

# OVERSIGHT OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

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## HEARING

BEFORE THE  
SUBCOMMITTEE ON CAPITAL MARKETS AND  
GOVERNMENT SPONSORED ENTERPRISES  
OF THE  
COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED TWELFTH CONGRESS  
SECOND SESSION

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# CONTENTS

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	Page
Hearing held on:	
April 25, 2012 .....	1
Appendix:	
April 25, 2012 .....	51

## WITNESSES

WEDNESDAY, APRIL 25, 2012

Schapiro, Hon. Mary L., Chairman, U.S. Securities and Exchange Commission .....	8
---	---

## APPENDIX

Prepared statements:	
Schapiro, Hon. Mary L. ....	52

## ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Garrett, Hon. Scott:	
Article by Beagan Wilcox Volz entitled, "Lawyer Skewers Boston Fed Chief's Money Fund Comments," dated April 24, 2102 .....	67
Schapiro, Hon. Mary L.:	
Written responses to questions submitted by Representative Grimm .....	70
Written responses to questions submitted by Representative Hensarling ..	71
Written responses to questions submitted by Representative Hurt .....	72
Written responses to questions submitted by Representative Miller .....	75
Written responses to questions submitted by Representative Schweikert ..	77
Written responses to questions submitted by Representative Sherman .....	78



## OVERSIGHT OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

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Wednesday, April 25, 2012

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

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Schweikert, Royce, Manzullo, Hensarling, Pearce, Fitzpatrick, Hayworth, Hurt, Grimm, Stivers, Dold; Waters, Sherman, Lynch, Miller of North Carolina, Maloney, Moore, Green, and Ellison.

Ex officio present: Representative Bachus.

Chairman GARRETT. Good morning. Today's hearing of the Subcommittee on Capital Markets and Government Sponsored Enterprises entitled, "Oversight of the U.S. Securities and Exchange Commission" is called to order. I thank Chairman Schapiro for being with us this morning with all of her notes and preparation.

With that, we will begin with opening statements, and I will recognize myself for about 3 minutes. And again, welcome.

The intention of today's hearing is to conduct appropriate oversight of the operations of the SEC, and there is no shortage of issues that we will be hearing about.

The SEC's current workload touches on almost every facet of the Nation's financial markets: money market funds; conflict minerals; the implementation of the JOBS Act; the oversight of broker-dealers and investment advisers; Title 7 rulemaking; credit rating agencies; market structure; accounting and auditing oversight; community advisers; and many more.

It is because of this breadth and scope that all new market regulations coming out of the agencies must go through a rigorous review of costs and benefits associated with each rule. I want to thank the Chairman for her recent focus on the importance of this concept with the new formal Guidance on Economic Analysis issued last month to agency divisions and offices. This guidance and its newfound consensus of cost-benefit analysis will hopefully rebut some of our colleagues on the other side of the aisle who continue to demagogue a cost-benefit analysis as simply a way to undermine Dodd-Frank regulation.

This analysis is actually a good faith attempt to ensure that new rules being produced meet their intended goals to not add unneces-

sary and overly burdensome costs to the private sector. So I look forward to continuing to work with the Chairman to ensure that this new guidance is binding on the agencies and the new standard in this document is applied to all rules under consideration. I also hope that the Chairman will be more supportive of my SEC cost-benefit legislation so that we can ensure that our future Chairmen are subject to the same appropriate standards.

Another broader issue that needs to be addressed is the fundamental restructuring of the agency. Section 967 of the Dodd-Frank Act required an independent study to be done and recommendations to be made as to how the SEC should reorganize itself to be more efficient and achieve better results with the taxpayers' money. Section 976 also required periodic reports to the SEC on the status.

The exploratory note to the SEC's March 30, 2012, report states, "The Commission was not consulted on the decision to hire the consultants advising to the MAP Project or the cost of the scope thereof." I do find that statement troubling.

Nowhere in Dodd-Frank are you required actually to spend literally millions of dollars for an outside consultant to help the agency implement the recommendations of the study. I have heard estimates of up to \$10 million, something which could have been done internally through the Office of the Chief Operating Officer. This is a very blatant example of millions of dollars that people say are being wasted. And I find it difficult to sympathize with requests then that we hear from the agency for additional taxpayer money year after year when we are spending in this manner.

Finally, I am dismayed that back in February when you gave a speech on the state of the SEC, you specifically omitted facilitating capital formation as a primary component of the SEC's mission. It is hard to imagine that this was just some sort of casual oversight, given the depth of the ongoing congressional negotiations at that time of the JOBS Act. Furthermore, in your testimony today, once again that area is omitted. Fortunately, there is a bipartisan and bicameral majority of Congress that recognizes the importance of capital formation on job creation, even if the agency and yourself do not.

Too many times, the idea of protecting investors is only framed under the umbrella of protecting them from fraud. Protecting investors is also about assuring investors that they have a place to invest their capital and make a return. It is about providing investors with choices and cost-effective ways to conduct their business. Capital formation is a vital and equally important part of that mission. And hopefully, you will remember that in future testimony and remarks.

With that, I yield back my time, and I recognize the gentlelady from New York for 3 minutes.

Mrs. MALONEY. Thank you so much. I would like to welcome you, Chairman Schapiro, and thank you for your service. It is nice to see you again. I believe I saw you last the week before the OGR Committee and that was hearing number 48. Is that correct?

Forty-two? So now, it is 43—43 hearings you have attended. And at that hearing last week, I asked you about the progress the SEC is making in terms of implementing the many rules in Dodd-Frank,

and I want to reiterate how important it is that these rules be done and finalized as soon as possible. Because in many ways I think it is the lack of certainty, not the rules themselves, that are concerning. And I know the SEC is working overtime to get these rules done and I am sure these issues concerning cost-benefit analysis will be firmly covered today and I believe that cost-benefit analysis is a very important part of making decisions going forward. I know that you do, too.

I do want to mention that I am very concerned about the clearinghouse rules. It is very important, going forward, to make sure that these clearinghouses are rock solid strong. And your decisions that you made recently on high-frequency trading and the consolidated tape throughout this process is a very important one. And I also wanted to mention the swap definition. I know that is a rule you are working on jointly with the CFTC and it seems like that needs to be put in place before many other rules can be addressed.

So I hope that you will be telling us where that is going forward. And the extraterritorial guidelines of exactly how far it goes and the oversight that you have, I hope is an area you will be discussing. As you know, the ranking member put forward an amendment in one of our bills that would have increased the oversight of the SEC in the territorial area. I also wanted to take a minute to raise the issue about real estate investment trusts which are a very important industry in my district.

Last August, the SEC published a concept release to revisit the scope and application of the statutory exemption of mortgage REITs from regulation under the Investment Company Act of 1940. You well know the important role that REITs play in terms of providing liquidity in the housing market, and given the fragility of that particular sector, it has been the hardest one to bounce back.

And the fact that significant holders of mortgage credit are backing away or deleveraging. We are always looking for ways to encourage increased participation of private capital. I know that you and your staff are giving due deference to these considerations. And I hope you will be mindful of this as you decide whether to move forward. And I look forward, as always, to your testimony, and I welcome you to your 43rd testimony before Congress this session.

Thank you.

Chairman GARRETT. The gentlelady yields back.

The gentleman from Alabama, the chairman of the full Financial Services Committee, is recognized for 3 minutes.

Chairman BACHUS. Thank you, Chairman Garrett, for holding this hearing.

And thank you, Chairman Schapiro, for being here this morning.

The Dodd-Frank Act expanded the SEC's authorities and responsibilities, requiring the Commission to promulgate 123 rules, conduct 32 studies, and establish 7 new offices or committees. That makes today's hearing particularly urgent, as this committee has the responsibility to conduct oversight of the SEC's activities and initiatives and budget requests.

The SEC's budget has increased by roughly \$1 billion over the past decade, and the Administration is requesting \$245 million more for the agency than it requested in 2012. How the SEC

spends its money is a reflection of the Commission's priorities, and this hearing will help us better understand what those priorities are, and how the SEC is prioritizing its resources.

One of those priorities appears to be further money market fund reforms, yet, as Vice Chairman Hensarling and I noted in a recent letter to you, Chairman Schapiro, the SEC has missed numerous deadlines for mandatory rulemaking. So the suggestion that the agency is now devoting time and resources to a discretionary rule, without providing Congress or the public with empirical data and economic analysis to justify such a rulemaking, raises questions about the SEC's priorities and abilities to manage its resources.

We believe the Commission should first determine whether more reforms are needed before choosing among the proposals that are reportedly under consideration. In past hearings, I have commended Chairman Schapiro for pursuing reforms designed to avoid future debacles such as the SEC's failure to detect or prevent the Bernie Madoff or Allen Stanford Ponzi schemes.

However, I do want to point out—and this is not to diminish the fact that you have made a lot of needed reforms—that one regulatory gap remains unaddressed—and you acknowledge this—relating to the Commission's oversight of investment advisers.

Last year, only 8 percent of investment advisers were examined by the SEC. This lack of oversight, particularly in the aftermath of the Madoff scandal, is perilous and risky. Retail investors are at risk if their investment professional is examined only once every decade.

All investment professionals should be subject to consistent examination and oversight, which is why bipartisan legislation I am introducing this week establishes one or more self-regulatory organizations to oversee retail investment advisers. This will dramatically increase the examination rate for investment advisers with retail customers.

A responsive SEC that is wisely prioritizing its use of resources is the goal for all of us to share.

I know you share that goal, Chairman Schapiro.

I thank Chairman Garrett for calling this important hearing, and I yield back the balance of my time.

Chairman GARRETT. I thank the gentleman.

Ms. Waters is now recognized for 3 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. I appreciate you holding this hearing today. And I would like to thank Chairman Schapiro of the Securities and Exchange Commission for coming before us to testify today. I appreciate that this subcommittee has conducted rigorous oversight of the SEC. By my count, this is the 16th time that the SEC has been before the Financial Services Committee during the 112th Congress. And of course, the Commission also makes frequent appearances before other committees in this Congress.

There are several topics I hope we can explore with Chairman Schapiro today, including the SEC's budget request, implementation of the JOBS Act, potential money market fund reforms, and of course, the continued work to finalize rules related to the Dodd-Frank Act. I hope that we can productively explore these topics, but I also hope that we can recognize attempts to weaken or under-

mine the SEC, by either underfunding it, or imposing upon it much more onerous cost-benefit rules.

I would like to believe, and I must believe, that we are all interested in an SEC that can perform the task and the mission that it is charged with. And that while there is need for clarification and definition, none of us on either side of the aisle would like to weaken the SEC and not have it do its job.

The Commission has made a good faith effort to be responsive to some of the criticism of their cost-benefit analysis, and I am curious to hear more about the recently issued guidance on this topic. However, there has been a lot of work done by this committee that can be identified as legislative efforts that may tie the hands of the SEC as it attempts to protect investors.

Some legislation that moved through this committee had perhaps laden the Commission with additional litigation expenses and could make it very difficult for the SEC to do the job that Congress asked it to do under the Dodd-Frank Act. There is no better effort or job that can be done by this committee than for both sides of the aisle to get together again and ensure that the SEC is not hampered in doing its job, and that all of the attempts that are being made in this committee are attempts to clarify, to define, and to clear up, rather than undermine.

Under this backdrop, I think it is important to keep fresh in our minds what has happened, the damage that has taken place to our capital markets and our great economy just 4 years ago. We cannot forget the many foreclosures that have taken place, and all of the dollars of household wealth that has been wiped out; it must be kept fresh in our minds. Although the financial services industry has rebounded, American households still struggle from the fallout from this recession.

Having said that, I hope that we can have a productive hearing today, and I certainly look forward to testimony from our witness.

And I thank you again, Mr. Chairman, for holding this hearing.

Chairman GARRETT. I thank the gentlelady.

Mr. Hensarling is recognized for 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

And welcome, Madam Chairman. I guess you took note that this is, I think, your 42nd appearance before the committee. Given that you have been in office for a little over 3 years, and given the provisions of the Dodd-Frank Act and a number of questions about the committee, my guess is we can get you up to 50 appearances in relatively short order.

As you well know, there are a number of members of this committee who are concerned about the lack of fundamental economic analysis that has historically taken place at the SEC. And I certainly want to commend Chairman Garrett for his legislation.

At a time when our Nation is still suffering from roughly 37 to 38 straight months of 8 percent-plus unemployment, with the underemployment being almost twice that, the worst record since the Great Depression, knowing how invaluable the efficiency and vibrancy of our capital markets is to job creation, it is a good and proper and important topic that we deal with on ensuring that there is meaningful economic analysis.

In addition, there have been questions concerning the relative priorities of the Securities and Exchange Commission, and the seeming misallocation of resources as well. I do want to commend you for the steps that you have taken in issuing staff guidance regarding economic analysis. I will look forward to hearing more in this hearing about that.

But I do want to also echo what Chairman Bachus said about—if my figures are right—the SEC having missed approximately 62 percent of its mandatory deadlines under Dodd-Frank. And in this case, that might not necessarily be a bad thing, but it does question certain discretionary rules that are being considered, particularly the money market fund regulations where we are still looking for the rationale and the empirical evidence that the 2010 administrative rule 2A-7 has not proven sufficient.

So that is an open question in our minds. But I look forward to your testimony.

And I yield back the balance of my time.

Chairman GARRETT. The gentleman yields back.

Is there a request for time? Yes? Yes, there is.

The gentlelady is recognized for 3 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman. I didn't prepare an opening statement, but I couldn't resist the opportunity to congratulate the Chairman of the SEC for the diligent hard work that they have done under very stressful situations with the tremendous numbers of additional responsibilities that have come to the agency upon the advent of Dodd-Frank.

It has occurred to me that there are many criticisms that are levied against the SEC about your increased spending authority, but you have tremendous increased responsibilities. And I just wanted to make note of the tremendous breadth and depth of reforms that you have already put into place.

I look forward to hearing your testimony and asking some very specific questions about some things I think are concerning to me.

And with that, Mr. Chairman, I would like to yield back the balance of my time.

Chairman GARRETT. Thank you. The gentlelady yields back.

Mr. Royce is recognized for 1 minute.

Mr. ROYCE. Thank you, Mr. Chairman.

There are some concerns. There have been many failures at the SEC over the last several years, and despite our hearing testimony from people like Harry Markopolos about the over-lawyered culture at the SEC and the "investigative ineptitude"—in his words—last Congress, Dodd-Frank rewarded the SEC with additional authority without looking at the fundamental problems within the agency. And that is one of our concerns.

And Chairman Schapiro, I do not envy you. You have a lot on your plate as you display in your testimony today; you do. And I appreciate also the work you are doing with this idea of taking a slow-to-act bureaucracy head on with the idea that we are going to take people with expertise in these critical areas from the market and put them into important positions, hire them to these positions because they have a background. Addressing the over-lawyered nature of the SEC is important because there is a perception of regulatory competence throughout the financial sector. There is this

perception that people do not have to do due diligence because, after all, the SEC is going to do that.

And that leads, frankly, to an erosion of market discipline, in my opinion. That is one of the things that happened. Like it or not, that perception is out there.

So it is in everyone's interest that we get this right to the extent possible following the crisis. And that is why these moves to bring people in with that type of expertise that you are undertaking, I think, is very important.

I yield back, Mr. Chairman.

Chairman GARRETT. The gentleman yields back.

Mr. Fitzpatrick for 1 minute.

Mr. FITZPATRICK. Thank you.

Chairman Schapiro, good morning.

You have made a number of speeches recently about your intention to propose rules later this spring to further limit the use of money market funds. And one element in the proposal would be to force money funds to float their net asset value so they could no longer be offered at a dollar per share.

Another would be to impose capital requirements on money funds which would essentially make them more like a bank product.

As a former county official from Pennsylvania whose county benefited from the use of money funds for cash management, I would like to hear about whether the SEC has done an analysis as to how many entities may not be able to use money funds under the proposed rules that are being considered at the SEC.

With that I yield back.

Chairman GARRETT. And the gentleman yields back.

Mr. Dold is recognized for 1 minute.

Mr. DOLD. Thank you, Mr. Chairman.

Chairman Schapiro, welcome back. As always, we appreciate your time and testimony here today.

These oversight hearings are critical. They are a critical congressional responsibility, and also critical for the Executive Branch agencies because they have a responsibility to help improve government transparency, accountability, and effectiveness.

So I want to thank you for your participation. I guess we are going on 42 or 43—depending on how you count it—but certainly, we appreciate it.

Obviously, the SEC is facing some significant changes, issues, and challenges. And these include conducting and completing multiple studies and reports, as well as writing and implementing many new and complicated and consequential rules, all dictated by Dodd-Frank.

I am certainly pleased that this committee has worked frequently on a bipartisan basis to try to clarify congressional intent and try to identify and avoid unintended consequences, which necessarily come from a complicated Dodd-Frank process.

I know that we will get into many of these issues today, but for now I want to specifically highlight the municipal advisers rule-making as one of the clearest, most important examples of the need to clarify congressional intent to avoid serious unintended negative consequences.

So I look forward to your testimony today, and I look forward to digging into some of these issues.

Thank you so much.

I yield back, Mr. Chairman.

Chairman GARRETT. The gentleman yields back.

And finally, Mr. Grimm is recognized for 1 minute.

Mr. GRIMM. I thank the chairman.

And welcome back, Chairman Schapiro.

