENNEDY. Sure.

Senator VAN HOLLEN. Thank you, Mr. Chairman. So, Mr. Giancarlo, good to see you. As part of your budget request the administration requested that $65 million of the $284 million be raised through an enacted user fee, which is not unlike what the SEC does for at least part of its budget. So, I am assuming that is something that you and the administration are advocating for. This is actually one of the things in the President's budget I will say, one of the few things, not that I think maybe it is a good idea because I think it is important that we generate additional resources for your work. Have you made an effort to encourage, you know, members of the Appropriations Committee to support the provision in the budget?

Mr. GIANCARLO. So, this President's budget, like many other President's budgets before, has a proposal for some sort of fee arrangement, whether it is transaction-based, which I have been frankly as a markets person not supportive of but some sort of fee structure. As I said to the chairman a few moments ago, I really believe that at the end of the day it for Congress to determine how this agency is funded, what its level of funding is. And, I have always felt as a public servant it is not for me to tell Congress what to do but for Congress to determine how we should be funded and then set the priorities as to how we do it. So, I would say that if it is Congress' determination that some part of our budget should come from the marketplace in some form, then obviously the agency would act on that.

Senator VAN HOLLEN. Well, I appreciate the deference to Congress. We appreciate the fact that, you know, you recognize the power of the purse here. I will say that this is a hearing of course to get the Administration's budget request and I think it is worth noting Mr. Chairman that part of that request is to apply this fee, which is a similar idea to what we have in place with the SEC. The FDA has a fee as well, a user fee. So, I know you have been interested in looking for ways to, you know, find additional resources without putting the obligations on the taxpayer. I hope we can have a conversation about moving ahead in this direction. Thank you.

Senator KENNEDY. Senator Coons.

Senator COONS. Thank you, Chairman Kennedy. Chairman Clayton, I have got a couple of questions for you if I might. First, your headcount I think in your written testimony you note this budget supplement, this budget request would allow you to back fill. You would complete backfilling 134 positions of the 400 that you lost through the hiring freeze. Is that sufficient? Is it realistic? You would still be operating with nearly 300, 276 fewer positions than you had at the SEC before the hiring freeze. I think that is about a 5 percent total decrease. What are you not doing that you could be doing if more fully staffed? Do you feel these 134 position add is enough and will remain level? Talk to me about your staffing request and requirements.

Chairman CLAYTON. So, I think we have been able to fulfill our mission. A lot of it really comes down to the dedication of the people we have in place. The 100 new positions that we are now in the process of hiring, I think that is money very well spent. These hires are mostly in the area of enforcement, inspections, and then market, some of the issues that I have just spoken to Senator Kennedy about, getting our market knowledge up-to-speed, and then cybersecurity, and support of course. The 34 are largely in some of those same places.

We are also now able to, in addition to the 134 hires, when someone leaves or retires, we are able to back fill their position. I feel good about that. You know, if you ask me 8 to 18 months or 2 years ago, you know, if you said, hey, here is another 50 FTEs, I might not have known where I could use those. At this point in the job and the relationship I have with my direct reports, I am sure I could put additional people to work on that kind of marginal basis. I think you should be able—you should have that in your mind if you are running an agency.

Senator COONS. I just think across both agencies, you know, the increasing complexities of the markets, new areas of regulatory responsibility, the Dodd-Frank, gave you new mandates and responsibilities. So, the opening statements you both made, it is critical that we have the best regulated financial markets in the world, and I want to make sure we are not being penny-wise and pound-foolish. Let me move to cybersecurity.

Last year we talked about the EDGAR system breach. Do you believe your budget request will give you all the resources you need to protect that database and other information held by the SEC, and can you talk at all whether that breach resulted in the perpetrators using the information to their market advantage? Is that something that—it would be relevant to help update us on.

Chairman CLAYTON. Yes. We believe that the breach did give them an advantage in the marketplace and we brought cases accordingly. And the money that you have appropriated in the past, and the money that we are requesting now, has enabled us to lift the security of EDGAR.

We have also reduced the amount of sensitive information coming into EDGAR. It is a very important system that is a legacy system. You know, it is somewhat of a kind of, maybe this is too negative, but imagine a cell phone that you purchased in the mid-90s, continuing to use it today, enhancing it and enhancing it. You know, if we were building the system from scratch, it would not look like this—but that is not where we are. So, I feel good about what our team has been able to do to lift it. We have had outside consultants come in and review our work, both Government consultants and private sector consultants, have done penetration testing. So, I feel a lot better, but we are going to continue to need to invest, investigate, and test as we go forward.

Senator COONS. Yes, I think for both of you, IT and cybersecurity are going to be ongoing, critical questions. Let me ask you one last question about it. A proposal that generates a fair amount of controversy, and I am just interest in your view on where we are going. You are currently in the rule-making process to require a new standard of care for financial professionals. Broker dealers would act in the best interest of their client but would not require the same fiduciary standard that applies to investment advisors.

As I am sure you are all well aware, the previous Administration moved forward a different approach. Your written testimony says the obligations of an investment advisor differ from that of a broker dealer. The DOL, regulation under the previous Administration, made them the same. Talk about the justification for the different standards in these two roles, its impact, and where you see this process going forward.

Chairman CLAYTON. Sure. So, one of the important things in our marketplace for retail investor services is competition and choice. It is important to me and my colleagues at the SEC—the career people at the SEC believe this as well—that you have a choice between a fee-for-service model like a broker model, I come to and kind of pay as I go, or a, fee per account model and that is an advisor model where I pay a fee either an annual fixed fee or based on assets under management.

There are many types of relationships for which the fee for the service model is cheaper than the fee for the account model, like the investment advisor model. That is important for competition. Now, there are many people for whom an investment advisor ongoing service monitoring discretionary investment is the better way to go but we need to keep that competition and choice. Then, you know what, the complaints that on the brokerage side there was too much activity that people said was "lawful" but made you sick, we need to fix that. We also need to fix, do I know who I am dealing with, how are they getting paid, and what their incentives are, right.

So, preserve that choice, preserve the competition, and raise the level of conduct required on the broker side. I can talk in detail about that, about what we are going to do, but that is what we are doing.

Senator COONS. I appreciate that broad overview. I see I am well past my time, Mr. Chairman.