As I am sure most of us here would agree, in order to have strong financial markets in the United States, we must have clear rules that are fairly and uniformly enforced by regulators such as the SEC. And, unfortunately, if the crisis of 2008 showed us anything, it showed that a lack of enforcement of existing rules did help to bring our financial system to the brink of disaster.

Therefore, today, if possible, I have particular interest in hearing what steps the SEC has taken thus far to implement the reform and modernization recommendation presented by the Boston Consulting Group, as well as which steps the Commission plans on taking in this area in the near future.

With that, I yield back. And I thank you.

Chairman GARRETT. The gentleman yields back.

And that, I believe, concludes all of the opening statements.

We will now recognize our witness, the Honorable Mary L. Schapiro, Chairman of the U.S. Securities and Exchange Commission.

Chairman Schapiro, you are recognized. And thank you again for being with us for many, many meetings.

**STATEMENT OF THE HONORABLE MARY L. SCHAPIRO,  
CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION**

Ms. SCHAPIRO. Thank you.

Chairman Garrett, Ranking Member Waters, and members of the subcommittee, I appreciate the opportunity to testify regarding the recent activities of the United States Securities and Exchange Commission.

In the past 3 years, the SEC has experienced enormous change, substantial challenges, and significant progress. The aftermath of the financial crisis, the extensive new responsibilities placed upon the agency, and the rapid growth of the financial markets have together obliged the SEC to become more efficient, creative, and productive to achieve its mission, which of course includes capital formation as well as investor protection.

I am pleased by our record. To cite just a few highlights, the Commission filed more enforcement actions in the last fiscal year than it has ever filed, and it obtained orders for more than \$2.8 billion in penalties and disgorgement.

We brought actions arising out of the financial crisis against more than 100 individuals and entities, naming 55 CEOs, CFOs, and other senior corporate officers.

We implemented a risk-focused examinations program, and in 2011 completed more than 1,600 oversight exams. The exam program has resulted in both improved guidance to the financial industry about risky practices and in actionable information for our enforcement unit.

We implemented a new whistleblower program that is already providing high-quality information regarding difficult-to-detect wrongdoing and permitting the investigators to focus resources more efficiently.

We improved our internal financial controls, which resulted in a GAO audit opinion for Fiscal Year 2011 with no material weaknesses. We implemented a host of internal reforms designed to improve the agency's structure, strengthen capabilities, upgrade internal controls, and enhance workforce competencies.

And we have used external hiring opportunities to obtain specialized industry expertise in areas as diverse as quantitative analysis, computerized trading, and structured products.

While we have made significant progress in many areas, we realize that we must constantly evolve to keep pace with those we regulate. In addition to improving our core operations, we are working to implement the significant new responsibilities assigned to the agency under the Dodd-Frank Act and the JOBS Act.

Already the SEC has proposed or adopted rules for over three-fourths of the more than 90 Dodd-Frank provisions that require SEC rulemaking. And we have issued 14 of the required studies and reports.

While the agency's budget has grown in recent years, so have our responsibilities in the size and complexity of the markets we oversee. For example, during the past decade, trading volume in the equity markets has more than doubled, as have assets under management by investment advisers now totaling \$48 trillion—trends that are likely to continue for the foreseeable future.

In addition to the growth of the market, the new requirement of the JOBS Act will also call for significant commitment of agency resources. There, too, we have made progress. We have formed rulemaking teams comprised of economists, attorneys, and experts. We have sought public comment earlier than the rulemaking process requires.

And in the days immediately following enactment, the staff prepared and posted practical guidance on, among other things, how emerging growth companies can file their confidential IPO submissions and on the new requirements and thresholds on Exchange Act registration and de-registration.

With respect to our budget request for Fiscal Year 2013, our request would allow the Commission to achieve four high-priority initiatives. First, it would allow us to enhance our investor protection activities by bolstering staff resources and our enforcement in our examinations units and by continuing to develop and implement robust analytical models that identify regulated entities with high-risk profiles.

Second, it would allow us to speed capital formation by eliminating regulatory bottlenecks, to improve economic analysis, and to efficiently consider authorizations to businesses engaged in new lines of business.

Third, it would allow us to strengthen the market stability effort. Currently, the SEC has fewer than 25 staff persons to monitor the 8 clearing entities that clear and settle an average of \$6.6 trillion in transactions every day. We believe a greater presence is needed.

In addition, there is a need for agency attention to important issues such as market structure improvements, high-frequency trading, exchange-traded funds, and enhanced efforts against cyber security threats.

Finally, it would allow us to make IT investments in data management, disclosure review, internal accounting and financial reporting, electronic discovery, and to modernize the EDGAR system and sec.gov.

I believe that our past efforts and our future priorities will help us fashion an ever-better equipped, more expert, and effective agency. I look forward to working with you to build on this progress.

And, of course, I am happy to answer any questions.

[The prepared statement of Chairman Schapiro can be found on page 52 of the appendix.]

Chairman GARRETT. Great. Thank you very much for your statement.

We will now begin with questions. And I will recognize myself first. We are limited for time, obviously, with all these questions, so what I thought I would do is run through half a dozen sort of yes-or-no questions, and then come back to elaborate on that, okay?

Starting, first and foremost, with cost-benefit analysis—I understand that a memorandum was issued regarding current guidance on economic analysis. Is that correct?

Ms. SCHAPIRO. Yes.

Chairman GARRETT. And that was done back in the spring of this year, in March?

Ms. SCHAPIRO. It was, I believe, distributed in March. It had been in the works for a while.

Chairman GARRETT. Yes.

This guidance is binding, then, on the agency?

Ms. SCHAPIRO. Yes, the staff is following the guidance.

Chairman GARRETT. Right.

Have you as Chairman put in writing, then, to each of the divisions that it is binding on them?

Ms. SCHAPIRO. The guidance has been distributed and everybody is following it, and everybody understands the expectation is that they will follow it.

And, of course, the Commission is the ultimate arbiter of whether the staff has followed the guidance. The staff understands that they are to follow the guidance.

Chairman GARRETT. Okay, so the staff understands. I guess the question, then, is out of—because the memorandum comes out of the OGC and the RSFI?

Ms. SCHAPIRO. It comes from the Chief Economist and the General Counsel.

Chairman GARRETT. Okay.

Should a directive come from your office?

Ms. SCHAPIRO. It certainly could. We have professional staff at the SEC, and they understand that this is the expectation and this is the requirement. I haven't sent out an e-mail that says, "You must follow this guidance." They will and are following it.

Chairman GARRETT. Will you instruct them?

Ms. SCHAPIRO. I certainly could.

Chairman GARRETT. Okay. Is this guidance publicly available?

Ms. SCHAPIRO. It is not publicly available, in part because it has been circulated to the Commissioners and we are awaiting input from the Commissioners to see if there is any further enhancements or evolution to the guidance based on their input.

At that point, I am comfortable having it circulated. And of course, a number of committees of Congress or Members of Congress have it, as it was provided for a cost-benefit analysis hearing last week.

Chairman GARRETT. So it is mandatory? I am going to go back, contrary to what I was going to do, yes or no. So it is mandatory on the agency, but it hasn't been—the Commissioners have not signed off on it?

Ms. SCHAPIRO. They have not formally voted on it. They are aware of it. They have been briefed on it. My understanding is most of them think it is excellent, and the staff is following it. If the Commission has edits to it or changes or enhancements, we will as a Commission work through those. And at that point, we can vote on it as a formal document.

Chairman GARRETT. Is it normal, the practice that something becomes mandatory on the agency before the Commission signs off on it?

Ms. SCHAPIRO. In fact, most policies like this, the Commission probably doesn't sign off on most internal procedural policies. But this one, because of its importance and because we think the Commission will have valuable input to the process, we wanted to make sure they all had it and were comfortable with it.

Chairman GARRETT. And since you just say because of its importance and because that it is now, as you say, binding on the agency, does the SEC need now then to what, to re-propose the rules that it had previously proposed but are not yet done in the process, that in other words are not yet final, in order to go through this process and to give the public notice of that?

Ms. SCHAPIRO. The staff is going through a process right now of looking at all of the rules that have been proposed but not yet finalized to see if, in light of the new guidance, additional economic analysis will be necessary. And where it is necessary, we will supplement with additional analysis.

It is important to note that this guidance, while it puts everybody on the same page and it communicates very clearly what the requirements are for economic analysis in SEC rulemaking, many of these things were being done in many rulemakings already. So I don't have a final count on whether it will be necessary to re-propose anything.

I can give you an example from 2 weeks ago. We actually reopened a comment period based on the receipt of additional data and were able to make that part of the file before we went final on a rulemaking. So we are looking at whether we need to do more with rules that have been proposed but not finalized.

Chairman GARRETT. Right, because they would have to—if this is the new way where you are going forward, that the public would want to be able to—the public should be able to have the ability to comment on the economic analysis, that in essence was not part of the process under this memorandum previously.

Ms. SCHAPIRO. Although for some rules, there was a complete economic analysis already done at the proposing stage, but if there is additional data, we can always open the comment period for comment on that data. But as I said, the staff is doing an analysis of all the existing rules proposals.

Chairman GARRETT. And so you will do that for each particular rule, say whether or not it will happen then? Is that what you are saying?

Ms. SCHAPIRO. On a case-by-case basis with each rule as it comes to the Commission for final approval, we will make a determination whether the prior economic analysis was sufficient and meets the standards of the guidance.

Chairman GARRETT. And just one last question. Normally when you come before this body, you do not give your opinion on legislation. That is sort of your policy I guess, which is fine. But I know that with regard to the JOBS Act, you did actually send your position in opposition to the legislation. Was there anything that prompted you to do that on that legislation? Is there anyone from the Senate or Senate staff who prompted either you or your staff to engage in that conduct?

Ms. SCHAPIRO. No. And, Mr. Chairman, I do give my opinion from time to time in fact. As you may recall, I have commented on H.R. 2308 in the past and some of the additional requirements in your bill on economic cost-benefit analysis for the SEC to do.

And, as I testified on a number of capital formation initiatives over the course of the last year, I stressed some of the issues that were in my letter about the need to balance investor protection.

Chairman GARRETT. But will this affect your ability to implement the JOBS Act because you have—

Ms. SCHAPIRO. Absolutely not.

Chairman GARRETT. And will you continue to prioritize it even though your limited resources over such a prioritization of Dodd-Frank?

Ms. SCHAPIRO. We have many Dodd-Frank rules to complete. As was pointed out, we have missed a number of deadlines already. Those are a high priority. The JOBS Act is a high priority. It is the law of the land. We will absolutely faithfully implement it as Congress intended.

Chairman GARRETT. Thank you. I appreciate it.

The gentlelady from California?

Ms. WATERS. Thank you very much.

I heard you just relate to a question relative to the JOBS Act. And I voted for the JOBS Act. It was a leap of faith for me. I had some concerns about it, but in an attempt to listen to the arguments about job creation and support for small business and all that, I supported it. But, I was very much desirous of having my amendment on research included in that.

I offered an amendment to the provision of the research section that would have taken several steps, including preventing the repeal of certain aspects of the so-called Global Settlement that former Attorney General Spitzer negotiated almost 10 years ago. This settlement limited potentially damaging conflicts of interest between the investment banking and research departments of large investment firms in the United States.

The U.S. Chamber of Commerce even wrote to the House, saying this aspect of the JOBS Act went too far, saying there may be blurring of boundaries that could create potential conflicts of interest between the research and investment components of broker-dealers. And I think you even wrote to the Senate leaders expressing your concerns with this provision after the bill passed the House.

And even though I did not get my amendment in, I don't know what your authority is to pay attention to this area because of your understanding and my concerns and others about this potential conflict.

Having said that, I also want—and you may have answered this question already about priorities. Does this in any way take priority—the JOBS Act—in the SEC over Dodd-Frank, or how do you view that?

And lastly, since I am going to get all of my questions in so you can answer them all at once, I was the author of a proxy access. And I know the decision of the courts on proxy access. What are we doing to get it back and to be able to frame in ways that the court indicated it should be dealt with?

Ms. SCHAPIRO. Congresswoman, I lived through the research analyst investment banking conflicts of interest in a very direct way at FINRA, and we participated in the Global Settlement. And so let me say that the Global Settlement remains in effect.

The issue becomes the fact that a number of FINRA (the self-regulatory organization) rules replaced provisions in the original Global Settlement. And several of those rules are directly implicated by the JOBS Act.

The JOBS Act is quite clear that those rules cannot continue to be maintained, nor could new rules be written in particular areas that sought to put a wall between research and investment banking.

So for example, right now research analysts are prohibited from participating in pitches with the investment bankers to get their investment banking business. Under the JOBS Act, that rule may have to be reconsidered.

There are also quiet periods that now operate within 40 days after an IPO or within 15 days of the expiration of a lock-up period where research can't be issued, so-called "booster shot" research. The JOBS Act makes it clear that quiet periods' rules cannot be maintained.

So we will, again, faithfully follow the law, as will FINRA; and where rules cannot be maintained, they will have to be eliminated.

Ms. WATERS. I and others will keep a close eye on this, and want to work with you to understand whether or not we are running into conflict of interest problems. And maybe we can revisit that at some time, but I am really worried about it.

Ms. SCHAPIRO. That would be fine, and we would be happy to provide Congress at some point with our view about whether issues are arising again. And let us hope that that they won't.

On your question about priority of Dodd-Frank over the JOBS Act, I would say that they are both very high priorities. Whenever we have congressional mandates, particularly those with specific deadlines, we prioritize them over other things. And so we will be

working very hard on both completing our Dodd-Frank work and our JOBS Act work.

And with respect to proxy access, I think that is not an issue that we have the capacity to take on, again, at this time.

Ms. WATERS. I don't understand exactly what your last answer was. What do you mean you don't have the capacity to take on at this time?

Ms. SCHAPIRO. In terms of re-proposing a proxy access rule and putting that on the Commission's immediate agenda, we don't have the capacity right now to redo that whole process in terms of the number of people and the hours in the day for the agency. It is something that we will continue to look at over time, but we are just not going to be able to get to it as we finish all this other work.

Ms. WATERS. Thank you very much. I am going to have to think about that.

Chairman GARRETT. I now recognize the gentleman from Alabama, the chairman of the full Financial Services Committee, Chairman Bachus.

Chairman BACHUS. Thank you.

Chairman Schapiro, you are hearing questions about economic analysis and capital formation. We have expressed concerns about the derivative rule, about the Volcker Rule, about the Federal Reserve's (Fed's) proposal to enact single counterparty credit limits, and all these questions concerning the JOBS Act. And you have expressed that the crowd funding could pose some risk.

Let me tell you what our motivation is. And I think I speak for most Members. My grandfather was a railroad engineer, and that was part of his identity. That is what he did. My dad was a contractor. My other grandfather was a farmer. That is really our concern. It is about jobs. And the jobs just aren't there today.

People talk about how homeownership is the American dream, but even to have homeownership, you have to have a job. And today we have unemployment. We have underemployment. We have part-time employment. We have temporary workers. We have 2 million Americans who have even given up looking for a job because they are so discouraged. And the reason we are concerned about the Volcker Rule's impact on jobs, and we passed the JOBS Act, which I think was a bipartisan effort, is we want to put America back to work. And I know you do too.

I can tell you that the institutions you supervise are not based on safety and soundness regulation; it is about disclosure and ensuring that investors have all of the information they need, and you should not be trying to take the risk out. You are charged with promoting capital formation and job creation.

You know, what does your uncle do? Well, he is unemployed. You have seen those lines during the Great Depression, and boy are those sad images. And that is why we keep saying, has there been an economic analysis on this proposal? What we are really asking is, is this going to eliminate jobs? Is this going to put people out of work? My question to you would be, do you know of any of the agencies that have undertaken a comprehensive economic analysis on what Dodd-Frank will do?

And I won't pose it as far as capital formation or availability of credit, but has anyone done a study on its impact on job creation?

Because we have had employer after employer that has come in and said, this is going to eliminate 2,000 jobs. This is going to eliminate 1,000 jobs. And this is somebody's father. This is somebody's son who is going to lose their job if we don't get this balance right. So I would ask you, do you know if there has been any study done on the cumulative economic impact of Dodd-Frank on job creation, or capital formation, or economic growth?

Ms. SCHAPIRO. Mr. Chairman, I am not sure that any agencies have done that. I have, I think, seen some private sector studies that talk about the potential cumulative impact and costs, although I don't know that they have translated it into the number of jobs.

I would say that we care deeply about job creation, although we come at it from a slightly different angle, which is that we must have markets in this country that operate with integrity so that investors have confidence to invest in companies that can create jobs, that can build factories, and that can create the economic growth that we are all striving for.

And it is getting that balance right with regulation that helps to ensure the integrity of the marketplace, that allows a company to trade freely and actively on the stock exchanges, and that gives investors sufficient information to make reasoned judgments about, "I will put my money here, but not here." To balance the regulation necessary for that to happen with a need to not have unnecessary and overly burdensome regulation and not to regulate to the nth degree because we won't take all the risk out.

Investing is risky. And it should be risky. But it should be risky not based on a lack of information or a market structure that doesn't work as it didn't on May 6th. Or because there is fraud or Ponzi schemes or other market abuses. So, I actually think we very much share the same goal and have slightly different perspectives about how to get there. Part of this rule-writing process has been about bringing so many perspectives through thousands of comment letters and hundreds of meetings together to help inform us about how to get that balance right.

Chairman BACHUS. Sure. And I appreciate that. I think your job is to prevent fraud and misrepresentation; to have markets that operate with integrity but not to take the risk out. Because with risk, can come reward. And if you try to take that out, it is an impossible venture.

Ms. SCHAPIRO. I absolutely agree.

Chairman BACHUS. Thank you.

Chairman GARRETT. The gentleman yields back.

Mrs. Maloney?

Mrs. MALONEY. Thank you, Mr. Chairman.

And welcome, Madam Chairman. I really agree very much with the gentleman from Alabama that we need to make it a priority to put Americans back to work. That is the priority. But we have to understand that this financial crisis which by all accounts and from every economist points to the cause as coming from huge swaths of the financial industry not being regulated at all, or de-regulated. And this crisis has cost this country \$18 trillion.

After the Great Depression, Congress put in place three major reforms: the FDIC; Glass-Steagall; and the SEC. It was after Glass-Steagall was dismantled and when huge swaths of areas that the

SEC regulated were deregulated principally in energy derivatives, that we got this financial crisis.

So I would argue that balanced and fair regulation can preserve jobs, grow our economy, and is very, very important. So I feel that we need to implement Dodd-Frank in order to preserve economic growth. I think every American would be pleased to have 60 years of economic growth, which is what we had after the crisis of the Depression and the reforms we have put in place.

I would like to ask you—you mentioned the equity market structures; and I know that you came out with proposed rules roughly 2 years ago. But I haven't seen any activity in the market structure since then. And this may be an issue on which we will hold hearings. It is certainly an area that many of my constituents are concerned about and some feel that our current market structure is outdated. So, what are your plans for moving forward on market structure proposals?

Ms. SCHAPIRO. Since the Flash Crash of May 6th which heightened everybody's awareness of the fact that market structure is actually an important issue for capital formation as well as investor protection, we have done a number of really important things. We put in place single stock circuit breakers so that trading in a stock is paused for 5 minutes if a stock moves more than 10 percent over a 5-minute period, as a way to prevent the kind of dramatic decline we saw in good stocks on that day for no apparent economic reason.

We also are working on market-wide circuit breakers that would halt trading across all the equity and derivatives markets based on certain price moves. We also banned naked access to the market-place, which now requires that customers go through a broker-dealer's risk management before they can put orders into the market. We eliminated stub quotes. We put out clear rules about when trades would be broken, and a number of other—

Mrs. MALONEY. Since my time is limited, I would like to go to the statement that you made on the Flash Crash in May of 2010, that it took the SEC 5 months to figure out exactly what happened and everyone involved agreed that 5 months is just too long.

So I was concerned about your walking away from your determination to get real-time data in market tracking and I would like to put several articles in the record concerning this, and I would like to find out exactly where you stand on this: the idea for a database. Do you still support the database? And is your database part of the Office of Research that was part of Dodd-Frank?

Did you just drop the real-time element of it, or the entire idea? And did you ever do an RFI to see if the technology was out there to be able to do it in real-time and get real comparative costs?

Ms. SCHAPIRO. We are going forward with the consolidated audit trail. As you point out, there is no single comprehensive audit trail that exists today. That is why, with heroics, it took 5 months for the SEC and CFTC staff to reconstruct trading from May 6th. That is just not acceptable, from my perspective, for the world's largest capital markets.

I hope the consolidated audit trail proposal will go to the Commission for a vote in the near future. We are likely to not require real-time reporting. The costs of that are extraordinary, and the benefit is limited.

Mrs. MALONEY. Madam Chairman, would this just be for the SEC or is this part of the total research project for—

Ms. SCHAPIRO. No, this is—

Mrs. MALONEY. —Office of Research?

Ms. SCHAPIRO. This is the SEC undertaking to reconstruct trading in the equity and options markets. We would hope eventually it would cover the futures markets as well.

Mrs. MALONEY. I think my time has expired. Thank you.

Chairman GARRETT. Thank you. The gentlelady yields back.

The gentleman from Arizona is recognized.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

Madam Chairman, why don't I do a broad-breadth question instead of, as I touched base with you before, where I was going over lots of microissues.

First, in the JOBS Act that now is in front of you, there are a number of implementing mechanics with which you must deal. Can you give me a top line of what is moving and any timelines you know of?

Ms. SCHAPIRO. I will be happy to try.

It is in its early days. I will say the on-ramp provisions were all effective upon enactment, but that still required that the SEC staff publish guidance and answer lots of the questions we have been getting. We did all of that within the first week of the bill being signed. And we have received two confidential IPO filings already and one bank is already coming to de-register.

With respect to Title II, the general solicitation, we are required to do rulemaking there. The deadline is 90 days. With respect to general solicitation, we are required to do rulemaking within 90 days. That is going to be very, very challenging because the requirement that purchasers be verified as being accredited will raise a lot of difficult issues about, "What does that verification process look like?"

Crowd-funding rulemaking is required within 270 days. And I will say for general solicitation, crowd funding, regulation A and 12G, we have two rulemaking teams already assembled. We were already doing some of this work on our own initiative to try to facilitate some capital formation issues before the JOBS Act was passed. So we have just slipped those people into these new roles.

In crowd funding, we have to deal with an intermediary registration system if a funding portal, not a broker-dealer, is going to be utilized and there are issuer disclosure requirements that we will have to develop.

Mr. SCHWEIKERT. And to that point—and I don't want to stop you—but to that point, any window of timeline there?

Ms. SCHAPIRO. As I said, the rulemaking is due in 270 days. I don't know what the staff's best estimate is, but I would be happy to try to provide that for the record.

Mr. SCHWEIKERT. If part of it is—I literally have dozens of folks, particularly from Arizona, who are just giddy about both the on-ramp and also some of the crowd funding and some of the opportunities here. And I keep ginning them up that, "Hey, it is coming; continue to do your work and get your mechanics laid out." So—

Ms. SCHAPIRO. We have already opened e-mail comment mailboxes, so we are actually already getting comments on what people

think are important features of these rulemakings. And I think that is going to be informative to us.

Reg. A, which extends the offerings up to \$50 million in a 12-month period, will also require rulemaking, although I think that is a much easier lift and the thresholds of shareholders for reporting under the 34 Act also requires rulemaking; but again, I think, not nearly as complicated as potentially crowd funding and general solicitation are.

Mr. SCHWEIKERT. Any discussions from counsel or around you in regards to—I guess the proper term is decimalization moving to—for lightly traded securities?

Ms. SCHAPIRO. My recollection is that the statute requires us to study that issue and so our economists are setting out the terms of that study now.

Mr. SCHWEIKERT. Okay.

To sort of leap to one of our favorite subjects here—and I know you have already actually touched on this a bit—give me a top line where you see us moving right now in the discussions on money market funds.

Ms. SCHAPIRO. I would be happy to.

And I just want to add on the JOBS Act, within a day after it was enacted, our staff did a Web cast for 1,000 people to explain the terms of the Act and how we expected it to operate and interact with existing SEC systems.

Money market funds—we could talk for a long time about that issue, and I know it is of interest to a number of Members. The staff is working on some proposals for the Commission to consider that would seek to try to bolster the resiliency of money market funds and finish the job that effectively was begun in 2010 when we did a lot of reforms. They were important reforms. I think they are judged to have been successful with what they were designed to do, which was to ensure that money market funds had sufficient liquidity to meet redemption requests. And we saw in the summer, with all the volatility in Europe, that they in fact did have sufficient liquidity.

What those rules did not do is protect against a default by money market—defaults on paper held by a money market fund as we saw in the Reserve Fund breaking the buck.

Mr. SCHWEIKERT. Mr. Chairman, I know we are out of time, but this is one of those occasions where my great concern is, we did have, what was it, two funds that ultimately broke the buck?

My fear is we do something that damages rates of return in those funds for so many investors, so many communities, so many pensions. So it is trying to find the rational balance of where we stay safe, where we don't also create a cascade of lower returns for lots of folks for decades to come.

Mr. Chairman, I yield back. Thank you, sir.

Chairman GARRETT. Thank you. The gentleman yields back.

Ms. Moore is recognized for 5 minutes.

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

And you know, I, of course, would like to pursue the same line of questioning as my colleague, Mr. Garrett, on the money market funds. I do want to commend you, Madam Chairman, for the reforms that you have made in the money market funds, these re-

forms. But I am concerned that the proposals that your staff may be reviewing now; I am just sort of perplexed as to how you came to the conclusion that this might be the most expedient thing to do?

I don't see how floating the net asset value will continue to retain the liquidity for the customers. And I fear that municipalities, for example, will really rely on this instrument—won't even be able to use it if you float it.

It certainly has been a very valuable instrument for liquidity for many companies and municipalities and I don't understand how sort of a pseudo margin requirement would operate and more importantly, I guess I am wondering that if there were customers who sort of fled money market funds because they would not be as attractive as a short-term investment, a place to just sort of park maybe your payroll or something.

What would happen with the \$2.5 trillion in funds that might make their way into banks? Wouldn't that increase some of the systemic risk that banks might have? I think a lot of banks don't even want the flood of \$2.5 trillion in the banking system.

So I am concerned about the rationale for these new proposals.

Ms. SCHAPIRO. Congresswoman, let me answer that. Maybe I can explain and bring multiple answers to your many questions by doing this.

But at the end of the day, what motivates this is a desire that the taxpayer never be on the hook again for these instruments as they were in 2008.

The Reserve Fund—

Ms. MOORE. But the taxpayers weren't on the hook.

Ms. SCHAPIRO. Oh, they absolutely were on the hook. The Treasury had to step in with a guarantee program; the Fed had to step in with a liquidity facility. There was a \$62 billion fund called the Reserve Fund that held just \$785 million of Lehman Brothers paper.

On the day that Lehman went into bankruptcy, Reserve experienced a run, \$40 billion of shares were—

Ms. MOORE. Right.

Ms. SCHAPIRO. —in 2 days.

They quickly depleted their cash and they began selling securities, further depressing prices in the market. That run quickly spread to other money market funds and during that week, investors withdrew \$310 billion or 15 percent of all money market fund assets.

Those money market funds depleted their cash and they sought to sell portfolio securities into, again, an illiquid market.

Ms. MOORE. We paid out like \$0.99 on the dollar to—

Ms. SCHAPIRO. On Reserve, after years of litigation.

But the point is the run spread quickly to the rest of—we call it neighborhood risk—the money market fund community—

Ms. MOORE. I keep—

Ms. SCHAPIRO. —and it only stopped when the—

Ms. MOORE. Madam Chairman, I am just afraid of my time—

Ms. SCHAPIRO. Okay.

Ms. MOORE. I just still want to make sure that you carry this in a direction that I want.

I do understand it. I think that the reforms that you have made really did address that. With respect to requiring greater capital requirements and I am just concerned—so go on.

Ms. SCHAPIRO. The run was only stopped because the Treasury stepped in and put a guarantee program in place. But the collateral consequences were not just the run on money market funds, but the short-term credit markets froze up completely, commercial paper issuers had to draw down on their backup lines of credit, and that put additional pressure on bank balance sheets.

Ms. MOORE. Madam Chairman, I just want to make sure—I understand that. I want you get to the question that I asked about the—what impact will this have when the money market funds no longer serve—for example, if we can't serve municipalities, they may not even be able to use a fund that is structured the way it is currently being proposed.

Ms. SCHAPIRO. There are certainly alternatives to money market funds and whether or not the Commission adopts a capital requirement or a floating net asset value, money market funds will continue to exist and will be an option for many, many investors.

Other options include bank accounts, CDs, direct Treasury or other government obligation investments, and direct commercial paper investments. But I think what is important here is that we will do analysis accompanying any proposal that we might put out that will talk about the range of alternative investment products that could be considered: What are the tradeoffs in terms of risk and yield and liquidity? The extent to which any reforms we propose could shift money market fund investments into alternative products; what the impact of those shifts will be.

We will estimate the best we can the operational costs and competitive impacts of anything we do. We will discuss the tax implications.

We will have a full-blown analysis. My guess is that this will have a very vigorous comment and debate process follow it, then we will make a decision about whether this protection of the system from a destabilizing and potentially devastating run is worth the cost of changing what the money market industry currently looks like. Those are hard, hard questions and I am not belittling them in any way. We recognize them, but I also think that they are important issues that we, as a regulator and with responsibility for the economic system and systemic risk, have to be willing to at least talk about.

Chairman GARRETT. Thank you.

Ms. MOORE. And thank you for your indulgence, Mr. Chairman. Chairman GARRETT. I recognize the gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman.

After listening to one of my colleagues earlier, I am again reminded of Santayana's famous admonition that, "Those who do not learn from history are doomed to repeat it." And until we learn the lesson of history that when Washington, D.C., decides to lower underwriting standards and effectively mandates, cajoles, incents and arm-twists financial institutions into loaning money to people to buy homes they cannot afford to keep, then I fear for future financial crises.

I would also note that, with the possible exception of the practice of medicine, I am not sure there was a more regulated industry prior to 2008 than the financial services industry; piling on more regulation on top of old is not necessarily a solution to the challenges that are before us.

Madam Chairman, I want to follow up on comments that our full committee chairman made, Chairman Bachus. I believe you know this, and I am heartened by things that I have heard you say today about balance, about the purpose of our capital markets. But I also recall that I find myself agreeing with about 80 percent of what our President says. I just end up disagreeing with about 80 percent of what he does.

And this goes to the whole question of economic analysis, which is really having a cogent defensible jobs impact statement to rule-making. I have to tell you, whether I am talking to Fortune 50 CEOs in Dallas, Texas, where I reside, or good, honest, hard-working small business people in the rural areas of the Fifth District of Texas, they cite the red tape and regulatory burden coming out of Washington as the number one impediment to job creation, at a time when you know our economy is hugely underperforming.

And so, the first question I have—and there is not much in Dodd-Frank I am fond of, but it is the law of the land. Much of it you have to implement. So my question is this: Since the passage of Dodd-Frank, how many additional employees have been added to the SEC? And what is the breakdown between attorneys and economists?

Ms. SCHAPIRO. I don't have an exact number on the breakdown between attorneys and economists. I would be happy to try to get that information for you. I think it is important to remember that we are also a law enforcement agency. And that requires that we have people who can go to court and try cases and conduct investigations.

I will also say that we have had the largest ramp up in economist staff under my tenure, and, I think, of almost any time in the agency's history. We have 24 economists just working on rule-writing, and we have many more economists who do litigation support, risk analysis, quantitative modeling, and so forth. We are hiring 20 more economists right now, and have offers outstanding to 17 recent Ph.D. candidates, and we have asked for 20 more in Fiscal Year 2013—

Mr. HENSARLING. My time is limited. I appreciate that. So if you could get the exact number in specific detail—

Ms. SCHAPIRO. I would be happy to provide you with that.

Mr. HENSARLING. —if you could relay that to me, I would be appreciative.

In the remaining time I have—there has been a lot of discussion obviously about money market funds, so I don't want to belabor the point. Clearly, there is concern here. And I guess, Madam Chairman, there may be something to what you are doing. Many of us have open minds.

But at the same time, we are not sure, given the recent changes that have been made, that there has been a really thorough study on what the impact is going to be on the investment community, whether or not the new additions to the rules have had a chance

to really be assessed. And so, there continues to be great concern here on a product that, again, many Americans rely on. And so, I would hope that you would be very careful in your deliberations there.

There continues to be a debate with regards to the request for funding of your agency. Now, I think we have had something like a six- to eight-fold increase in the last decade. Clearly, you have outlined a number of challenges. As you are aware, an independent management study was part of the Dodd-Frank Act.

And as I understand it, on March 30th, the SEC issued a report of the implementation of the SEC organizational reform recommendations, where it said, "Staff and management time to devote to this initiative will continue to be in short supply, and in future phases of implementation are likely to require levels of funding that must be directed at other agency priorities at this time."

Again, given some of the criticisms of the U.S. Court of Appeals with respect to the proxy access rules, certain management challenges with respect to leasing and other matters, I guess I have the question—I don't know if you are pushing back on the conclusions of the management study, or you just simply don't see it as a priority, whether I am interpreting this correctly? But many of us have great problems in simply putting more money into a vehicle that in many respects may not be working.

Ms. SCHAPIRO. Congressman, I am not arguing with the recommendations at all. In fact, we have made a lot of progress. A number of them have been, in fact, implemented, and we are continuing to do so. All we are trying to say there is that BCG estimated it would cost \$45 million to \$55 million to implement all of those recommendations over a 2-year period. We don't have that kind of money to spend on this. We don't think that is an appropriate amount of money to spend on this. So we are going to take these recommendations in chunks.

And so, we have done a number of things. We have redesigned our information technology group. We have implemented a continuous improvement program that is identifying cost savings. In fact, over \$8 million in cost savings was identified very recently. We are restructuring different operations. We have recalibrated the relationship with SROs so that our reliance on them is a leverage point for us. We have implemented a new performance management system. We are doing strategic hiring, as Congressman Royce mentioned.

But we are going to focus on these in increments while work continues on all 17 groups of recommendations that came out of BCG. And we are only going to put supplemental contractor dollars to workforce planning initiatives and data governance initiatives until those are completed. And then, we will do more of them while we continue to do things like look at our regional office strategy and some of the other ongoing work streams.

So we are moving ahead on multiple fronts, but we also have an enormous amount of work that Congress has asked us to do, whether it is Dodd-Frank or the JOBS Act, and management attention is in a bit short supply.

Mr. HENSARLING. I yield back.

Chairman GARRETT. The gentleman yields back.

I believe Mr. Green actually has been here since the beginning. So—

Mr. GREEN. Thank you, Mr. Chairman.

And I thank Chairman Schapiro for appearing here today as well.