Senator KENNEDY. That is okay. Thank you, Senator. I have got two more questions, and just let me say to both of you, what I admire about both of you is you thought deeply about issues at the macro level. And I really appreciate that. Chairman tell me about your swaps reform.

SWAPS REFORMS

Mr. GIANCARLO. So, I was a supporter of the court reforms that became Title VII of the Dodd-Frank Act, and somewhat uniquely, perhaps coming from my side of the aisle but I believe that actually Congress got Title VII right because it adopted actual emerging practices in the marketplace themselves. Moving swaps to clearing was already starting to increase in the marketplace, and while clearing is not a panacea for risk, it provides superior risk management, mutualization, and diversification.

I was a supporter of the swaps reporting requirements and have been a supporter of continuing that at the Commission. In terms of the swaps execution position, I think Dodd-Frank got that right, but I think in a number of areas, the CFTC erred in how it implemented that. Now, I think the errors were natural because what the CFTC did is it took what it knew, which was the futures market, and used that model for the unlisted, over-the-counter swaps market. And I think the result of that was to make our market much less competitive on a global basis than it should be. In 5 years, under the current approach, we have had no new innovation in the market. We have had no new entrants into the market offering services. We have not had new platform development, and so what I have proposed, and we put this forward on a four to one vote on the Commission in the fall, was a more flexible approach, which does two things.

I think it is actually more true to what Congress said because Congress did not dictate the mode of execution for transactions, but also I think it is truly more American. It is much more flexible. It is much more innovative, and I think it will lead to an explosion of innovation in our markets. In fact, one analyst said that it will lead to dozens of new market participants coming into the marketplace, and what could be more American than competition in the marketplace. It brings down fees. It brings down costs. Allows new entrance and participation in the market.

I am very proud of the proposal we have forwarded to the Commission. I am sorry that I probably will not have the time to see it through during my term, but I encourage the future Chairman and the Commissioners there to take it up. I think it will be good for American competitiveness and for American market robustness and market activity.

Senator KENNEDY. Chairman Clayton, I want to talk to you for a second, this will be my last question, about the Municipal Securities Rulemaking Board (MSRB), and I have got a bill, I am not going to ask if you are supporting it. That would not be fair. Let me just say that municipal securities, rule-making board, there is some really good men and women on it, have some good leadership, their past members really fine past members, but as you know, we have talked about, I have some concerns about it.

I think the structure of it in terms of who gets to be on it is incestuous, as I have explained to you. My bill would reduce the board from 21 to 15, 15 people. I think that will be more manageable. As you know, the board has private representatives, folks who represent the private-sector, and people who represent the public sector. The problem in my mind is that many of the public members used to be in the private sector. That is okay. They garnered a great deal of experience, but my bill would provide that there needs to be 5 years between their work say as a broker-dealer, and then putting on the hat of representing the consumer, if you will. It would require members of the MSRB to be confirmed by the SEC. You know, you are kind of responsible for them. You know, you did not father the child, but you have got to raise it, so I figured give you some parental control.

The other thing has to do with salary-cap. Now, I know this is not public money, but it also didn't fall from heaven. There is not a money tree. I am not saying that they are not good people over there, but we have got folks over there making $1.4 million, you know, that is just a lot of money from somebody who is running a Government organization and I think we need to take a look at it. It is not personal. Give me your thoughts in general about the MSRB.

Chairman CLAYTON. Okay. So, let me say, I will go to the governance, structional issues in a second. On a substantive issue, I have enjoyed my engagement with the MSRB.

Senator KENNEDY. As have I.

Chairman CLAYTON. Yes. And I think we are doing better. I have made a few issues——

Senator KENNEDY. We are since you have been there.

Chairman CLAYTON. But there are few things that I really care about including that investors know how old the financial disclosure is that they are getting about municipalities. The way municipal securities transactions are executed and reported so that buyers know what the all-in cost of getting in and out a muni bond is. Those things are important, and they have worked well with us in, I would say, elevating those standards and can continue that.

In terms of governance of the Self-Regulatory Organizations (SROs), people who perform a function—look, I think we should always be examining whether our governance gets the job. I mean, governance is not an end in itself, it is a means to an end, but accountability does drive pretty good ends. And as a general matter I favor accountability, like, you know, I did not wake up this morning, I can't wait to go answer your questions, but I think it is a good idea.

Senator KENNEDY. Well you operate off of fees in the private sector. Do you make a million bucks?

Chairman CLAYTON. No.

Senator KENNEDY. Okay. Just checking. Chris, do you have anything else?

Senator COONS. Two quick questions if I could. Just this is more satisfying my own curiosity than anything else. Impact of Brexit potentially, Chairman Giancarlo, and then the Fed just came out with a report historically high corporate debt. I would be interested in your thoughts on whether the increase in debt owned by U.S. businesses poses unacceptably high risks to our economic stability.

BREXIT, CYBER, DEBT

Mr. GIANCARLO. If I could also add, after I discuss Brexit, if I could just add a word about cyber from the CFTC's point of view. I know Chairman Clayton addressed it and I agree with what he said, but I do want to talk about it for just a moment. On Brexit, we have two particular concerns at the CFTC. One is simply the impact on not just the European economy with a British exit, the entire European economy, but the global economy of what a sudden and unexpected Brexit exit could have brought. I think it now seems to be on a much slower burn. I think a lot of that is priced somewhat into the market and so if there is no sudden moves, I think we are a little less concerned about a short term market disruption.

We still remain concerned long-term about more impact, but there is something that is very particular to derivatives that is unique about London. London has emerged over the last several decades, in fact the last decade in particular, as the global servicing center for the global derivative market because of a combination of special utilities like the London Clearing House where most of the interest rates swaps are now cleared, as well as the use of English law in contracts and accounting, and other settlement services. London is really the epicenter of that marketplace.

There is really no continental European locale that has the readiness to take that on and some of the proposals out of Europe were to break up that set of clearing that takes place in London. If London were to be displaced and disrupted as the global center for swaps and markets, that could have a real strong impact on the markets that we at the CFTC are in a unique role to oversee. So, we have taken the lead on alerting market participants, speaking to our friends in Brussels and London, as well as with our own Financial Stability Oversight Council, of these concerns and have been very active in the area.