My intelligence indicates that in 2005, you had approximately 19 examiners for each \$1 trillion managed by investment advisers. And today, you have approximately 10. Is this correct, Madam Chairman?

Ms. SCHAPIRO. The magnitude is about right. I am not sure of the exact numbers. But, yes, we are only now back at our 2005 staffing levels overall for the agency.

Mr. GREEN. There is also an indication that broker-dealers have increased from 95,000 in 2005 to 160,000 today. Is this generally in the ballpark as well?

Ms. SCHAPIRO. That would be broker-dealer branch offices?

Mr. GREEN. Yes.

Ms. SCHAPIRO. The actual number of broker-dealer firms is about 4,500, I believe.

Mr. GREEN. 4,500?

Ms. SCHAPIRO. But 160,000 branch offices.

Mr. GREEN. Yes. Is it fair to say that with these increases, you do need additional cops on the beat?

Ms. SCHAPIRO. We do. The markets are not only extraordinarily more complex, but they are growing rapidly. New products are devised and introduced all the time. We have new responsibilities with respect to over-the-counter derivatives, with respect to municipal advisers, private funds and hedge funds and so forth that have registered, and new credit rating agency responsibilities.

We are trying to deploy the best technology in the SEC's history to help us manage all of this burden. But, we do need more examiners and we do need more enforcement staff.

Mr. GREEN. Much has been said, and I agree with much of what has been said, about overregulation. But I do think that you should take just a moment and give us some indication of what can happen if we have underfunding such that you cannot properly police the consequences of underfunding. Would you speak briefly on the consequences, please, of underfunding?

Ms. SCHAPIRO. Sure. I think there are four broad categories of problems. One is that we won't adequately staff our mission-essential functions, like going into brokerage firms, mutual funds or investment advisers and examining their activities to ensure that they are treating customers fairly. And we won't have the resources to bring all of the fraud cases and stop the Ponzi schemes that we should.

Mr. GREEN. For just a moment, do this. Elaborate on what happens to market integrity and investor confidence when there is a failure in the system because of underfunding.

Ms. SCHAPIRO. I can give you a very specific example.

After May 6th, the Flash Crash, when we saw that our market structure failed very badly, there were net outflows from equity mutual funds by investors for about every single week for about 6 or 8 months after that period. Investors had lost confidence in the integrity of the marketplace and its ability to function fairly.

We see investors harmed by an enormous number of frauds to very devastating consequences. And that stops them from ever investing again, and that takes that capital out of the system and away from companies that can use it to create jobs and to grow their businesses. So, a failure to enforce the securities laws has real concrete, on-the-ground ramifications for investors who are cheated or defrauded. It has real consequences for our ability to oversee the marketplace when we don't have adequate funding.

And also, it has real consequences for businesses that don't want to face regulatory bottlenecks. If they come to the SEC and say, "I want an exemptive order in order to be able to offer a new exchange-traded fund," and we don't have the staff and the resources to devote attention to that exemptive order, businesses are held up from doing what they want to do as well.

Mr. GREEN. As I close, it is a difficult position that you are in, because you have a big job to do. It is huge.

If you are not properly funded and we have some sort of breakdown—and I am trying to be polite with my language—you will be accused of not doing your job. And many times the reason that things can't get done is because you don't have the resources to do these things.

So it puts you in a very difficult position. You, on one hand, have to politely ask for the funding, understanding that if you don't get it, there can be consequences. But it is difficult for you to talk about the consequences, because you don't want to insult the people that you have to ask to fund the agency.

And I have great sympathy for the position that you are in. I do hope that you can continue to make the case for the need for funding and the consequences of underfunding. I think overregulation is without question a matter to be considered. But underfunding is also of paramount importance and I thank you for making the case.

Chairman GARRETT. The gentleman yields back.

Mr. Pearce is recognized for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

And thank you, Madam Chairman, for being here and answering the questions. On page 11 in your testimony, you talk about investor confidence and the fairness of the financial markets. And so I kind of want to pursue the information on MF Global.

Coming down into the decision on the bankruptcy there was an option to go one direction to Chapter 11, which there are nuances that seem to favor creditors. And then the other option was to go to Chapter 7, which seemed to have nuances that favored customers.

So who made the decision that it—I previously questioned Mr. Harbeck with SIPC, the CEO, and he told me that he was notified by a member of the SEC Trading and Market Division at 5:20 a.m. that, "Things are really rapidly deteriorating at MF Global." So at 5:20 in the morning, Mr. Harbeck was informed that the decision had already been made. Who made that decision?

Ms. SCHAPIRO. Congressman, my understanding, and I will be happy to verify this for you, is that with respect to the holding company, the decision to go into bankruptcy was made by them and their management. The SEC staff made a—

Mr. PEARCE. Who decided that it was going to be selected as a security firm rather than a commodity trading firm? That was a pretty key little point.

Ms. SCHAPIRO. The SEC staff made a recommendation to the CFTC Chairman and to me that the broker-dealer, the dually registered Futures Commission merchant broker-dealer be put into SIPC.

Mr. PEARCE. Which would mean that—so that we are going to go and we are going to favor the creditors rather than the customers, right?

Ms. SCHAPIRO. Not under SIPC, no. And SIPC is required, when it becomes clear that a brokerage firm is not capable of meeting its obligations to its customers—

Mr. PEARCE. Yes, but—

Ms. SCHAPIRO. —and SIPC—

Mr. PEARCE. —proceeding as a Chapter 11, if I could interrupt—proceeding as a Chapter 11 allows them to continue to try, doesn't it?

Ms. SCHAPIRO. But that is not at the broker-dealer level. That may have been at the holding company level. At the broker-dealer level, once it is clear they can't meet their obligations to their brokerage customers under SIPA, the appropriate course is the institution of a SIPC proceeding.

Mr. PEARCE. So that decision was again made by whom?

Ms. SCHAPIRO. It was a recommendation by the SEC staff to—

Mr. PEARCE. You all were in the room watching the progression of MF Global. When they began to dip down and use those customers' segregated funds, did that qualify as misconduct?

Because I am reading in the second paragraph on page 11 there that you were to act quickly to halt misconduct. Is that misconduct when MF Global began to reach down and use that money?

Ms. SCHAPIRO. I have to say that I don't want to prejudge any potential enforcement action by opining upon whether they violated the law.

Mr. PEARCE. So you think that it is okay for—

Ms. SCHAPIRO. No, it is never okay to utilize customer assets for the—

Mr. PEARCE. Okay, so they were doing it. It says here that you are to act quickly. That is your testimony. It says, "We are going to act quickly to halt misconduct." And you are saying it is never appropriate. Why didn't you step in and stop that?

Ms. SCHAPIRO. Congressman, if I could just point out, there were only 318 securities accounts at this firm. There were 30,000 futures accounts. We were not the regulator or primarily looking at—or looking at all at—what was happening with respect to the futures segregated accounts. That would have been—

Mr. PEARCE. But you have an input into the room; so you have the guy who worked for Goldman Sachs sitting there in the room, Mr. Gensler, who later recuses himself. Did you as the SEC express concern about who the CFTC had in the room; that you had a guy who was really deeply embedded with the people who are in the process?

I think that on October 27th—I think Goldman Sachs actually made a large purchase. So you have Mr. Gensler sitting in here,

who previously worked for Goldman. They make a large purchase of securities. They didn't even bother giving the money to them.

So MF Global is starving for cash and surely—you said your law enforcement agency—surely law enforcement doesn't stop and say, "I am only in charge of law enforcement for my 318 firms?" Somebody has to be blowing the whistle here.

Ms. SCHAPIRO. Of course, I agree with you. And the SEC, the CFTC, the FBI, and the U.K. Financial Services Authority are all heavily engaged, along with the trustee in bankruptcy and the trustee in SIPC, with investigating exactly what happened and what went wrong in this firm.

I raise the point about there only being 318 securities accounts because it is a very tiny part of what happened here as compared to the futures side.

So the primary regulator there was the Chicago Mercantile Exchange—

Mr. PEARCE. If I can take back my time, I need to make one more comment.

From this perspective, I see all the regulators sitting in a room watching the thing turn upside down. You have 36,000 hog farmers and dairy farmers and people out here who have their money at stake. They would be the 99 percent.

I see regulators which allowed Goldman Sachs to come in and buy assets; George Soros to buy assets at deeply discounted prices all the while saying that, "We are there to stop misconduct." Watching people dip into the customer trading accounts without securitizing it on the other end. For 4 or 5 days, the regulators sat there.

We talk every day in this Administration about fairness to the 99 percent. But when I see the actions, I see things that look desperately like the 1 percent got much more fair treatment than the 99 percent.

Ms. SCHAPIRO. Congressman, let me just say that if there are violations of the law here, we will pursue them with as much vigor and force as we possibly—

Mr. PEARCE. I hear that, but the last time we asked, nobody had even bothered talking to Mr. Corzine. Mr. Corzine was the one at the helm. Nobody had even bothered talking to him.

I yield back, Mr. Chairman.

Chairman GARRETT. The gentleman yields back.

Mr. Lynch is recognized for 5 minutes.

Mr. LYNCH. Thank you Mr. Chairman.

And Madam Chairman, thank you very much for coming to this committee and helping us with our work.

I do want to follow up on the line of questioning that was being conducted by Ms. Moore previously regarding the possibility of the proposal of the SEC going to a net asset value standard for short-term money market funds.

And I understand that about 57 percent of the short-term municipal debt is currently being held in these short-term money market funds.

As you well know, in many of our districts, State and local governments are in difficult straits. And I am wondering how you see the proposal to go to a NAV standard? What that will do to munic-

ipal markets? I am very concerned about that. And I just wanted to follow through your thinking on that?

Ms. SCHAPIRO. Absolutely. This is an area of concern for us. And—

Mr. LYNCH. I would be happy to hear that.

Ms. SCHAPIRO. And I should say—and you may not have been in the room when we began this conversation—we do not take this on lightly, this whole area of money market fund reform.

We did a set of changes in 2010 we think were very important and very helpful to bolster the resiliency of this market. It is a \$2.5 trillion market. We understand it is important. We understand why people love it. The risk isn't priced into the product.

But, I also believe it creates real systemic risk and the potential for the taxpayer to be on the hook again as they were in 2008 when the Reserve Fund broke the buck. That said, there are lots of important issues to explore here. One is the use by municipalities of money market funds and what kind of cost-benefit analysis we can do around that issue to understand what their alternatives are and whether or not just having a floating net asset value or perhaps a capital requirement would in any way dissuade them from continuing to utilize this product. And we are having those conversations.

Mr. LYNCH. Let me just jump in there because I don't want all my time to be—I have another question.

But, if you look at the whole market, it is probably closer to \$6 trillion. I know that you know the very short-term is probably \$2.5 trillion to \$3 trillion, but if we move that money out of short-term money market funds, it is like to go into banks that we are trying not to get bigger.

We don't want these banks to get even bigger. But I think that might be the perhaps unintended consequences of what you are proposing here. Or going to hedge funds or some other alternative, as you—that really presents another set of risks that I think we may not be anticipating.

Ms. SCHAPIRO. There no question that each alternative involves tradeoffs, whether it is less yield or more risk. And, we are currently evaluating survey data from corporate treasurers, including those who actually don't use money market funds, to look at how they currently allocate their portfolios.

I will say for the corporate treasurers who don't use money market funds for cash management, the bulk of their assets are actually in government securities; although a significant amount are in bank accounts.

But, these are important issues and they are issues we will be pursuing as we try to formulate a potential approach here.

Mr. LYNCH. I just ask for caution; that is all.

Ms. SCHAPIRO. Absolutely.

Mr. LYNCH. I really am concerned about this, especially with respect to the municipal markets here.

Ms. SCHAPIRO. We have heard the concern, believe me.

Mr. LYNCH. Okay.

Ms. SCHAPIRO. I have been the subject of lots of vitriol about even raising this issue. We have done a President's Working Group report that laid out a series of options. We have held a roundtable.

We have had hundreds of meetings and comment letters. And we haven't even put out a proposal yet. So—

Mr. LYNCH. Okay.

Ms. SCHAPIRO. —we will proceed with great deliberation, I assure you.

Mr. LYNCH. All right. Thank you for that.

The other question I had is, back in January 2010, the SEC issued a concept release on restructuring U.S. equity markets.

Mr. Capuano and I recently asked for some response to that. I know you have moved to put into effect the proposals and the concept release and you have not done that yet. And we are still dealing with a fair amount of volatility in market structure, such as opaqueness and a high percentage of canceled orders.

I guess what I am asking you is, do you foresee the SEC putting out a proposal on the concept release any time soon?

Ms. SCHAPIRO. We have done quite a few things in the market structure area already—single stock circuit breakers; banning naked access to the markets.

We will shortly, I hope, approve a new proposal for a limit up, limit down that will not allow orders outside a specified range to even be entered into the marketplace, hopefully helping to stem some of the volatility. And I hope that we will shortly propose and adopt market-wide circuit breakers that will be keyed across the equity options and futures markets, and if we have very dramatic moves in the marketplace.

That said, there is unfinished work in the market structure area, particularly with respect to high frequency trading.

Mr. LYNCH. I just want to add that I know you are working at 2005 funding levels. And that is absolutely wrong. So I am not blaming you. I don't think you have the resources you need. But this is an incredibly important issue. And, we have to get this done. So—

Ms. SCHAPIRO. I couldn't agree with you more. To me, one of the most important things the SEC needs to be focused on is market quality and what is contributing to or detracting from market quality.

Mr. LYNCH. All right.

Thank you, Mr. Chairman. I thank you for your indulgence.

Chairman GARRETT. Thank you.

Mr. Royce is recognized for 5 minutes.

Mr. ROYCE. Thank you.

Chairman Schapiro, it is nice to see you today.

As you know, the Department of Labor is currently working on a proposal to revise the definition of fiduciary as it relates to the provision of individualized investment advice for a fee, which the Department might release this summer.

And officials at the Department have made a number of public comments about how they are working with the Commission and how they are working with other Federal agencies, I assume Treasury and the CFTC and so forth, to mitigate the impact that the revised definition will have on the regulations being enforced by the other agencies.

Is there a concern at the Commission that the next proposed rule issued by the DOL will have implications beyond fair jurisdiction and implications for your jurisdiction?

Ms. SCHAPIRO. It is a great question. And we have had a number of conversations with the Department of Labor. Our economists have been, in fact, sharing literature reviews and so forth. And I think there are three primary issues.

One has been resolved, fortunately. And that is whether the disclosures that would be required by swap dealers and swap market participants under Dodd-Frank could turn those entities into fiduciaries under ERISA. And DOL has given us clear guidance in a letter to us and to the CFTC that that will not be the case.

But it leaves the second issue, which is whether there should be a fiduciary duty for investment advisers and broker-dealers when they are giving advice to retail customers about securities, a standard that exists on the adviser side but not the broker-dealer side currently, and whether there is a potential for the DOL fiduciary rule to conflict with that.

We will work very hard to make sure that conflict doesn't occur. Our fiduciary duties are more disclosure-oriented. DOL's are more toward prohibiting certain kinds of transactions by fiduciaries.

The third issue—and I think the one the securities industry is most concerned about—is whether broker-dealers who provide advice on IRA accounts, which I think account for about 40 percent of broker-dealer accounts, would be fiduciaries under ERISA. Today they are not, and I think that is probably the major point of contention in the DOL rulemaking from the perspective of the securities industry.

Mr. ROYCE. Let me ask you—the letter that you received—that is not binding from the DOL. Am I correct, or how do you interpret that?

Ms. SCHAPIRO. I haven't looked lately. It came last fall. I would have to go back and look at the exact wording of it. But, I took it as an official declaration that they do not believe compliance with the business conduct standards under Dodd-Frank rulemaking would turn those dealers into fiduciaries.

Mr. ROYCE. Let me ask you another quick question. The issue I wanted to talk to you about again was the liquidation of Lehman.

In your response previously, you mentioned the Commission staff is implementing the recommendations regarding the trustees' fees. What progress can you share with us? Because the data I have is as follows, and this is on the progress report by LBI.

And so here are the highlights: Unresolved customer claims, \$41 billion; claims that moved from disputed to closed, \$300 million—so that is 0.7 percent of unresolved claims; claims allowed in the period, 0.1 percent of unresolved claims, or \$40 million; fees in the 6-month period for the trustee, the fees are \$92 million; total fees to date, \$733 million. So for every \$1 of claims resolved in the last 6 months, the trustee spent \$0.27.

To get back to a point that I have raised before—at what point do we look at the progress being made, which after those initial back office customer account transfers appears to be minimal, and at what point do we look at this huge bill being run up and question the reasonableness of these fees?

Ms. SCHAPIRO. I think it is a very fair question. And there has clearly never been a more complex liquidation proceeding than the Lehman one under SIPA. As you pointed out, we are looking very closely at recommendations from our Inspector General about our oversight of SIPC. And he put forth, I think, 12 recommendations.

Ten of those have already been implemented. The last two are in the process of being implemented. They required consultation with the Commission. And we are working hard to do closer oversight of SIPC and the trustee's fees. As you know, we don't select the trustee. And in fact, under SIPA, it is required.

Mr. ROYCE. I know, but that brings up another point. And that is why I would like you to monitor this case; because, as you know, this was the trustee that was assigned to the MF Global case as well. To me, it seems that a critical function of a trustee is to manage disputes and settle claims, and I watch the progress on this and it really calls that into question in my mind.