We continue to monitor it closely. We view the U.S. dollar as a global reserve currency so we do not have a territorial view as to where the dollar denominated assets must clear provided it is stable, provided it is done properly. If London were to be displaced, then we would have some concerns as to the future of the market.

A quick word on cyber. Chairman Clayton and I have spent a lot of time talking on this. I think we share the view that cyber is the number one risk to our markets and in some ways, number one risk to our own agency operations because the amount of data. The amount of data that we take in every day at the CFTC has gone from 10 million per day to over a 100 million in just the last several years. We are increasingly becoming a database regulator, but we are very concerned about cyber activities. We see close to 200,000 separate cyber-attacks on our agency per month and that amount is going up all the time.

Senator KENNEDY. How many?

Mr. GIANCARLO. 200,000 per month. And they are coming from all over the world. Now just to give you an idea, before I took over as Chairman our budget for cyber-defense was about $5 million a year and even though our budget has not gone up until recently, we have been able to increase our cyber spending to close to $7 million. We will devote close to $7 million this year. But in our budget is a request for close to $10 million.

Of all the things we need, we really, really need that. You know, it is not a question of if an agency or institution or enterprise will be cyber hacked, it is only a question of when. We have been fortunate the last few years of not having suffered that to the extent we know, because sometimes you do not know till long afterwards, but we do need to, and I am not saying we have weaknesses now. I think our position is very strong, but we do have—there are some facilities we would like to move to, and it is just simply a matter of resources. And so, if I can ask amongst all our requests, if that one you could give special attention to because we really do that. Thank you.

Senator COONS. Chairman Clayton, anything on risky levels of corporate debt?

Chairman CLAYTON. Yes. Corporate debt has increased in absolute and relative terms. We should not be surprised by this. We have a credit financed economy. Dodd-Frank, other measures, we have relatively shrunk the size of the bank lending sector, so someone has got to fill in the credit. The corporate credit side has done that. Other factors, low interest rates. Low interest rates make actually increasing the amount of debt you are willing to take on more attractive if you are a person looking to structure your balance sheet in the appropriate way.

Okay, change. We ought to recognize that and ask ourselves has this created new risks and how are we monitoring them? And I am pleased to say that Chairman Giancarlo, Chairman Powell, Vice-Chair Quarles, Chair McWilliams, Comptroller Otting, we have all met on this. Not only said, okay, it has changed, let's get more granular, what sectors has it changed in. Importantly, are people who are buying this debt are they buying it for liquidity or trading, which in any kind of exogenous thing would lead to greater shocks, or are they buying it for a long term investment? Are they buying it as asset-liability management say an insurance company versus liquidity in a mutual fund? Those are two very different buyers. Where is this corporate debt coming to rest and what kind of risk does that present?

So, I commend my people because they have been looking at this now for a while. I feel smarter about it today than I did before. Sharing that with our colleagues both inside and outside the United States, and the answer to your question is, the short answer is, yes, this is where we should be looking. We should be understanding it. And, is there anything that keeps me up at night about that market at the moment? No, but if we had a—let me give you an example of what would keep me up, a very large mutual fund having significant holdings in leveraged loans where people expected immediate liquidity. Would that create maybe a systemic risk? Probably not, but is that a risk to those investors that maybe they do not know what they are facing? Yes. This is a subject on which I can talk for way longer than the time you have but, the short answer is we are looking at it.

Mr. GIANCARLO. If I could just say, a real quick note to that, we started project in our Office of Chief Economist to look at how banks that are in the leverage loan marketplace are then using different techniques to mitigate their exposure to the market by trading in and out of some of those. A lot of those loans the banks will then trade out of or will use other techniques to reduce either their exposure to the interest rate exposure or even the credit exposure. And so, we have got a study going on this and we will make that public once we have it, but we think there is a fair amount of risk mitigation going on.

So, when you see figures from let us say, there is $1 trillion of these loans and $300 billion are on the balance sheets of banks, in fact that $300 billion is an absolute number. It may be a lot less in terms of risk to the market because of hedging practices that are used by those banking institutions. But it is an area that we are looking into and we will have a report for that when it is done.

Senator COONS. Could you ask your helpers to send me a copy? I would like to see it.

Mr. GIANCARLO. Yes.

[The information follows:]

A draft of the paper on the interest-rate risk of banks, including their use of derivatives, will be ready in a couple of months to the end of summer. We will share when it is completed. A different paper on bank credit risk management and the use of CDS, is in a much more preliminary stage.

ADDITIONAL COMMITTEE QUESTIONS

Senator KENNEDY. Alright, gentlemen. Thanks. The hearing record is going to remain open until next Wednesday for any statements or questions.

[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. CHRISTOPHER GIANCARLO

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

First off, I want to express my great appreciation for your work to return the CFTC to its Ag roots. I hope the valuable partnership between the CFTC and the Kansas State University for the Agricultural Commodity Futures Conference continues under your eventual successor.

In February, you and your fellow Commissioners—Republican and Democratic Commissioners alike—submitted a unified comment letter to the prudential regulators raising concerns about a proposed rulemaking related to bank capital rules.

These concerns surround the calculation of the supplementary leverage ratio (SLR) related to derivatives transactions. As you know, the SLR currently fails to recognize the risk-reducing nature of segregated client margin in these transactions. This has led to rising costs and less competition in the derivatives markets for commodity producers seeking to hedge risks in the markets.

a. How will the change you and your fellow commissioners propose contribute to the health of the cleared derivatives market—in particular for the farmers and ranchers back in Kansas?

Answer. On June 20, 2019, the Basel Committee on Banking Supervision announced an agreement on a targeted and limited revision of the leverage ratio to allow margin received from a client to offset the exposure amounts of client-cleared derivatives. I was pleased to see that the Basel Committee recommended the exclusion of initial margin from the leverage ratio. I have consistently raised the concern of whether the amount of capital that bank regulators have caused financial institutions to take out of trading markets is at all calibrated to the amount of capital needed to be kept in global markets to support their overall health and durability. Studies have shown that end users and others, risk losing access to cleared derivatives markets as the leverage ratio disincentivizes the provision of clearing serves.