Ms. SCHAPIRO. All I can really say is that we are redoubling our efforts for oversight in this regard, but there are contingencies in this liquidation that are going to take a significant amount of time to resolve. As you know, there are multiple entities involved, multiple jurisdictions involved, and it is enormously complex.

I do think that the litigation with Barclays over the transfer of funds under the Asset Purchase Agreement having been resolved on one level could amount to a substantial payout. The problem is that decision has been appealed to the courts. And again, that will take time.

Mr. ROYCE. Thank you, Chairman Schapiro.

Thank you, Mr. Chairman.

Chairman GARRETT. Thank you.

The gentleman from California is recognized.

Mr. SHERMAN. Thank you.

Madam Chairman, thanks for being here; so many questions, so little time. Many of the questions I raise I will ask you to respond to for the record.

The first concerns REITs. Let me mention that the SEC published—your concept released to revisit the—Congress has provided a carve-out in the Investment Company Act of 1940.

We need REITs to be involved, especially in the California economy. Investor protection is paramount, but I know you will give due consideration to the congressional carve-out of mortgage REITs and the role they play in capital formation.

Now let me shift over to Iran. Companies that do business with Iran—particularly with the Iranian government, particularly in areas of strategic significance—undermine American foreign policy, but also expose their shareholders to risks, namely sanctions.

And, in fact, inside word here from Congress—don't want to provide insider information—those risks are going to increase as Congress imposes new sanctions on those companies, both U.S.- and foreign-based, that do business with Iran and its government.

By a vote of 410 Members of the House, we adopted the Iran Threat Reduction Act. And I would like you to tell us for the record what the SEC has done to further the disclosure requirements of that Act.

I think investors deserve to know which companies are engaged in what kinds of activities with Iran, both to protect themselves financially, but also investors have a right to make investment decisions based on foreign policy concerns as well.

Chairman Schapiro, you were here back in July 2010, and you told us that you would be taking steps to educate investors. And I would like to know what steps the SEC has taken to educate investors about the risks companies face from doing business in Iran and the potential impact of sanctions.

Of particular concern is that the SEC established 4 years ago a Web-based tool to allow investors access to a list of companies which in their public filings with the Commission disclosed that they conduct business in countries that sponsor terrorism.

Now the greatest problem with is that it was effective, and the companies wanted to deny potential investors information about what they were doing. They didn't want to have to face investor pressure. So they pressured the Commission, and they said, "Aha! Your tool is imperfect."

The response of the SEC was to pull the tool and to try to make it even more perfect. And now it is 4 years later and nothing has been done and the tool still isn't up. So I would like to ask what efforts the SEC is making to reestablish this tool so that investors can easily identify those companies that do business in countries designated as state sponsors of terrorism.

Why don't I give you a minute to make some more comments about Iran? And then I will have one other question I need to squeeze in.

Ms. SCHAPIRO. Congressman, I am going to have to get back to you on the tool, specifically. I remember reading about it. It was discontinued by my predecessor. I remember there were lots of issues around it. But I would like to supplement the record—

Mr. SHERMAN. The real issue was that it was effective.

Ms. SCHAPIRO. That may well be the case. I will say—

Mr. SHERMAN. And we did have a promise that it would be restored, and it has been 4 years.

Ms. SCHAPIRO. I will get right on it. I will also say that the staff had been working on a disclosure rule for companies that face material risks from possible violation of sanctions legislation. And that is circulating with the Commission.

But I will say that the Senate appropriations report for this year actually directs us to require disclosure by companies of activities that may subject them to sanctions under the Iran Sanctions Act and the staff is in the process of developing that rule. It is very similar to what the House passed in December, so I can get you an exact timeframe for that, but it is well under way.

Mr. SHERMAN. I look forward to reading that timeframe in your written response. And I hope that you will be moving forward as you promised us in 2010 with an education program.

Finally, I would like to shift to the FASB standards dealing with leases. This could balloon the liabilities reported on the balance sheets of almost every American company.

There are economic studies that show that this rule could do real harm to the U.S. economy. And I would like you to explain what steps the SEC will take to work with the FASB to make sure that

the economic impact of rule changes is reviewed and that the SEC takes a broad policy view as to this possible change in FASB standards.

Ms. SCHAPIRO. As you know, we oversee the FASB, and I am not intimately familiar with all the requirements of the proposed standard, but I will be happy to provide you with information about exactly where it stands and what the Commission's approach will be to that.

Mr. SHERMAN. You come here for 5 minutes and you end up with a lot of work, but thank you very much for your future steps. Thank you.

Ms. SCHAPIRO. Thank you.

Chairman GARRETT. Great.

The gentleman yields back.

Mr. Fitzpatrick is recognized for 5 minutes.

Mr. FITZPATRICK. Thank you.

Chairman Schapiro, a couple of weeks ago, we had a hearing in this subcommittee on the issue of mandatory audit-firm rotation. And at that hearing the chairman of the PCAOB—his name is Mr. James Doty—stated that conducting a cost-benefit analysis related to the PCAOB concept release on mandatory audit firm rotation would be, what he called, “putting the cart before the horse.” And I was wondering if you agreed with that sentiment?

Ms. SCHAPIRO. I didn't hear that statement. I know that under the JOBS Act, the PCAOB will be required to do an analysis and that would be important for the SEC to see in reviewing any proposed PCAOB standard.

Mr. FITZPATRICK. I also, at that hearing—I brought with me a stack of comment letters which would be submitted to the PCAOB, and a vast majority of those comment letters were opposed to the idea of mandatory audit firm rotations so it sounds like you can commit to the committee that the SEC will require—you are saying the JOBS Act requires—

Ms. SCHAPIRO. I believe it does—

Mr. FITZPATRICK. —financial analysis?

Ms. SCHAPIRO. —that it requires some kind of an economic impact analysis.

And, of course, the comment period I think has just ended, maybe this week, on this proposal and the PCAOB has held some public hearings and roundtables. So there will be a lot of information available for the SEC staff in reviewing this potential rule as well as for the PCAOB staff.

Mr. FITZPATRICK. But the Commission had, in the event that the JOBS Act doesn't require they take the position, it is not required by the Act, had the SEC step in and say, we want to see an economic analysis?

Ms. SCHAPIRO. We will certainly want to see an analysis. This is a very major undertaking. This is an issue that has been debated for years—was debated in Sarbanes-Oxley. The alternative that was adopted then was a lead partner rotation and that happens every 5 years and I think that has actually had a positive effect.

So this is not a new issue to us and one which we will be very closely involved in.

Mr. FITZPATRICK. Okay.

And I wanted to follow up on Congresswoman Moore's questions. In 2008, was it only the second time in over 40 years that a fund broke the buck, this is on money markets. As a result, in 2010, the Commission adopted reforms for the money market industry and the reforms seem to be working. So I was wondering, what is the purpose of proposing rule changes at this point?

Ms. SCHAPIRO. Sure. But it is important to note that while the Reserve Fund was one of only two that actually broke the buck, just in the period of I think 2008 to 2009, it might have been 2007 to 2008, over 100 money market fund sponsors had to step in and provide capital or other support so that their money market funds wouldn't break the buck. Now that is implicit; it is not explicit. Investors expected it to happen, but there is no source of capital that is committed or dedicated to money market funds that had to necessarily be there.

And of course in the Reserve Fund's case, they didn't have any capital. Their parent or their sponsor was not in a position to buy out that Lehman paper that caused them to break the buck. The result was obviously a devastating run stopped only by the American taxpayer in the form of a Treasury guarantee program.

We still believe that even though the reforms that we put forward in 2010 have had a very positive impact on money market fund resiliency, it doesn't protect against a credit event that could cause a money market fund to break the buck. Investors don't appreciate that these are investments—these are not cash instruments, they are investments, and when they break the buck, the impetus to run is enormous, and institutions get out first, leaving retail investors in the fund and the losses are concentrated with those remaining investors.

And again, from my perspective, the fact that the American taxpayer had to be on the hook for this \$2.5 trillion industry, at that time it was even larger, is just not an acceptable place for us to be. We have to explore whether there are other things we can do to ensure that that doesn't happen.

We will be very deliberate. We will try to be very thoughtful and very careful about how we go forward with this.

We appreciate that these are valuable instruments for corporate treasurers, for municipalities, for individual investors, but the reality is they have a structural weakness that makes them susceptible to runs that can devastate our entire economy.

Mr. FITZPATRICK. So is this a proposed rule at this point or are you actually—

Ms. SCHAPIRO. It is not even—

Mr. FITZPATRICK. —in the process?

Ms. SCHAPIRO. —it is not even a proposed rule.

The staff is working on a proposal. And it has largely taken the form of either floating net asset value, meaning the price would reflect the actual value of the instrument, or in the alternative, capital requirements so that if one does get into trouble, there is a capital buffer there to absorb the losses, or a capital requirement in conjunction with some kind of minimum account balance for some short term of time.

Mr. FITZPATRICK. Where do the other Commissioners stand?

Ms. SCHAPIRO. You would really need to ask them. Some of them have spoken publicly about it and expressed reluctance. I think they all would say right now they still have an open mind. But we will see and, of course, it will require three votes to become a proposal.

Mr. FITZPATRICK. Thank you.

Chairman GARRETT. The gentleman yields back.

Mr. Miller is recognized.

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

I will have questions for the record or a question for the record about the conflict minerals regulation to sort of certification that conflict minerals were not used in manufactured products.

But the questions I have today are about the valuation of second liens in the biggest banks financial statements.

Obviously, the biggest banks are enormous and they do everything and they operate everywhere. Chase's balance sheet, for instance, is \$2.3 trillion. It is apparent from the fact that several of the biggest banks are trading well below book value that investors are skeptical about the valuation of some of their assets and their liabilities. And one of those appears to be second liens.

They have enormous portfolios of second liens and apparently do not—they continue to buy those at par as long the second liens are performing, but a good many of those second liens are behind firsts that are not performing or behind firsts that are underwater. So those are second liens that may have trouble in their future.

And if a first mortgage ends up defaulting and going into foreclosure, the second lien loses everything, they lose out completely.

Is that something the SEC is looking at as an investor protection the valuation of second liens?

Ms. SCHAPIRO. It certainly would be and our concern obviously would be for the quality and the truthfulness of the disclosure and the disclosure by the banks. I have a recollection, but I would like to clarify it for the record, that we have given guidance in this area in the last 6 months or so to the large banks.

But if I could supplement the record with that information, that would be great.

Mr. MILLER OF NORTH CAROLINA. Okay. You will provide that additional information in—

Ms. SCHAPIRO. Absolutely.

Mr. MILLER OF NORTH CAROLINA. —in a supplemental? Okay.

Ms. SCHAPIRO. But whether we have given guidance, we are seeing in our review of the largest financial institutions—public disclosure on this issue.

Mr. MILLER OF NORTH CAROLINA. And you do agree that second liens are behind even if a second lien is performing if it is behind either a nonperforming first, a delinquent first, or an underwater first, which is essentially unsecured debt, that it should be valued at much less than par?

Ms. SCHAPIRO. I am not an expert so I probably should not say whether I agree, but that seems to make sense to me.

Mr. MILLER OF NORTH CAROLINA. All right.

Mr. Chairman, I will yield back.

Chairman GARRETT. Thank you.

The gentleman yields back.

Mr. Stivers is recognized for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman.

Welcome Ms. Schapiro, and thanks for taking a lot of your time today to talk with us about a few things.

I wanted to follow up a little bit on a few things that have already been asked.

One question that has not been asked is sort of a structural question; a question about harmonization between the SEC and the CFTC which will lead to a bigger structural question in a second. But how are you doing at harmonizing the derivatives rules?

Ms. SCHAPIRO. I think we are actually doing very well.

Last week, we were able to finalize a really important foundational rule which is the definition of security-based swap dealers, major swap market participant, major security-based swap market participant. And for all those dry words, those are really important rules. We were able to do that jointly and get that done.

The next big joint rulemaking will be to define the products: what is a security-based swap and a swap?

Once those are done, the two agencies can go forward with finalizing other rule requirements, some of which will not be identical because there are differences in the markets we each regulate. We are just 5 percent of this multi-hundreds of trillions of dollar market. The CFTC has the bulk of it and with commodity swaps and energy swaps and interest rates, it is a very diverse market for them. For us, it is a much narrower market.

Mr. STIVERS. And do these new agreed-upon definitions conform with the Securities and Exchange Act, because I know that your rules originally did and the CFTC's did not. So I would like it when you conform with the law—let me go ahead and be clear there.

Ms. SCHAPIRO. Yes, I think what we relied on a lot in our security-based swap dealer definition is the trader-dealer distinction that exists, and has existed for many, many years under the securities laws. And I think what the CFTC ultimately adopted as this process went along was much more of that thinking. So I think they are consistent with the Federal securities laws.

Mr. STIVERS. Great.

And I don't know if you have paying attention to what has happened here in the House. The House has passed a couple of bills, one of which is mine, H.R. 2779; and another, H.R. 2682, which we passed with overwhelming majorities.

I know mine got 357 votes, and I think Mr. Grimm's got more votes, so congratulations to him.

My bill deals with their affiliate swaps and how they are treated; and H.R. 2682 deals with end-user exemptions.

Have you come to any agreement with the CFTC with regard to those things? Obviously, the Senate has not moved either one of those bills yet. But with the overwhelming bipartisan majorities in the House, have you come to agreements that will make either of those bills unnecessary?

Ms. SCHAPIRO. I don't know the answer to that with respect to the inter-affiliate transactions, and I would be happy to come back to you on that one specifically. With respect to the end-user margin, that is generally a CFTC issue, because it is the non-financial end-users commodity—producers, agricultural, co-ops, and others—

that are the kind of end-users we have all been most concerned about in this regard. So since we are only regulating security-based swaps, we see this as much less of an issue on our side.

Mr. STIVERS. Sure, okay.

I am certain to run out of time. I do want to ask you—follow up on the questions that the chairman raised earlier about the regulatory system. You came to my office a few months ago, and we talked about the SRO model. Can you give us a few sentences of your opinion on the SRO model and whether it works or not?

Ms. SCHAPIRO. Sure.

With full disclosure, I spent 12 years at an SRO, FINRA, and its predecessor, NASD, so you will understand where I am coming from. But I think in a time when there are constrained resources within the Federal Government, the ability to leverage a self-regulatory organization is really critical. And if you just look at our numbers, we examine about 8 or 9 percent of investment advisers every year.

Mr. STIVERS. I need to cut you off, but I do know you have three models for investment adviser oversight. I hope you will choose the one that includes authorizing self-regulatory organizations, because I think it works.

Ms. SCHAPIRO. You will have to choose that. We don't have the authority.

Mr. STIVERS. Okay. We will get on that. The other thing that you just talked with, I think Mr. Fitzpatrick, about was the floating net asset value and you talked about some options that you have come up with. Have you looked at some illiquid investments in these money market mutual funds?

Have you looked at a regulator choosing a capital requirement that closely conforms with the illiquid investments, because frankly, that is the real issue? And I didn't see that as one of your choices of your three options that you explained to Mr. Fitzpatrick.

Ms. SCHAPIRO. I think the economic analysis that we do will actually look at how big a capital buffer you need under different rate and redemption scenarios, for example. And so, we will try to do some analysis of how you might calibrate appropriately the capital buffer.

Mr. STIVERS. Thank you.

And I yield back my nonexistent time. Thank you.

Chairman GARRETT. I appreciate that.

Mr. Ellison is now recognized for 5 minutes.

Mr. ELLISON. Thank you, Mr. Chairman.

Just a few questions—can you share with us the status of the salary ratio and the rule process? How is it coming? Are we going to make it on track? I appreciate you responding to my letter of March 8th on this topic.

Ms. SCHAPIRO. I am happy to do that. This is not a rulemaking I believe that had a specific deadline, although there is obviously a lot of interest in it. This is the calculation of the median of employees' compensation compared with the total compensation of the CEO.

Our staff is working very hard on that rule. I will tell you that it is a very, very difficult rulemaking. If it was a matter of adding up all the W-2s of employees and comparing that to the CEO, we

could have done it quickly. It is quite a prescriptive provision in the law, and there are very extensive record-keeping requirements in order to come to a total compensation calculation.

For example, right now, companies have to give that total compensation calculation for five named executive officers. They actually compute that manually. That can't be done manually when you have 60,000 or 70,000 or 80,000 employees around the world. There are a lot of questions about, "How do we treat part-time employees in this calculation; what about joint venture employees; what about employees overseas?"

And as I said, the definition of total compensation is quite complex, and includes the necessity of calculating pension benefits and so forth. This is a long way of saying we are working on it. We have had lots of meetings with interested investors as well as public companies and we are working hard to try to get it right in a reasonable way.

Mr. ELLISON. I want to urge you to continue that effort, because it seems to me that one of the problems we get into in this committee, and probably in others, is that we start with a simple idea: What is the ratio of CEO pay to other average employees? It sounds like a simple idea like you said; the W-2 thing versus CEO pay.

And then, people who really don't want to do it, never wanted to do it, and are fundamentally against doing it because they don't want to disclose, come up with an inordinate number of ways to just make it complicated and therefore impossible. And so, I just hope you don't let the complexity of the situation overcome you, and that you keep on soldiering on, because it is important.

And if there is any doubt about that, there was a recent report about how shareholders at Citigroup came out and said, on CEO pay, "We have a problem with this compensation." It is about empowering shareholders. Some people think, why are you interfering? At the end of the day, shareholders and the public want to get a better handle on this issue of compensation for a lot of reasons. And I don't have time to go into all of them.