The suggested revision will significantly reduce capital costs for clearing members. As I have said in the past, if these savings are fully passed on to their customers, these reductions could translate into an increase in trading activity, especially hedge positions that are carried overnight. A reduction in cost to a service that is important to managing systemic risk in swaps supports the critical FCM link in the mandatory clearing model. I believe that the financial system will be safer and more stable for it.

b. Are you and your staff at the CFTC continuing to engage with the prudential regulators on this topic as they move forward with the rulemaking process?

Answer. Once the Basel Committee publishes its standards, I would urge the relevant bank regulatory agencies in the US and elsewhere to move quickly to implement these amended standards in their respective rules. This will help mitigate a key systemic risk present in our derivatives markets.

c. Do you think they will make this change to the SLR calculation?

Answer. Yes, I believe they will.

d. If not, does Congress need to step in with a legislative fix?

Answer. It is my hope that this change will be done through rulemaking by the relevant agencies.

I urge you to continue engaging with your fellow regulators. The ag community in my State needs access to affordable risk management tools. I'd hate to miss an opportunity that could help them in this key area, particularly when there is bipartisan support from your fellow Commissioners on this topic.

Thank you for your continued service to our country until your eventual successor's confirmation and it has truly been a pleasure working with you.

QUESTIONS SUBMITTED TO HON. JAY CLAYTON

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

1. In light of the effective collaboration under Chairman Giancarlo's and your leadership, what can the SEC do to alleviate the ills of calculating the exposure amount of derivatives contracts and ensure bank capital rules are adequately risk-sensitive?

Answer. We understand that market participants have expressed concerns to the U.S. Federal banking agencies and to the Basel Committee on Banking Supervision (BCBS) regarding the impact of the Basel III leverage ratio (referred to in the United States as the supplementary leverage ratio) on central clearing. More specifically, they have raised concerns about the treatment of cash collateral posted to a clearing agency as initial margin (cash that is received by a clearing member from its client and that is generally passed to the clearing house).

We understand that BCBS met on June 19 and 20 of this year in Basel and, at its meeting, agreed on a targeted and limited revision of the leverage ratio to allow margin received from a client to offset the exposure amounts of client-cleared derivatives. While we are not a member of the BCBS and do not oversee the prudential regulation of banks, we are committed to continuing our productive collaboration with the CFTC and prudential regulators to examine areas of common concern in regulating derivatives markets, including issues that may impact central clearing.

2. I know the Consolidated Audit Trail (CAT) project was dropped in your lap and you are making the best of a tough situation to get this surveillance mechanism to improve investor confidence in our markets up and running.

   While I appreciate that and support your efforts, I am deeply concerned about one thing: that the CAT still plans to collect the personally identifiable information (PII) of America's retail investors.

   The CAT can work without PII and the cost of subjecting the personal information of Americans across the country to cyber risk and identity theft outweighs any benefit of collecting this information.

   2a. We both care deeply about investor protection. Can you give me a public assurance today that the CAT will not collect and retain retail investors' PII in a single centralized database?

   I strongly urge you to continue exploring an expedited request mechanism that more closely reflects the current blue sheet process instead of creating such a high-value target at significant cybersecurity risk.

Answer. I know there are concerns about the protection of investors' PII that would be stored in the CAT. I share many of these same concerns and continue to make the security and confidentiality of CAT data, particularly any form of PII, a threshold issue.

The CAT is intended to enable regulators to oversee our securities markets on a consolidated basis—and in so doing, better protect these markets and investors. The CAT Plan developed by the national securities exchanges and national securities associations (collectively, the SROs) includes specific security requirements designed to mitigate the risk of a breach of the CAT and the possibility of misuse of data reported to the CAT. The security features required by the Plan include, among other things: (1) the encryption of PII and all other CAT data, as well as a comprehensive System Security Plan that must cover all components of the CAT System such as physical assets and personnel; (2) adherence to the NIST 800–53 security standards, which are a set of security and privacy controls for Federal information systems and organizations; (3) incorporation of tools that will enable logging, auditing and access controls for all components of the CAT system; (4) secure methods of connectivity; and (5) development of a Cyber Incident Response Plan.

While these and other features are designed to ensure that the CAT provides appropriate protection for proprietary data and reflect a current assessment of the key measures necessary to achieve an effective data security environment, it is also important that we continually assess whether the CAT's approach to PII is appropriate and effective or can be improved. I am aware that the SROs are moving forward with a plan to eliminate the need to maintain social security numbers in the CAT database. I support this effort and will continue to monitor the SROs' progress in this area. More specifically, as the SROs continue to make progress in the development, implementation and operation of the CAT, I believe that the Commission, the SROs and the plan processor must continuously evaluate their approach to the collection, retention and protection of PII and other sensitive data. In addition, as I have stated on several occasions, the SEC will not retrieve sensitive PII information from the CAT unless there is a regulatory need for the information, and we are confident that there are appropriate protections in place to safeguard the information.

I look forward to working with you and other members of Congress as the implementation of the CAT moves forward.

3. You have undoubtedly heard the unrest surrounding the January, 2020 implementation of the current expected credit loss (CECL, "see-sull") accounting standard developed by an unaccountable standard-setting body.

   3a. What are you and your staff at the SEC doing to address the meaningful concerns regarding the negative impact CECL will have on the U.S. economy, banks, and access to credit nationwide?

   At a House subcommittee hearing in December, Joe Stieven—an investor who was co-chair of FASB's investor advisory committee—was very clearly opposed to CECL and said he knew of no bank investors who supported it. We've also heard of other large bank investors who do not support CECL.

   3b. What kind of outreach has the SEC done to understand these concerns and what will the SEC be doing in response?

   We are hearing that banks are being bombarded by software vendors and auditors to help them comply with CECL. In fact, a cottage industry for CECL implementation has developed and banks are on the wrong end of it.

   3c. In the end, who is benefitting? The investors or the auditing firms? Given the potential disruptions and costs involved, don't you think we should put on the brakes, study, and figure out how to move forward in a more responsible manner?

Answer. I am and continue to be supportive of all parties engaging in productive dialogue regarding the new accounting standard to further our shared goal of maintaining high-quality financial reporting for the benefit of investors in the U.S. capital market and addressing unintended negative consequences of a change in accounting standards. The SEC's role is not to endorse standards adopted by the FASB. The Sarbanes-Oxley Act grants the SEC authority to designate an independent private sector standard setter, but it does not create a mechanism for the SEC to approve or endorse the FASB's standards. But this does not mean that accounting standards are, or should be, developed in isolation.

The SEC staff monitors the FASB's standard-setting activities and process as a part of the SEC's oversight, and the SEC staff has participated as an official observer in the FASB's public meetings of its Transition Resource Group for Credit Losses. Transition Resource Group members include companies, investors, auditors, regulators, and FASB members and staff. In addition, the SEC Chief Accountant has participated as an official observer to the FASB's transition resource group.

The SEC staff also regularly engages with market participants to listen to stakeholder concerns, understand emerging issues and risks, answer questions and share staff views on current financial reporting matters, including CECL. In these discussions, stakeholders have shared their views with SEC staff, and some stakeholders have offered public studies and data, the results of which are mixed and incorporate broader public policy objectives than the topic of accounting standards. Implementation of CECL involves complexities and potential unintended consequences, including because the affected institutions vary significantly in size as well as type and scope of operations. Many of the concerns expressed also appear to me to be the result of the interaction of the new accounting standard with existing regulatory capital requirements. I understand the Federal banking regulators are currently reviewing whether CECL should have a direct impact on bank capital requirements and stress-testing rules. I support the work of these agencies and encourage them to understand the anticipated effects of CECL on regulatory capital requirements and the effect of those regulatory capital requirements (after an institution's adoption of CECL) on the U.S. economy. SEC staff will continue to engage with the prudential regulators on this issue and provide any assistance they require as they undertake their process for reviewing their standards.

This week, at the July 17, 2019 meeting, the FASB voted to propose a delay to the effective date of the standard for certain entities, including SEC filers that are smaller reporting companies and private companies. We are monitoring this development.

The SEC expects the FASB to continue to engage with relevant stakeholders throughout the implementation process, and I support all parties engaging in productive dialogue regarding the new accounting standard to further our shared goal of maintaining high-quality financial reporting for the benefit of investors in the U.S. capital markets and addressing unintended negative consequences.

QUESTIONS SUBMITTED BY SENATOR JOE MANCHIN, III

1. FOREIGN PURCHASE OF SECURITIES

—I'm concerned with the many illegal actions that foreign companies take to undercut our economic successes—stealing trade secrets, personal identifying information, or patents.

—Especially attempts from foreign companies to make investments and gain control of certain American technologies and industries. We know than many of these foreign companies, especially in the case of China, are ultimately controlled by their government.

—As such, I'm extremely supportive of the Committee on Foreign Investment's (CFIUS) efforts.

—While I recognize CFIUS falls under the Treasury Department I know it engages many other departments and agencies as needed.

Question 1a. Can the SEC effectively identify and punish public companies that do not accurately disclose violations of CFIUS or other export laws?

Answer. The Division of Corporation Finance (Corporation Finance) conducts reviews of filings made under the Federal securities laws with respect to public reporting companies. Staff in Corporation Finance issues comments to companies where it appears that they could enhance their compliance with applicable disclosure requirements, which may include providing additional disclosure about material government regulations, including those relating to CFIUS or other export laws, and about material risks relating to conducting business in certain countries in light of ownership restrictions and the foreign legal and regulatory environment. When warranted, Corporation Finance refers potential violations to the Division of Enforcement.

A significant portion of the SEC's enforcement program involves identifying (including through internal referrals, such as those from Corporation Finance) and charging public companies that make material misstatements or omit to state material facts necessary to make the statements not misleading. A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. If public companies do not accurately disclose required material information to investors, which may include information relating to violations of CFIUS or other export laws, then the SEC has jurisdiction to investigate and, where appropriate, bring civil actions for violations of the Federal securities laws.

Question 1b. Are there other resources or authorities that can help the agency identify these violations?

Answer. The SEC staff frequently coordinates with other agencies at the Federal, State, and local level to, among other things, assist in the identification of potential violations of the Federal securities laws. These agencies include those more directly implicated by CFIUS and other export laws, such as the Treasury Department. While the SEC currently does not expect to need additional authorities or resources, beyond those identified by our fiscal year 2020 budget request, we will keep Congress informed should we identify statutory or resource impediments.

Question 1c. From the SEC's perspective, what is the greatest threat, either domestically or internationally, to our financial markets?

Answer. Your question addresses a topic—threats and risks to our markets and investors—that is front of mind for me and my colleagues at the SEC. The U.S. and international financial markets of today are substantially different from those of the past, including the markets of the early 2000s. As markets evolve, market risks change, and new risks emerge.

In my view, there is not one single threat that stands apart from other threats as presenting the greatest risks to our financial markets. Our markets are subject to a constantly evolving framework of threats and risks, and therefore, we must continuously keep abreast of developments in the capital markets, as well as other areas that affect these markets. This includes, for example, monitoring relevant macroeconomic factors, as well as events and trends in other markets that affect the securities markets, directly or indirectly. It also includes ensuring we have the resources in terms of human capital expertise and technology to keep pace with these market changes.

There are, however, a number of significant risks to the securities markets we are currently monitoring closely, including: (1) cybersecurity—from the perspectives of market oversight and integrity, issuer disclosure, and our own agency's cybersecurity risk profile; (2) the transition away from LIBOR as a reference rate for financial contracts; (3) Brexit—and its potential effects on U.S. investors and securities markets and on our global financial markets more broadly; and (4) issues related to market structure, including market fragmentation and participant concentration.[1]

Regarding the first risk, cybersecurity, the SEC is looking at this risk from a number of perspectives. From the issuer disclosure perspective, it is important that investors are sufficiently informed about the material cybersecurity risks and incidents affecting the companies in which they invest. From a market oversight and integrity perspective, we continue to prioritize cybersecurity in our examinations of market participants. The SEC is also focused on assessing and improving our own cybersecurity risk profile. We now have a Chief Risk Officer to help coordinate our risk management efforts across the agency. We have worked to promote a culture that emphasizes the importance of data security throughout our divisions and offices and have been engaging with outside experts to assess and improve our security controls.