Let me ask you this question: Will you be able to continue aggressive action to protect investors in capital markets without the budget increase you requested?

Ms. SCHAPIRO. We think the budget increase is really essential, given the additional responsibilities that the agency is taking on under Dodd-Frank and under the JOBS Act. And so, with whatever resources we have, we will work our hearts out to protect investors, to facilitate capital formation, and to make sure our markets operate with integrity.

But we are underresourced to the task that we have been given, and while we are becoming ever more efficient and innovative in leveraging alternatives to do our job, I think it is really critical for this country, and for this economy to have a strong Securities and Exchange Commission.

Mr. ELLISON. And if I may also add, we underfund an agency, and then when a Madoff situation comes up we blame the agency, and then use that catastrophe as proof that the agency is not doing a good job; therefore, a justification to cut it even more. And it is disappointing when that happens. And so I do hope that your budg-

et is fully supported, because of course it is essential that the work you do goes forward.

I did want to ask you a question about the cost-benefit analysis you are required to do with regard to rules. How is that affecting your ability to promulgate rules? Is it undermining, is it helping, is it an aid, is it a hindrance, is it mixed? What are your thoughts?

Ms. SCHAPIRO. We firmly believe a good cost-benefit analysis, an economic analysis, is important to us in informing the policy choices that we need to make in order to do rules that will accomplish what Congress has asked us to do in the legislation. So we are very committed to doing it.

I will say it has probably slowed us down in some cases, that we are doing a more robust, more analytical cost-benefit analysis, although we have always done cost-benefit analyses. We have done Paperwork Reduction Act, Reg Flexibility Act, efficiency, competition and capital formation analysis, burdens on competition analysis.

Of all the Federal financial regulators, we do the most cost-benefit analysis and we are used to doing that. But we appreciate that we need to do it even better, and our new guidance I think will enable us to have everybody working from the same page and do an even better job.

Mr. ELLISON. Yes.

Mr. Chairman, I ask unanimous consent to submit for the record a Bloomberg article, entitled, "Dimon Widens Gap with JPMorgan as Wall Street Pay Slides."

Chairman GARRETT. Without objection, it is so ordered.

Ms. SCHAPIRO. I would add that it is a key reason we need more resources. We are hiring many more economists to do our rule-making.

Mr. ELLISON. Right. We hear you.

Thank you.

Chairman GARRETT. Thank you.

The gentleman yields back.

Mr. Dold is recognized for 5 minutes.

Mr. DOLD. Thank you, Mr. Chairman.

Chairman Schapiro, in May of 2009 Martha Haines, the head of the Office of Municipal Securities, told this committee that establishing an effective registration and examination program for municipal advisers would be easy, because there were only about 260 non-broker-dealer municipal advisers. Clearly, her estimate was inaccurate, as the proposed rule I believe could force thousands of individuals to register with the SEC.

Is Dodd-Frank Section 975 written so broadly that the SEC has no other choice but to capture thousands of unsuspecting individuals as municipal advisers?

Ms. SCHAPIRO. I don't think so. The statute is written broadly, but I think the SEC has the ability to tailor the rulemaking. And as you and I have discussed, I think we cast the net too widely in our proposing release. And when we get to final rules, I think that you will see that we have tailored it quite a bit more.

We have received 1,000 comment letters, so we know that there is deep interest in this issue from a wide range of the community; from engineers and geologists, to accountants, bank employees, and

volunteer appointed officials in municipal entities. There are a lot of people who have weighed in with very good comments on how to tailor the rule more appropriately. And I am hoping that we will be able, at the end of the day, to strike the right balance.

Mr. DOLD. I certainly hope so. And I know that you have told this committee before that you believe, as you just did, that the rule as proposed is far too broad and that the Commission plans to scale back the rule before it is finalized. But can you at least give us some more specific areas where you would like to see it scaled back?

Ms. SCHAPIRO. Sure. For example, the definition of investment strategies is probably too broad and includes activities that don't necessarily need to be regulated by the SEC, such as whether the proceeds of a municipal offering ought to go into a bank account; and whether or not traditional banking and trust activities really need to be covered since those are otherwise regulated entities.

We have received comments. I don't know that I have a view yet on whether the underwriter exemption needs to be broader, because it doesn't include enough activities that are related to underwriting.

I do think that the exclusion for employees of municipal entities should be expanded to include those who are appointed officials. We do not want to dissuade citizen volunteers from serving and the definition excluded those who are elected, but not those who are appointed.

Again, that is an area where I think we can make some reasonable carvebacks, and not do any damage to the goal behind a municipal adviser registration, but also not layer on unnecessary burdens.

Mr. DOLD. I certainly appreciate that. And that was actually going to be in my next question. As we look at 975, it did go through the process of exempting elected officials out, but didn't go through the process of actually exempting out those that were appointed.

And you can just imagine school boards, all these different individuals who are out there across our Nation who are giving of their time to make the communities a better place, and I know you have heard from literally thousands of commenters that this would be a significant disincentive for these citizens to get engaged and get involved, because you would be forcing them to in essence register with the SEC, which you know is a fairly significant process.

Ms. SCHAPIRO. Absolutely.

And it wasn't as though we wanted to capture them. We assumed that they would not be performing the functions that the rule dictates require registration. So it was really a lack of clarity on our part, not making a conscious distinction that elected is out, but appointed is in.

We didn't think appointed would be engaged in the activities that would require registration. We clearly need to fix that.

Mr. DOLD. I think as we take a look through on a number of the different rulemakings—I certainly hope that this can provide some additional clarity, which I think is one of the important things for why we are having this hearing today; is so that we can provide additional clarity.

I certainly hope that you take this back. Because we want to make sure that this is narrowly tailored and that we are not casting that wide net as you talked about before.

Ms. SCHAPIRO. Absolutely. And this is why the comment process is so valuable to us, too.

Mr. DOLD. Chairman Schapiro, thank you so much for your time. I appreciate your being here.

Mr. Chairman, I yield back.

Chairman GARRETT. The gentleman yields back.

Mr. Hurt is now recognized for—

Mr. HURT. Thank you, Mr. Chairman.

And Chairman Schapiro, I want to also join in my thanks to you for appearing before our committee.

I was reminded by the opening statements by some of our colleagues this morning about how funny I think people back home think it is when we congratulate ourselves for doing our job.

With respect to the number of times that you have appeared on Capitol Hill, I think it is worth noting that whatever the failures may or may not have been of the SEC over the years, I think that we can all agree that a lack of congressional oversight has probably contributed to that.

And we in Congress are as responsible for those failures as anybody I think in the executive agency. And I know, based on my observations of you in your job, that you fully understand that.

Again, I appreciate your appearance. I appreciate the time that you spent with me and my colleagues I know on an individual basis coming to make sure that we understand what the issues are, because, good gracious, we need to.

And so I thank you for that commitment. I know you have a tough job and it seems almost perhaps even impossible on some days considering the fact that we are borrowing \$0.40 on every \$1 we spend in this country.

We have diminished resources to be able to do the important work or to provide funding for the important work that you do at the SEC. I was interested particularly during your comments with your hat tipped to capital formation and how we can reduce the regulatory bottleneck that can free up more resources in the private sector for capital formation.

With that said, I would been thinking about the JOBS Act and I know that at least certainly an important portion of trying to reduce some of the red tape so that we can have more resources to create jobs, has to do with the registration process for banks and the deregistration process, and those certain thresholds.

We have banks in my district in Merle, Virginia, the Fifth District, that now will be affected by these new thresholds. And with respect to the deregistration process, it is my understanding that once certain paperwork has been filed, they are immediately terminated from registration but have been informed by the SEC that they will have to continue to file periodic reports with the SEC for a certain period of time, maybe 90 days.

I wonder if you could speak to that, the purpose of that and why that is necessary, and if there is anything that can be done to make it easier for these banks to have that certainty and get through that process more quickly?

Ms. SCHAPIRO. Congressman, I would like to get back to you further on that, but my recollection is that the reason the staff made that judgment was because there are people who are receiving public disclosure about these registered reporting companies that would no longer get any disclosure; therefore, there ought to be a time period where they get some final disclosure so they can make decisions about whether they want to continue to own the stock, in light of the fact that there will not be public reporting anymore.

So yes, they will have the burden a little bit longer after they deregister, but the investors who own their shares will also have the loss of information as a result of the deregistration. So I think it goes to that, but I would be happy to get you more information.

Mr. HURT. It does seem to me that some sort of final report might be in order. But it seems to me to make the periodic reports for the time going forward, for 90 days or whatever, it seems not to be consistent, frankly, with the law—

Ms. SCHAPIRO. I believe it may also be the current requirement pre-JOBS Act. For companies, of course, that go dark before two—just at much lower numbers. But let me come back to you—

Mr. HURT. Thank you.

Ms. SCHAPIRO. —if I could on that.

Mr. HURT. And then the other question I wanted to ask has to do with the registration of private equity companies that you have been very kind to discuss with us, and whether or not your exemptive authority would apply in exempting P.E. companies of any size, certain sizes, from registration. But in particular I wanted to ask you about whether or not the interpretive guidance that I think that you have indicated that you all will be providing.

What is the status of providing that interpretive guidance for the registered advisers that deal with these private equity funds that would make clear that there are differences between private equity and other financial services products?

Ms. SCHAPIRO. Again, I know the staff has been working very closely with the P.E. industry to try to answer their questions and provide whatever relief would be appropriate under the statute and I would be happy to get back to you on that specifically.

I think you also know that we have tried very hard to scale the requirements. For example, the systemic risk reporting for P.E. is only for firms with over \$2 billion under management. And they only file very, very basic information annually.

So we have tried to be very sensitive to the fact that a P.E. fund is different than a hedge fund and we understand that. And P.E. is different than a liquidity fund and different, frankly, than a venture capital fund and our requirements are scaled to the potential risks that they might pose. But I would like to come back to you, if I could, on where they are exactly with the relief.

Mr. HURT. I would appreciate that. Thank you very much.

Chairman GARRETT. The gentleman yields back?

Mr. HURT. I yield back. Thank you.

Chairman GARRETT. I now recognize the gentleman from New York, Mr. Grimm.

Mr. GRIMM. Thank you, Mr. Chairman.

And thank you, Chairman Schapiro. You have been very gracious with your time.

Trying to bring a little continuity—we were just speaking about the JOBS Act. One of the provisions of the JOBS Act I believe brings shareholder limits from \$500 to \$2,000. Just for clarification, is that going to be implemented—is that effective immediately or is that after all the rulemaking when the rest of the JOBS Act is done?

Ms. SCHAPIRO. I believe this requires some rulemaking. But I don't think it is very much rulemaking in this regard, unlike crowd funding which requires much more extensive rulemaking. I am sorry—I am just not recalling the details.

Mr. GRIMM. I will take that as, “After the rulemaking, it will become effective?”

Ms. SCHAPIRO. I—

Mr. GRIMM. Do you want to get back to me on that one?

Ms. SCHAPIRO. Yes, I would like to get back to you because in fact we have had one bank already come in to deregister and we obviously haven't done rulemaking. So it may be that it is immediately effective.

Mr. GRIMM. Okay.

Ms. SCHAPIRO. I am just not remembering exactly.

Mr. GRIMM. That is fine.

In that same vein, my understanding is that it was drafted in a way that it may not include savings and loans. But my understanding is you have the authority within your purview to fix that. Can you or will you fix that?

Ms. SCHAPIRO. We are looking at that. I received a letter about a week ago from a number of savings-and-loans asking us specifically about that issue, so the staff is looking at that.

Mr. GRIMM. Okay. Great.

Let me switch to the Volcker Rule for a second. As written in the Volcker Rule proposal—could treat a mutual fund as a banking entity in limited cases? For example, I think a bank sponsor that has just launched a mutual fund and owns nearly all the shares of the new fund. As a result, the mutual fund itself would have to comply with trading and investment restrictions of the Volcker Rule? Yet that fund, like all mutual funds, will eventually become wholly shareholder owned.

The proposed rule also states that a banking entity is prohibited from having an ownership interest interacting as a sponsor to a hedge fund, private equity fund or similar fund as the agency determines collectively. The proposed rule is called a covered fund.

That term is defined so broadly that it could sweep in a range of investment vehicles, even highly regulated mutual funds. So my question is this: Do you agree that the Volcker Rule should not limit a bank's ability to sponsor, invest, and register investment companies?

Ms. SCHAPIRO. I will say that these are issues that have been raised in the course of the Volcker rulemaking. We have gotten 18,000 comment letters. It is a joint rulemaking among all the financial regulators. We are looking at it very closely, including the prohibitions and the extent to which we have any flexibility with respect to sponsoring funds. I don't have an answer right—

Mr. GRIMM. All right. I will broaden that. Congress' intent, I don't think, was restricting a mutual funds trading and investment activities.

Ms. SCHAPIRO. I think that is probably right.

Mr. GRIMM. Okay. Fair enough.

If we could go back for a second—my colleague asked about MF Global. And you threw out some stats. I think it was 318 securities accounts, I suppose the vast majority being CFTC-segregated customer funds.

Ms. SCHAPIRO. Right. I believe there are 36,000 futures accounts, and only 318 active securities accounts.

Mr. GRIMM. Okay. That is what is bothering me.

That begs the question—when the SEC staff recommended going with SIPC, Chapter 11; when you look at the disproportionate number of accounts, this firm mostly was covered by the CFTC. The vast, vast majority was covered by the CFTC, which would make me lead that the suggestion should have been to let the CFTC have the bankruptcy under Chapter 7.

Ms. SCHAPIRO. SIPC handles the bankruptcy of the combined entity, which was a broker-dealer as well as an FCM.

Mr. GRIMM. Actually, my understanding is that the law says that they have the ability to do so. It is discretionary, which is why you had the conversation in the first place. You wouldn't have needed a recommendation if the law said it has to go under SIPC.

Ms. SCHAPIRO. I don't recall that there was any discussion about—and I could be wrong, and I certainly wasn't in on every conversation—about whether or not to somehow try to separate the broker-dealer piece of this from the FCM piece of it. And of course, the trustee is working mostly to try to—

Mr. GRIMM. No, but here is the problem.

Madam Chairman, here is the problem. Now that it has gone Chapter 11, the segregated fund, the customers have become creditors. They were never creditors. Had it been under Chapter 7, they would have been protected.

Because now they are going to be in U.K. foreign courts, which you have seen with Bear Sterns, you have seen with Lehman Brothers, years and years of litigation. But if you are a creditor, that is fine. You have taken on that risk; but as someone that has the protection of a segregated account—and that goes back to your statement before that part of your mandate is ensuring the integrity and consumer confidence of the markets.

If I am a foreign investor and I am putting my money in an FCM, I am told that money cannot be touched. It is protected. Guess what? The decision that the SEC and CFTC made just turned that upside down because that is not true anymore. Because the monies that were taken out of those segregated funds, unlawfully, however it was done, shouldn't have been done. We understand it shouldn't have been done, but we know it does happen. That is why we have criminal statutes in place. But it does happen. People break the law.

The bankruptcy decision took away my rights as a customer and made me a creditor. Why would I ever invest in the U.S. markets again under those circumstances if regulators can decide by bankruptcy law that now you are a creditor? And that is why I think

that in light of Bear Sterns, in light of Lehman Brothers, we should really be looking at that.

Because those decisions matter, especially when it is 318 securities accounts, which means they really weren't doing much securities business; over 36,000 customer accounts. They were mostly an FCM, and, therefore, the CFTC should have put it under Chapter 7, in my opinion.

I thank you, and I yield back.

Chairman GARRETT. The gentleman yields back.

The gentlelady from New York is recognized.

Mrs. MALONEY. Thank you, Mr. Chairman.

Thank you, Chairman Schapiro. And I hope that your day will get easier from here.

With all that we have been talking about, it is clear that one of the themes becomes management of limited resources, not only from the standpoint of the broad economy, but also from the standpoint of you as head of the SEC.

Even if you were to be granted the entirety of your request, you would still probably be sorely challenged to get accomplished the full slate of things that you have to do just in terms of Dodd-Frank implementation. The Volcker Rule alone strikes me as something that could consume all of your time.

So in light of that, I want to get your broader perspective just on how you are prioritizing. Because it strikes me, respectfully submitted, that you would want to prioritize your tasks really, and guide us accordingly, as those who advise or authorize the funding market impact of the rulemaking that you have to promulgate; the rules that you have to promulgate, including a cost-benefit analysis.

Obviously we have talked a lot about that, recognizing that market participants also have limited resources to bring to bear; the material fulfillment of your prudential role, which Representative Grimm was just referring to obviously in terms of MF Global, which is a prominent case that does shake investor confidence; preventing overt fraud; having the resource allocation to do those things that really were antecedent to Dodd-Frank, that prudential regulatory role.

So I would submit to you that—and I know just about all of us have chimed in about money market funds, but I do submit, with all due respect, that given the reforms that were put into place in 2010, the additional protections, it is not broke at this point.

I haven't devoted any additional resources to that kind of task at this moment, nor would I to the CEO compensation calculations required by Dodd-Frank, which as you note are arcane and abstruse at best, byzantine almost, and take resources away from where we need them to be deployed without any additional information, because clearly those discussions about compensation ratios can be had within existing rules and regulations.

So within that context, how would you propose really prioritizing your menu of tasks over the next several months?

Ms. SCHAPIRO. It is a great question.

I think from where I sit, our number one obligation is to fulfill the mandates that Congress has given to us. And that is Dodd-Frank and the JOBS Act right now. Those are high priority, and

they have been. We have been running at full speed since Dodd-Frank was passed. Now we have the JOBS Act work to do. And those would be two very high priorities.