The second risk that I identified relates to the transition away from LIBOR as a benchmark reference for short-term interest rates. LIBOR is used extensively in the United States and globally as a benchmark for various commercial and financial contracts, including interest rate swaps and other derivatives, as well as floating rate mortgages and corporate debt. It is likely, though, that the banks currently reporting information used to set LIBOR will stop doing so after 2021, when their commitment to reporting information ends. The expected discontinuation of LIBOR could have a significant impact on the financial markets and may present a material risk for certain market participants, including public companies, investment advisers, investment companies, and broker-dealers. It is important that market participants plan and act appropriately. The SEC staff is actively monitoring the extent to which market participants are identifying and addressing these risks and recently issued a statement that contains guidance to help participants respond to risks associated with the discontinuation of LIBOR.[2]

The third identified risk is Brexit. Even though exit has been delayed, Brexit and its potential effects on U.S. investors and securities markets, and on our global financial markets more broadly, remains a risk. I have directed the staff to focus on the disclosures companies make about Brexit and the functioning of our market utilities and other infrastructure. With regard to market utilities and infrastructure, following the 2016 Brexit vote, SEC staff commenced discussions with other U.S. financial authorities, with our U.K. and E.U. counterparts, and with market participants, all with an eye toward identifying and planning for potential Brexit-related impacts on U.S. investors and markets. These discussions are ongoing, and I expect their pace to increase.

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[1] *See* SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks (Dec. 6, 2018), *available at* https://www.sec.gov/news/speech/speech-clayton-120618.

[2] *See* Press Release 2019–129, *SEC Staff Publishes Statement Highlighting Risks for Market Participants to Consider as They Transition Away from LIBOR* (July 12, 2019), *available at* https://www.sec.gov/news/press-release/2019-129.

Finally, we and many of our regulatory colleagues are examining market structure issues from various perspectives to identify potential systemic and other material risks. Issues we are focused on include risks related to market fragmentation and participant concentration.

These are just a few of the risks to the domestic and international financial markets. My approach to identifying, monitoring and responding to risks takes into account the ever-changing risk environment and the related need to draw on information and resources from across the SEC and other bodies, including through the President's Working Group on Financial Markets, the Financial Stability Oversight Council (FSOC), the Financial Stability Board (FSB) and other organizations.

In recognition of the SEC's critical role in this area, earlier this year I created a new position focused on market and activities-based risk. This senior officer position is responsible for managing and coordinating the agency's efforts in this area. The bulk of our agency's work identifying, monitoring and responding to market risks is performed on a daily basis by the SEC's various operating divisions and offices, particularly the Division of Trading and Markets, the Division of Economic and Risk Analysis, the Division of Investment Management, and the Office of Compliance Inspections and Examinations.

In addition, the SEC plays an active role and contributes to and benefits from our participation in various domestic and international organizations that focus on market and systemic risks. As for engagement with FSOC, I serve as one of the 10 voting members on the Council. In addition to voting on proposed FSOC actions, I, along with the SEC staff, also actively contribute to FSOC deliberations and the development of FSOC's priorities, agenda and annual report. The SEC staff also actively participates in FSOC's staff-led committees, including: (1) Systemic Risk Committee, which serves as a forum for FSOC member agency staff to identify and analyze potential market risks; (2) Regulation and Resolution Committee, which supports FSOC in its duties to identify potential gaps in regulation that could pose risks to U.S. financial stability; and (3) FMU Committee, which supports FSOC's work in monitoring and evaluating risks relating to FMUs and their activities. In addition to engagement with FSOC and other formal organizations, we also directly coordinate with and share information and observations on almost a daily basis with our regulatory counterparts at the Treasury Department, the Commodity Futures Trading Commission (CFTC), and the Federal Reserve, among others.

2. CRYPTOCURRENCIES AND ONLINE SALES OF OPIOIDS

For Chairman Clayton and Chairman Giancarlo

—I have long had concerns related to the implications of financial technology, such as cryptocurrencies especially the lack of clear regulating authority and ability to protect the safety and security of our citizens.
—During this ambiguous time, I'm concerned with how cryptocurrencies are being used. Specifically, in connection to the sale of opioids.
—West Virginia has had to deal with the devastating consequences of the opioid epidemic longer and more directly than nearly any other State.
—I'm eager to understand if and how opioids are being sold using cryptocurrencies.

Question 2a. Can you elaborate on what the SEC and CFTC are doing or plans to do in regards to the regulation of cryptocurrencies?

Answer. The SEC works closely with other financial regulatory and law enforcement partners, including the CFTC, to make sure we are coordinated appropriately in our approach to digital assets. An individual determination by one agency that certain conduct involving a particular digital asset falls under its regulatory jurisdiction does not negate the possibility that conduct involving the same digital asset may also be regulated by another agency. A number of agencies may have concurrent jurisdiction over different aspects of conduct involving a digital asset. We work closely with other regulators, including through interagency working groups, to coordinate our activities to the extent possible and appropriate under the circumstances.

To determine whether an activity involving a digital asset falls under the SEC's statutory and regulatory authority and mission, we look at the facts and circumstances, including the economic substance and structure of an activity to determine whether the digital asset itself, manner of offer or sale, parties to a transaction or documentation and disclosures concerning an activity, among other things, are subject to the SEC's jurisdiction.

If a particular digital asset is considered a security for purposes of the Federal securities laws, that status triggers a number of important obligations under the

Federal securities laws, many of which focus on investor protection, including SEC registration and reporting obligations for the offering and sale of securities. To determine whether a digital asset is a security, generally speaking we look at whether the digital asset fits the definition of a security set forth in the Federal securities statutes and regulations. We also apply tests developed through decades of case law—including the U.S. Supreme Court's ruling in *SEC v. W.J. Howey Co.,* 328 U.S. 293 (1946)—to determine whether, for example, a particular digital asset is an "investment contract." The crux of that test "is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."

The definition of security is broad, but one thing to emphasize is that the approach we take when evaluating a digital asset is really no different than what the SEC has been doing for years when evaluating all kinds of novel instruments.

In an effort to further coordinate the SEC's work on digital assets, in October 2018, the SEC announced the Strategic Hub for Innovation and Financial Technology (FinHub) staffed by representatives across the agency to serve as a public resource for fintech-related issues and serve as a portal for public engagement. On April 3, 2019, though staff-level guidance, FinHub published a framework to aid market participants in analyzing whether a digital asset is an investment contract, and therefore a security. On that same day, the Division of Corporation Finance issued a staff no-action letter to a market participant in connection with a proposed offer and sale of a digital asset. Additionally, SEC staff, along with FINRA, recently issued guidance related to broker-dealer custody of digital assets. To the extent market participants continue to have questions regarding whether a particular digital asset is a security, SEC staff is encouraging market participants to reach out through the FinHub webpage.

Unfortunately, while some market participants have engaged with the SEC constructively and in good faith, others have sought to prey on investors' excitement about cryptocurrencies and Initial Coin Offerings (ICOs) to commit fraud or other violations of the Federal securities laws. The SEC, through the Division of Enforcement, has brought numerous enforcement actions for violations involving digital assets that meet the Supreme Court's definition of "investment contracts." These matters have included actions for fraud violations, failures to register offerings with the SEC and violations by gatekeepers.[3] For example, the SEC obtained an emergency court order against a company and its founder, halting pre-ICO sales and an upcoming ICO, alleging that the company falsely claimed, among other things, that it would be the first U.S. licensed and regulated tokenized cryptocurrency exchange and index fund and that the ICO was registered with and approved by the SEC.[4] Similarly, the SEC charged three individuals with fraud in connection with an ICO that raised $32 million, alleging that the defendants targeted retail investors, falsely stated that they had a partnership with Visa and MasterCard, and created fictitious executives with impressive backgrounds.[5]

The SEC has acted swiftly to crack down on allegedly fraudulent activity in this space, particularly where the misconduct has targeted Main Street investors. Regardless of the promise of this technology, those who invest their hard-earned money in opportunities that fall within the scope of the Federal securities laws deserve the full protections afforded under those laws.

Question. 2b Are either of your agencies tracking if cryptocurrencies have been used in the sale of opioids? What resources would you need to be able to do this?

Answer. The SEC's jurisdiction includes the enforcement of the Federal securities laws and regulations, including with respect to digital assets that meet the definition of a security. The SEC's jurisdiction does not, however, extend to the criminal enforcement of laws and regulations, including those related to the illegal drug trade. To the extent the SEC identifies digital assets within our jurisdiction that involve potential violations of the Federal securities laws, we investigate such matters and bring appropriate charges if warranted. To the extent the SEC, during the course of those investigations, uncovers evidence or information about potential violations of other laws, including those related to the illegal drug trade, it is our practice to refer those to the appropriate agencies, including the Department of Justice, as appropriate.

We understand that, with regard to cryptocurrencies, money transmission businesses that operate in the United States generally must register with FinCEN and

[3] *See* U.S. Sec. and Exch. Comm'n, Cyber Enforcement Actions, *available at* https://www.sec.gov/spotlight/cybersecurity-enforcement-actions.

[4] *SEC v. Blockvest LLC, et al.,* Litig. Rel. No. 24400 (Feb. 14 2019).

[5] *SEC v. Sharma, et al.,* Litig. Rel. No. 24117 (Apr. 20, 2018).

applicable state regulators. Many of the cryptocurrency trading platforms have registered as payment services that are not subject to direct oversight by the SEC or the CFTC. To the extent these platforms are complying with applicable Bank Secrecy Act (BSA) obligations, it is possible that the filing of reports under the BSA could provide some evidence of such conduct.

3. VOLCKER RULE

For Chairman Clayton and Chairman Giancarlo

—With 5 regulators—including the SEC and CFTC—involved in the implementation and enforcement of Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule, it has made the implementation complex for both banks and the agencies. This view has been confirmed by a number of current and former regulators including past Fed Chair Janet Yellen.

—In December of last year, I signed onto a letter expressing support for your efforts to clarify and improve various aspects of the Volcker Rule, and I appreciate both of your written responses acknowledging my letter.

—I want to be clear, I believe the Volcker Rule is a critical component of the post-crisis regulatory framework and I strongly support its purpose.

Question 3a. Can you provide an update on your efforts to revise the Volcker Rule?

Answer. The SEC, together with the other four agencies responsible for implementing the Volcker Rule, proposed amendments last year that were intended to make the rule work in a more efficient manner, while maintaining and enhancing inspection and enforcement capabilities consistent with the objectives and requirements of the statute. Those underlying objectives include placing limits on proprietary risk-taking by banking entities and promoting the safety and soundness of the U.S. financial system.

In preparing the proposal, the SEC and its staff worked closely with the staffs of the four other agencies, and each agency brought its own perspective and expertise to the proposal. Adoption of amendments to the Volcker Rule is on the SEC's near-term Regulatory Flexibility agenda, and I believe they are important to complete. Although I cannot say definitively when we will complete our work, I can state that both the staffs and the principals of each of the five agencies responsible for implementing the Volcker Rule remain engaged in regular and ongoing dialogue with each other. We also continue to review and analyze carefully the comments received on the proposal, both with respect to the specific requests for comment in the release and additional suggestions from commenters. Any final rules adopted by the five agencies will take into account all relevant comments.

Question 3b. What are some of the other reforms that can be made that prohibit the dangerous trading that led to the 2008–2009 financial crisis?

Answer. I believe that improving the operation of the Volcker Rule should go a long way towards furthering the goal set forth in your question. As you know, the Volcker Rule generally prohibits U.S. banking entities from engaging in proprietary trading because of the perceived risks of those activities to U.S. banking entities and the U.S. economy. To that end, in the course of preparing the 2018 proposal, the five agencies responsible for implementing the Volcker Rule asked a number of questions aimed at soliciting information about potential changes that could improve the rule. We continue to review and analyze carefully the comments received on the proposal.

It also is important to note that the SEC and its staff endeavor to ensure that firms can comply with all of the rules the SEC adopts, including the Volcker Rule, in as streamlined and efficient a manner as possible, while at the same time furthering the objectives of the underlying statute. In that respect, the proposed amendments to the Volcker Rule were designed to provide banking entities with greater clarity and certainty about what activities are prohibited, to reduce compliance obligations for small and mid-size banking entities relative to their trading activity, and to improve the effective allocation of compliance resources where possible.