I have a personal deep interest, and I think it is incredibly important for the future of our country, frankly, that we get market structure issues well in hand. We have done a lot, but there is more to do. There is more to understand about our market structure and whether the rules that govern how our markets operate are still effective and still work, given technology, given globalization, given complexity.

I think we have to continue to prioritize the internal reforms, hiring the new skill sets, bringing in different ways of thinking and doing things, and building our technology. We have four incredibly important technology projects that we are working on right now. Those have to continue to be a priority.

I also think we have to prioritize issues coming out of the financial crisis—and I will disagree with you—like money market fund reform, where a really devastating run was only stopped because the taxpayers stepped in and guaranteed an industry that should never have to be guaranteed by the taxpayer.

So we have to explore those issues. How long that takes us and where we land at the end of the day, I don't know. But I think we have to be willing to have the debate and the discussion. And so, I think those are all important areas for us to be dealing with.

I will also put in the category of financial crisis areas, a new look at our capital rules and our broker-dealer custody requirements coming out of events like Madoff. We try to learn from the bad experiences the agency has had and make sure that we are doing what we can internally to make sure they don't happen again, and where the regulatory regime needs to be bolstered to do that as well.

So that is basically how I had prioritized them. And of course there are a thousand decisions under those broad categories.

Mrs. MALONEY. Thank you, Mr. Chairman.

And I know our time has expired. I yield back.

Chairman GARRETT. Yes, the gentlelady's time has expired.

The gentlelady yields back.

If the Chairman is amenable to staying for another 10 or 12 minutes for just the Members who are here or in the back room, I will go through a proverbial lightning round for about—if we do 2½ minutes each, that is another 15 minutes; because I know you have been sitting there for some period of time.

So very quickly, I recognize myself. The MAP program, Section 967, required of course that an outside look at the SEC, as far as management and proposals for corrections, administratively be done. Two reports have been submitted by the SEC. These basically have been focusing on administrative actions, and this is to my opening statements.

The SEC has spent approximately, from what I see in the report on page 60, around \$16.5 million for outside consulting and staffing. This goes to your question about you all, I am sure you are, working your hearts out here. Isn't this an area where you all—basically you are chief operating officer, should be working their hearts out and not putting this into outside consultants?

Ms. SCHAPIRO. I think they are working their hearts out, but I don't think we necessarily had all the internal skills that were necessary.

Chairman GARRETT. But this is just administrative at this level that they are trying to do.

Ms. SCHAPIRO. Oh, no, but it is not.

For example, it is not administrative to redesign the Office of Information Technology, create an Office of the Chief Data Officer, and implement a continuous improvement program where we have identified savings as much as we can.

Chairman GARRETT. So how much money has been spent and will be spent on outside consultants in these areas?

Ms. SCHAPIRO. My understanding is that to date, we have spent \$8.5 million for implementation plan development, modeling, risk management, and creation of the program office to support the 17 work streams.

Chairman GARRETT. And have the Commissioners—all the Commissioners have not been involved. Only the chairman has. Is that correct?

Ms. SCHAPIRO. I have administrative responsibility for running the agency. The Commissioners have all been briefed on the work streams by the senior staff of the SEC who lead those work streams. That is not led by—

Chairman GARRETT. So you don't think that they should be involved?

Ms. SCHAPIRO. I am happy for them to be—I have a very open door. I am happy for the Commissioners to be involved to whatever extent they would like to be. And I think they have all been briefed. They have all been asked for their input.

Chairman GARRETT. Okay.

And one last question on another area, on ETF and ETF backlog. This goes to the issue about—as far as money needed for this.

I understand you are saying the suggestion is that it is an issue of dollars and cents. They need more money. But Eileen Rominger was I guess giving testimony or information over in the Senate indicating that is not the case, that money is really not the issue, that there are other issues here.

And part of the proof of the fact is that a backlog of ETFs go back over all the way, 4 or 5 years, to 2007. So that would say it is not a money issue. That is another issue. Maybe that is a decision orientation of the department or the agency instead.

Ms. SCHAPIRO. No.

Look, sometimes there are money issues in terms of backlogs being created where industry wants relief and we don't have the people that we can throw at them. For example, we get about 2,000 self-regulatory organizations, including exchange, filings, every year that have to be processed under Dodd-Frank on a very short timeframe. We move resources from other places to do that.

There are a lot of very complex issues with respect to ETFs, particularly highly leveraged—

Chairman GARRETT. In 4 of 5 years, there is some of these—this—

Ms. SCHAPIRO. I would have to go and look at what those specific ones were. I am guessing that the staff does not believe they can

make the public interest finding to approve those. But I would be happy to get back to you on the specifics of those applications.

Chairman GARRETT. Okay. So that may be an issue there as far as what they are finding, as far as the public interest as opposed to a lack of funding, particularly or actually coming up and doing.

Ms. SCHAPIRO. It is possible and it is possible it is a combination.

Chairman GARRETT. Thank you.

Mr. Stivers is eagerly writing down—

Mr. STIVERS. Yes, I am dutifully writing down—before I get to a question, I did want to associate myself with the remarks from Mr. Dold on the municipal advisors rule; hopefully you will redo that to avoid inadvertently capturing a bunch of extra folks.

I also want to strongly associate myself with the question Mr. Grimm asked about savings and loans. Clearly there was no intent in this Congress to allow bank holding companies to move to 2,000 shareholders, but not allow savings and loans. And there may have been some inadvertent drafting that may or may not limit it, but I know that you have the ability, as you actually had the ability, you raised the capital limits from \$1 million to \$10 million over the years but left the shareholders alone.

You actually had the ability as we have talked in my office, to raise the shareholder limit and I hope you will use your discretion to ensure that there is a seamless transition for both banks and savings and loans to that 2,000 limit, the 1,200 to deregister because I think it is really important that we don't change the competitive landscape between banks and savings and loans on capital formations.

But my larger question is something that has not come up much today and that is on conflict minerals. I know that you have worked on some rules and you were talking about—the rumor is that sometime mid this year there will be a final rule and the problem that I know a lot of companies have is that they are forced to prove a negative, which is really hard. And even on trace amounts of minerals, they are potentially forced to go through this.

I know there was at some point some discussion about maybe trying to get some flexibility and latitude on really small, almost minimal amounts of minerals. Do you know if you have come to any conclusion on that, or is there anything that we can do to help you on that?

Ms. SCHAPIRO. I think it is the staff's view that there is not really the flexibility to have a de minimis exception, in fact, because most products that contain these minerals do contain a very de minimis amount.

That said, we are working through an awful lot of issues here; another enormous anxiety, I think, on both sides is whether you believe in the conflict minerals rule as a good thing or not.

We know there is a lot of interest in it and a lot of anxiety and we are trying to work through to achieve the congressional intent, but also to make it as workable as we possibly can.

Mr. STIVERS. I will say before my time runs out—actually, I guess after my time runs out—we all want you to get it right as opposed to do it fast.

Ms. SCHAPIRO. “Fast” is out of the question, I would say—

Mr. STIVERS. Okay.

Ms. SCHAPIRO. —but we are working on “right.”

Mr. STIVERS. Thank you.

I yield back the balance of my time.

Chairman GARRETT. The gentleman yields back.

By the way, I don't know if you saw the 60 Minutes piece this past weekend on Sunday—60 Minutes is on Sundays here—on Lehman's.

I know whenever programs are on Sunday, we will get a call on Monday about them. And the calls in general, with regard to you all, the SEC, were all the folks who were at Lehman who were from the SEC today.

The idea being, “Should they have caught something and didn't”—this was all Repo 105, and we have had some hearings on that issue.

And so, the question is, “Where are the regulators who were actually inside Lehman's, not just the days before, but for months before, and—”

Ms. SCHAPIRO. That was all before my time—

Chairman GARRETT. Yes.

Ms. SCHAPIRO. —so I would have to go back and see who was there and where they are now. I am sure some of them are still with the agency, some of them are really talented people, but they were part of—

Chairman GARRETT. The piece on 60 Minutes—and 60 Minutes is good for it, of course, as you know how 60 Minutes is—

Ms. SCHAPIRO. Yes.

Chairman GARRETT. —raises a question all across. And that was a question—is, “If they missed then, are they missing it someplace else? Are they over at the Federal Reserve today missing someplace else?”

Ms. SCHAPIRO. What I will say is that they were part of a program, the consolidated supervised entity program, which I have testified—

Chairman GARRETT. Yes.

Ms. SCHAPIRO. —about before. It was started and ended under my predecessor.

Chairman GARRETT. Right.

Ms. SCHAPIRO. It was wholly inadequately funded and supported by the agency. They were a small handful of people, I believe less than a dozen, responsible for the five largest investment banks. And it was a voluntary program. So—

Chairman GARRETT. Yes.

Ms. SCHAPIRO. I think one of the lessons of that is that voluntary programs don't work very well and if you are going to take on the regulation of the largest banks in the world, you need more than a dozen people to do it and they need to be adequately trained and have authority.

Chairman GARRETT. The other takeaway that—we get calls from districts on that after the program—was the lack of civil actions either by the SEC or by Justice. And I guess the report that came out was the 2-year—a couple of years ago indicated that perhaps that would have been appropriate.

Would you be able to say whether there is any—

Ms. SCHAPIRO. I—

Chairman GARRETT. —likelihood? Yes?

Ms. SCHAPIRO. No, it would be inappropriate for me to comment on matters that remain under investigation and analysis. But I can tell you that our staff has conducted an independent and extremely extensive investigation of all these issues. They have searched through millions of pages of documents. We have taken testimony of all the key people including members of Lehman senior management, outside accountants. We—

Chairman GARRETT. The fact that you can't testify, does that mean the fact that it is still under review?

Ms. SCHAPIRO. It is still under review, I would say. But I would also add that I saw 60 Minutes. I actually went out right after the examiner's report was issued with the senior team from the SEC and met with Mr. Valukas for several hours to go through all of his findings and details so we would be sure that we had a road map.

Chairman GARRETT. Right.

Ms. SCHAPIRO. But it is clear that, at least in my experience, the illegality of conduct is something not quite as clear cut as it seems to be or is reported to be. And it makes bringing cases extremely difficult.

Chairman GARRETT. Did you ever make a recommendation to Justice, then, on something like this?

Ms. SCHAPIRO. I think on this matter, we talked quite extensively with Justice, as we do on many matters.

Chairman GARRETT. Do you make recommendations to them like go ahead with criminal charges?

Ms. SCHAPIRO. Again, not speaking to this particular matter—

Chairman GARRETT. No to this—

Ms. SCHAPIRO. —but there are certainly cases where we call Justice and say, this is criminal conduct, do you need to bring the case at the same time we are?

Chairman GARRETT. And can you say whether you did that in this case?

Ms. SCHAPIRO. I can't say.

Chairman GARRETT. Okay.

And will you be able to say on—are you able to say on this case or any other case, or any other case when—like made up of all the cases that we talked about here—are you able to say when you finish an investigation—

Ms. SCHAPIRO. Sure.

Chairman GARRETT. —and when we come to you and then you would say—

Ms. SCHAPIRO. Sure.

Chairman GARRETT. —“Our investigation is done and we are either going to investigate or either going to recommend or not recommend”—are you able to say at that point?

Ms. SCHAPIRO. Once we have closed a matter and are not bringing in an enforcement case, we have done that and clearly we have done it with Madoff. I personally have spoken extensively about the issues surrounding the Madoff matter and we have done so in other cases.

Once the case is resolved—

Chairman GARRETT. Yes.

Ms. SCHAPIRO. —there is nothing that prohibits us—

Chairman GARRETT. So it is not—

Ms. SCHAPIRO. —from talking about it.

Chairman GARRETT. —so it is not like sometimes with maybe—I may be mistaken on this, over in criminal area and FBI, they will say they will never tell you what the outcome is if they complete their investigation, they just sort of end them or something like that. You never know whether you are done being investigated by them or something like that is my understanding, at least that is what I hear.

Ms. SCHAPIRO. I think we tend to, too.

Chairman GARRETT. You draw a line—

Ms. SCHAPIRO. I think we do. I couldn't tell you if we do it 100 percent—

Chairman GARRETT. Yes.

Ms. SCHAPIRO. —of the time, but I think we do.

Chairman GARRETT. Okay, I appreciate that.

Ms. SCHAPIRO. Thanks.

Chairman GARRETT. And with that, I only have one item to put into the record, which is an April 24th article entitled, "Lawyer Skewers Boston Fed Chief's Money Fund Comments," by Beagan Wilcox Volz. And without objection, that is entered into the record.

At this time, I appreciate the time and attention and questioning and the answers from our witness, Ms. Schapiro. And I thank you for being here on the 40—

Ms. SCHAPIRO. I don't—42nd, 43rd—

Chairman GARRETT. It all blurs together at this point. I look forward to seeing you here again.

Ms. SCHAPIRO. Thank you.

Chairman GARRETT. Thank you.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to this witness and to place her responses in the record.

This committee is adjourned.

[Whereupon, at 12:46 p.m., the hearing was adjourned.]

# **A P P E N D I X**

April 25, 2012

**Testimony on “SEC Oversight”**  
**by**  
**Chairman Mary L. Schapiro**  
*U.S. Securities and Exchange Commission*

**Before the Capital Markets and Government Sponsored Enterprises Subcommittee and  
Financial Institution and Consumer Credit Subcommittee of the U.S. House of  
Representatives Committee on Financial Services**

**April 25, 2012**

Chairman Garrett, Ranking Member Waters and members of the Subcommittee: I appreciate the opportunity to testify regarding the recent activities of U.S. Securities and Exchange Commission (SEC).<sup>1</sup>

The past three years have been a period of enormous change and challenge for the SEC. The aftermath of the financial crisis, the passage of legislation that imposes extensive new responsibilities on the agency, and the growth in the size and complexity of the financial markets have demanded that the SEC become more efficient, creative and productive to achieve its mission. While we have made significant progress in many areas, much work remains to be done. My testimony today will highlight a number of the actions we have taken over the past three years to reform and improve SEC operations. In addition, I will describe our progress on implementation of financial reform legislation, upcoming challenges, and the agency’s FY13 appropriations request.

**Operational Improvements and Recent Accomplishments**

As you know, the SEC has responsibility for approximately 35,000 entities, including direct oversight of about 12,600 investment advisers, 9,900 mutual funds and exchange traded funds (ETFs), and over 4,500 broker-dealers with more than 160,000 branch offices. We have responsibility for reviewing the disclosures and financial statements of more than 9,100 reporting companies and also oversee approximately 450 transfer agents, 15 national securities exchanges, eight active clearing agencies, and nine nationally recognized statistical rating organizations (NRSROs), as well as the Public Company Accounting Oversight Board (PCAOB), Financial Industry Regulatory Authority (FINRA), Municipal Securities Rulemaking Board (MSRB), and the Securities Investor Protection Corporation (SIPC). Due to recent changes in the law, smaller investment advisers will transition from SEC to state oversight during 2012, but with the corresponding addition of advisers to private funds, we estimate that the agency will still oversee approximately 10,000 investment advisers with about \$48 trillion in assets under management. During FY 2012 and FY 2013, we also expect to fully implement our new oversight responsibilities with respect to municipal advisors and entities registering with us in connection with the security-based swap regulatory regime.

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<sup>1</sup> 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 full Commission.

The SEC continues to make significant progress in improving core operations. Over the past three years, we have focused on revitalizing and restructuring the enforcement and examination functions. We also have taken steps to enhance safeguards for investor assets, improve internal collaboration within the agency, and improve our risk assessment capacity. These efforts are producing demonstrable results. For example, during FY 2011, the SEC:

- Filed 735 enforcement actions – more than the SEC has ever filed in a single year – with more than \$2.8 billion in penalties and disgorgement ordered. Among the cases filed in FY 2011 were 15 separate actions related to the financial crisis, naming 17 individuals, including 16 CEOs, CFOs, and other senior corporate officers. To date, the SEC has filed financial crisis-related actions against 101 individuals and entities, naming 55 CEOs, CFOs, and other senior corporate officers. In FY 2011, the number of enforcement actions related to investment advisers and broker-dealers also grew, with a total of 146 enforcement actions related to investment advisers and investment companies, a single-year record and 30 percent increase over FY 2010. The SEC also brought 112 enforcement actions related to broker-dealers, a 60 percent increase over the prior fiscal year.
- Implemented a more risk-focused examinations program and completed over 1,600 oversight exams designed to detect and prevent fraud, strengthen industry compliance, monitor new and emerging risks, and inform policy. This risk-focused examination strategy resulted in improved guidance to the financial industry about risky practices and actionable information for enforcement investigations.
- In light of concerns about the risks of exposures to holdings of European sovereign debt by a number of large financial institutions, issued staff disclosure guidance in January 2012 for the purpose of providing investors with enhanced information about the potential impact on financial condition or results of operations as a result of these holdings. Following the issuance of the guidance, the staff has noted clearer and more transparent disclosures made by the various financial institutions about the risks and consequences of these holdings to investors.
- Created the Cross-Border Working Group, an inter-divisional, proactive, risk-based initiative formed by the Division of Enforcement focusing on U.S. issuers with operations primarily overseas. The efforts of this group have resulted in a wide array of actions to protect U.S. investors, including suspending trading in at least twenty foreign-based entities because of deficiencies in information about the companies, instituting stop orders against foreign-based entities to prevent further stock sales under materially misleading and deficient offering documents, revoking the securities registration of at least a dozen foreign-based issuers, and instituting administrative proceedings to determine whether to suspend or revoke the registrations of approximately thirty more. Importantly, once we have revoked the registration, no broker-dealer or national securities exchange can execute a trade in the stock unless the company files to re-register the stock. Most of these actions have involved companies based in China, as the majority of issuers whose securities are registered in the United States whose operations are primarily overseas are located in the PRC region.