4. SEC BEST INTEREST STANDARD

—As you are well aware, the Dodd-Frank Act required that the SEC conduct a study on various aspects of standards of client care for retail investors. Released in 2011, the SEC recommended a uniform fiduciary standard for the retail advice given by all types of financial professionals, including broker-dealers.

—The fiduciary standard for financial professionals was originally under the purview of the Department of Labor, but the DOL Fiduciary Rule was vacated.
—In April of 2018, you (the SEC) proposed a package of proposals including the Regulation Best Interest (Reg BI) which would require a broker-dealer "to act in the best interest of a retail customer when making a recommendation of any securities transaction or investment strategy involving securities".
—This standard has been praised by industry and criticized by consumer groups.

Question 4a. Why do you feel the Reg BI will effectively allow for financial professionals to act in the best interest of the customers?

Answer. Regulation Best Interest, or Reg. BI, substantially enhances the standard of conduct for broker-dealers. Importantly, it does so in a manner that establishes a standard of care for transaction-based advice that draws upon principles underlying the investment adviser fiduciary duty, and is workable for broker-dealers. As a result, (1) whether a retail investor chooses a broker-dealer or an investment adviser (or both), the recommendation or advice is required to be in the best interest of the retail investor and cannot place the interests of the firm or the financial professional ahead of the interests of the retail investor, and (2) the ability to choose between a broker-dealer transaction-based model and an investment adviser portfolio-based model—and choose among the various iterations and combinations of each—will be preserved.

Below are a few (of the many) key features of Reg. BI that enhance the standard of conduct:

1. Reg. BI applies to account recommendations, including recommendations to roll over or transfer assets in a workplace retirement plan account to an IRA, as well as recommendations to take a plan distribution. These recommendations are often provided at critical moments (such as at retirement), may be irrevocable (or very costly to reverse), can involve a substantial portion of a retail investors net worth, and can have significant long-term impacts on the retail investor. Accordingly, this is a critical enhancement over both existing broker-dealer obligations and our proposal.
2. Reg. BI affirmatively requires broker-dealers to act in the best interest of their retail customers and not place their own interests ahead of the customer's interests. The broker-dealer must comply with the four component obligations. The specific component obligations of Regulation Best Interest are mandatory, and failure to comply with any of the components will violate Regulation Best Interest.
   —The Disclosure Obligation, which requires full and fair disclosure of all material facts about the scope and terms of its relationship with the customer, including material facts relating to conflicts of interest associated with its recommendations.
   —The Care Obligation, which requires brokers to exercise reasonable diligence, care, and skill, to understand the potential risks, rewards, and costs associated with the recommendation, and to consider those risks, rewards, and costs in light of the customer's investment profile in order to make a recommendation that is in the best interest of the retail customer and does not place the broker-dealer's interest ahead of the retail customer's interest.
   —The Conflict of Interest Obligation, which requires firms to implement policies and procedures to mitigate (and in some cases, eliminate) certain identified conflicts of interest that create incentives to make recommendations that are not in the retail customer's best interest.
   —The Compliance Obligation, which requires firms to implement policies and procedures reasonably designed to achieve compliance with Reg. BI as a whole.
3. The Care Obligation will apply to a series of recommended transactions (currently referred to as "quantitative suitability") irrespective of whether a broker-dealer exercises actual or de facto control over a customer's account. This enhancement will allow us to bring enforcement actions against broker-dealers engaging in misconduct over the course of a relationship more efficiently and thereby return money to harmed retail investors more quickly.

Whether a broker-dealer has acted in the retail customer's best interest will turn on an objective assessment of the facts and circumstances of how the specific components of the rule are satisfied. This principles-based approach is a common and effective approach to addressing issues of duty under law, particularly where the facts and circumstances of individual relationships can vary widely and change over time, including as a result of innovation. This approach to determining what is in the "best interest" of a retail customer is similar to an investment adviser's fiduciary duty, which has worked well for advisers' retail clients and our markets.

5. SEC BUDGET

—The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.
—Your (the SEC) budget request seeks $1.746 billion, a $71 million increase from fiscal year 2019 enacted amount, including 34 new positions.
—Last year we provided the SEC with the funding for 100 additional positions in fiscal year 2019.

Question 5a. Given that roughly 130 positions have been or will be added over fiscal year 19 and fiscal year 20, is this sufficient to address priorities of the agency?
Question 5b. Can you explain how these new 34 positions would help the SEC achieve its mission?

Answer. Yes, I believe the additional positions will be sufficient to address the key priorities of the agency. With the enactment of the fiscal year 2019 appropriation, the SEC is adding new positions in critical areas to enhance our expertise in areas with emerging issues and challenges. These include additional staff in the cybersecurity and risk management functions, staffing the newly-created Office of the Advocate for Small Business Capital Formation, expanding our enforcement and examination programs with a focus on Main Street investors and enhancing our oversight of the changing markets—especially in areas experiencing rapid technological advancements.

Our fiscal year 2020 request builds on our fiscal year 2019 request by adding new positions in areas where they will contribute significantly to achieving the objectives of the SEC's Strategic Plan for fiscal years 2018–2022 and addressing staff shortages in mission-critical areas. The request would enable us to invest in staff with the skills and expertise in vital areas such as cybersecurity and market oversight, shift or expand our focus in certain key areas for the benefit of our Main Street investors and companies, and to adapt our regulatory oversight to keep pace with changes in the markets we oversee.

SUBCOMMITTEE RECESS

Senator KENNEDY. If you are here from CFTC or SEC raise your hand, please ma'am and sir. Thank you for your good work, and I mean that. And thank you for the leadership. Chairman Giancarlo, we are going to miss you. I mean that. You have done an extraordinary job.

Mr. GIANCARLO. I think I thought I would never say this, but I am going to miss you too.

[Laughter.]

Senator KENNEDY. Well, your sentence is up, okay. Five years is a long time.

[Laughter.]

Mr. GIANCARLO. Thank you.

Senator KENNEDY. Godspeed. Thank you all. Meeting is adjourned.

[Whereupon, at 12:30 p.m., Wednesday, May 8, the subcommittee was recessed, to reconvene subject to the call of the Chair.]