- Developed detailed staff guidance for rulewriting to further improve the economic analysis the SEC employs in rulemaking.
- Implemented a completely revamped system for handling the huge volume of tips, complaints, and referrals (TCR) that the SEC receives each year. The new TCR system is fully operational, and includes search capabilities, robust tracking and audit trails, as well as a comprehensive workflow system with the ability to annotate records and upload additional documents and materials. The TCR system can be accessed by authorized personnel across the Commission and acts as the central repository for the agency.
- Improved our internal financial controls, which resulted in a GAO audit opinion for FY 2011 with no material weaknesses.
- Developed and began deployment of TRENDS, a web-based tool that combines workflow, document and data management to help make our national exam program more uniform, focused, efficient and effective.
- Established the Office of Minority and Women Inclusion as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). In FY 2012, we are also establishing three other offices required by the Dodd-Frank Act, specifically the Office of Credit Ratings, Office of Investor Advocate, and Office of Municipal Securities.
- Implemented, with the assistance of targeted contracted expertise, a number of internal reforms designed to improve the agency's organizational structure, strengthen capabilities, improve controls and efficiencies, and enhance workforce competencies and talent.
- Focused external hiring opportunities on filling strategic vacancies and obtaining specialized industry expertise in areas as diverse as quantitative algorithms, computerized trading, securitization, structured products transactions, risk management, derivatives valuation, financial forensics, value-at-risk analysis and stress testing, building predictive models of equity return and risk, underwriting municipal transactions, and exchange-traded funds.
- Implemented a new rule establishing large trader reporting requirements to enhance the agency's ability to identify large market participants, collect information on their trading, and analyze their trading activity.
- Implemented a new rule to require broker-dealers to have risk controls in place before providing a customer with access to the market and to prohibit broker-dealers from providing "unfiltered" or "naked" access.

#### **Financial Reform Implementation**

In addition to improving our core operations, the SEC has worked to implement significant new responsibilities assigned to the agency under the Dodd-Frank Act. The SEC was tasked with writing a large number of new rules and issuing over twenty studies and reports. Over the past 21 months since passage of the Act, we have made significant progress towards completing those

tasks. Of the more than 90 provisions that require SEC rulemaking, the SEC already has proposed or adopted rules for over three-fourths of them. Additionally, the SEC has finalized fourteen of the more than twenty studies and reports that the Dodd-Frank Act directs us to complete.

While we have had much success, we are continuing our work to implement all provisions of the Dodd-Frank Act for which we have responsibility – even as we also perform our longstanding core responsibilities of pursuing securities violations, reviewing public company disclosures and financial statements, inspecting the activities of investment advisers, investment companies, broker-dealers and other registered entities, and maintaining fair and efficient markets. In particular, I would highlight the following rulemakings:

#### *Hedge Fund and Other Private Fund Adviser Reporting*

The Dodd-Frank Act mandated that the Commission require private fund advisers (including hedge and private equity fund advisers) to confidentially report information about the private funds they manage for the purpose of the Financial Stability Oversight Council (FSOC) assessing systemic risk. On October 31, 2011, in a joint release with the Commodity Futures Trading Commission (CFTC) and based on SEC staff consultation with staff representing members of FSOC, the Commission adopted a new rule that requires hedge fund advisers and other private fund advisers registered with the Commission to report systemic risk information on a new form (Form PF).<sup>2</sup> Under the rule, Commission registered investment advisers managing at least \$150 million in private fund assets will be required to periodically file Form PF.

The Form PF reporting requirements are scaled to the size of the adviser. Advisers with less than specified amounts of hedge fund, liquidity fund or private equity fund assets under management will report only very basic information on an annual basis. Advisers with assets under management over specified thresholds will report more information, and large hedge fund and liquidity fund advisers also will report on a quarterly basis. Private equity advisers will only report annually. This approach is intended to provide FSOC with a broad picture of the industry while relieving smaller advisers from much of the reporting requirements. In addition, the reporting requirements are tailored to the types of funds that an adviser manages and the potential risks those funds may present, meaning that an adviser will respond only to questions that are relevant to a particular investment strategy. The Dodd-Frank Act provides special confidentiality protections for this data.

#### *Whistleblower Program*

Pursuant to the Dodd-Frank Act, the SEC has established a whistleblower program to pay awards to eligible whistleblowers who voluntarily provide the agency with original information about a violation of the federal securities laws that leads to a successful enforcement action. In May

<sup>2</sup> See Release No. IA-3308, *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF* (October 31, 2011), <http://www.sec.gov/rules/final/2011/ia-3308.pdf>.

2011, the Commission adopted final rules to implement the whistleblower program. Since the rules went into effect in August 2011, the Commission has received hundreds of tips through the program from individuals all over the country and in many parts of the world. That, of course, is in addition to the tens of thousands of tips, complaints, and referrals the agency receives every year. Our new Office of the Whistleblower is reviewing these submissions and working with whistleblowers. The office has filed two annual reports to Congress detailing its activities since its creation.<sup>3</sup> These include, among other things, the establishment of an outreach program, internal training programs, development of policies and procedures, meeting with whistleblowers and their counsel, and coordination on investigations with Commission staff.

We already are reaping the early benefits of the whistleblower program through active and promising investigations utilizing crucial whistleblower information, some of which we expect to lead to rewards in the near future. In addition, the quality of the information we are receiving has, in many instances, enabled our investigative staff to work more efficiently, thereby allowing us to better utilize our resources.

#### *OTC Derivatives*

The SEC also is engaged in rulemaking to establish a new oversight regime for the OTC derivatives marketplace. To date, the Commission has proposed rules in thirteen areas required by Title VII of the Dodd-Frank Act. In addition, earlier this month, we adopted joint rules with the CFTC to define key terms under this new regime, including “security-based swap dealer” and “major security-based swap participant”, a foundational step in the implementation of Title VII. The Commission also has taken a number of steps to provide legal certainty and avoid unnecessary market disruption that might otherwise have arisen as a result of final rules not having been enacted by the statutory effective date of Title VII. Specifically, we have:

- Provided guidance regarding which provisions in Title VII governing security-based swaps became operable as of the effective date and provided temporary relief from several of these provisions;<sup>4</sup>
- Provided guidance regarding – and where appropriate, interim exemptions from – the various pre-Dodd-Frank provisions that would otherwise have applied to security-based swaps;<sup>5</sup> and

<sup>3</sup> See <http://www.sec.gov/about/offices/owb/whistleblower-annual-report-2011.pdf>; [http://www.sec.gov/news/studies/2010/whistleblower\\_report\\_to\\_congress.pdf](http://www.sec.gov/news/studies/2010/whistleblower_report_to_congress.pdf).

<sup>4</sup> See Release No. 34-64678, *Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps* (June 15, 2011), <http://www.sec.gov/rules/exorders/2011/34-64678.pdf>.

<sup>5</sup> See Release No. 34-64795, *Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment* (July 1, 2011), <http://sec.gov/rules/exorders/2011/34-64795.pdf>; and Release No. 33-9231, *Exemptions for Security-Based Swaps* (July 1, 2011), <http://www.sec.gov/rules/interim/2011/33-9231.pdf>.

- Taken other actions to address the effective date, including extending certain existing temporary rules and relief to continue to facilitate the clearing of certain credit default swaps by clearing agencies functioning as central counterparties and adopting exemptions for security-based swaps that are issued by registered or exempt clearing agencies functioning as central counterparties.<sup>6</sup>

While the Commission has made significant progress to date, much remains to be done to fully implement Title VII. In particular, we need to complete the core elements of our proposal phase, notably rules related to the financial responsibility of security-based swap dealers and major security-based swap participants. Concurrent with that process, we intend to seek public comment on an implementation plan that will facilitate a roll-out of the new securities-based swap requirements in a logical, progressive, and efficient manner that minimizes unnecessary disruption and costs to the markets. Many market participants have advocated that the Commission adopt a phased-in approach, whereby compliance with Title VII's requirements would be sequenced in some manner. Commission staff is actively engaged in developing an implementation plan that takes into consideration market participants' recommendations with regard to such sequencing.

Additionally, the Commission intends to address the international implications of the security-based swap rules arising under Title VII in a single proposal in order to give interested parties, including investors, market participants, and foreign regulators, an opportunity to consider as an integrated whole our approach to the registration and regulation of foreign entities engaged in cross-border security-based swap transactions involving U.S. parties. We understand that our approach to the cross-border application of Title VII must strike a balance between sufficient domestic regulatory oversight and the global nature of the derivatives market. As a result, the development of our cross-border approach is informed by our discussions with counterparts in other jurisdictions. For example, Commission staff, along with the staff of the CFTC, has been working closely with counterparts from Canada, the European Union, Hong Kong, Japan, Singapore, and other jurisdictions to coordinate technical issues that arise as each jurisdiction develops derivatives regulation that have cross-border impact. These efforts not only aid the development of our approach to the cross-border application of Title VII, but also help promote consistency among approaches to derivatives regulation globally.

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<sup>6</sup> See Release No. 34-64796, *Order Pursuant to Section 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions from Clearing Agency Registration Requirements under Section 17A(b) of the Exchange Act for Entities Providing Certain Clearing Services for Security-Based Swaps* (July 1, 2011), <http://sec.gov/rules/exorders/2011/34-64796.pdf>; and Release No. 33-9308, *Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies* (March 30, 2012) <http://www.sec.gov/rules/final/2012/33-9308.pdf>. The Commission also had extended certain existing temporary rules to facilitate clearing of certain credit default swaps. See Release No. 33-9232 *Extension of Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps* (July 1, 2011), <http://www.sec.gov/rules/interim/2011/33-9232.pdf>. Those temporary rules expired on April 16, 2012 and were superseded by the exemptions adopted in March 2012.

### *Credit Rating Agencies*

The Commission is required to undertake approximately a dozen rulemakings related to nationally recognized statistical rating organizations (NRSROs). The Commission adopted the first of these required rulemakings in January 2011,<sup>7</sup> and we are continuing to work to finalize a series of proposed rules intended to strengthen the integrity of credit ratings.

The SEC also is required to conduct three studies relating to credit rating agencies, including a study about alternative compensation models for rating structured finance products. With respect to alternative compensation models, the Dodd-Frank Act directs the Commission to study the credit rating process for structured finance products and the conflicts associated with the “issuer-pay” and the “subscriber-pay” models. The Commission also must study the feasibility of establishing a system in which a public or private utility or a self-regulatory organization would assign NRSROs to determine the credit ratings for structured finance products. Accordingly, the Commission requested public comment on the feasibility of such a system, asking interested parties to provide comments, proposals, data, and analysis.<sup>8</sup>

### *Volcker Rule*

In October 2011, the Commission proposed a rule jointly with the Federal banking agencies to implement Section 619 of the Dodd-Frank Act, commonly referred to as the “Volcker Rule.”<sup>9</sup> This proposal reflects an extensive, collaborative effort by the Federal banking agencies, the SEC, the CFTC, and their respective staffs to design a rule to implement the Volcker Rule’s prohibitions and restrictions in a manner consistent with the language and purpose of this complex statute.

As required by the statute, the joint proposal generally prohibits banking entities from engaging in proprietary trading and having certain interests in, and relationships with, hedge funds and private equity funds. The proposed rule also provides certain exceptions to these general prohibitions, consistent with the statute. For example, the proposal permits a banking entity to engage in underwriting, market making-related activity, risk-mitigating hedging, and organizing and offering a private equity fund or hedge fund, among other permitted activities, provided that specific requirements set forth in the proposed rule are met. Further, as established by Section 619, an otherwise-permitted activity would be prohibited under the proposed rule if it involved a material conflict of interest, high-risk assets or trading strategies, or a threat to the safety and soundness of the banking entity or to the financial stability of the United States. The proposal defines “material conflict of interest,” “high-risk asset,” and “high-risk trading strategy” for these

<sup>7</sup> See Release No. 33-9175, *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (January 20, 2011), <http://www.sec.gov/rules/final/2011/33-9175.pdf>.

<sup>8</sup> See Release No. 34-64456, *Solicitation of Comment to Assist in Study on Assigned Credit Ratings* (May 10, 2011), <http://www.sec.gov/rules/other/2011/34-64456.pdf>.

<sup>9</sup> See Release No. 34-65545, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds* (October 12, 2011), <http://www.sec.gov/rules/proposed/2011/34-65545.pdf>.

purposes. As set forth in the Dodd-Frank Act, the Commission's rule would apply to banking entities for which the Commission is the primary financial regulatory agency. These banking entities include, among others, certain registered broker-dealers, investment advisers, and security-based swap dealers.

The joint proposal requested comment on a wide range of issues due, in part, to the complexity of the issues presented by the statute and the proposal. The comment period for this proposal ended on February 13, 2012. We received thousands of comment letters on the joint proposal and we are reviewing them carefully. We are continuing to work with the other regulators through the rulemaking process.

In addition to the rules highlighted above, the SEC has adopted or proposed rules on a wide variety of topics including municipal advisors, asset-backed securities, payments to governments by resource extraction issuers, sourcing of conflict minerals, mine safety information, disqualifying "bad actors", accredited investor status, and corporate governance and compensation. We also are considering the recommendations in the staff's Study on Investment Advisers and Broker-Dealers<sup>10</sup> and preparing a request for data and economic analysis related to standards of conduct and enhanced regulatory harmonization to help inform any follow-on rulemaking.

#### **JOBS Act Implementation**

The Jumpstart Our Business Startups Act (JOBS Act), enacted on April 5, 2012, makes significant changes to the federal securities laws, including:

- altering the initial public offering process for securities of a new category of issuer – called an "emerging growth company" – and providing exemptions for such companies from various disclosure and other requirements generally for up to five years following their initial public offerings.
- requiring the Commission to modify the prohibition against general solicitation and general advertising in Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 (Securities Act).
- requiring the Commission to provide exemptions under the Securities Act for "crowdfunding" offerings and unregistered public offerings up to \$50 million.
- increasing the number of shareholders a company can have before it must register under the Securities Exchange Act of 1934 (Exchange Act), and changing the Exchange Act thresholds for registration and deregistration for banks and bank holding companies.

The JOBS Act also requires several SEC studies and reports to Congress.

Some of the JOBS Act's provisions became effective immediately upon enactment, while others require extensive Commission rulemaking, in some cases under very tight deadlines. Commission staff have been working to analyze the legislation and provide information to companies and practitioners about the provisions currently in effect. For example, immediately

<sup>10</sup> See <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

following enactment of the JOBS Act, staff in the Division of Corporation Finance posted procedures on the Commission's website to assist emerging growth companies that wished to submit draft registration statements for confidential non-public review, as permitted by Title I of the JOBS Act. In the days following enactment, the staff also prepared and posted practical guidance, addressing frequently asked questions by companies and practitioners on the confidential submission process for emerging growth companies and other matters under Title I, and on changes to the requirements for Exchange Act registration and deregistration.

We have formed rulemaking teams, which include staff from across the agency, including economists from the Division of Risk, Strategy and Financial Innovation. These teams are beginning to prepare proposed rules with economic analyses to recommend to the Commission to implement the various provisions of the JOBS Act. To aid the rulemaking process and increase the opportunity for public comment, we have made available to the public a series of e-mail boxes on the SEC website through which interested parties can send preliminary comments on each of the parts of the JOBS Act before any rules are proposed and the official comment periods begin.

#### **Section 967 Response**

To fulfill the requirements of Section 967 of the Dodd-Frank Act, the SEC engaged the services of The Boston Consulting Group (BCG), an organizational consulting firm with significant capital markets expertise, to conduct a broad and independent assessment of SEC organization and operations. The SEC retained BCG for the express purpose of carrying out the assessment required by Section 967 of the Dodd-Frank Act, which required, among other things, an independent assessment of the SEC's internal operations, structure, funding, and need for comprehensive reform. Specific topics of study included: the possible elimination of lower priority or redundant units at the SEC; improvement of internal communications and organizational chain-of-command; the effect of new market technologies such as high-frequency trading; hiring authorities and personnel practices; and oversight and reliance on self-regulatory organizations (SROs).

On March 10, 2011, BCG delivered the results of its assessment to the SEC and to Congress in a 263-page final report titled *U.S. Securities and Exchange Commission: Organizational Study and Reform*.<sup>11</sup> The final report, which was submitted within the 150-day deadline specified in Section 967, identifies initiatives for the SEC to pursue to improve efficiency and effectiveness of operations.

Over the last year, SEC staff have conducted in-depth assessments of the BCG recommendations for potential organizational improvement opportunities across the agency. This initiative, known as the SEC Mission Advancement Program (MAP), has recognized operational improvements in three key areas:

- *Reorganizing critical internal infrastructure.* Following the 2010-2011 reorganizations of the Division of Enforcement and the Office of Compliance Inspections and Examinations

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<sup>11</sup> See <http://www.sec.gov/news/studies/2011/secorgreformreport-df967.pdf>.

(OCIE), the SEC is restructuring the offices of Financial Management (OFM), Administrative Services (OAS), Information Technology (OIT), and Human Resources (OHR) to align the organizations; better define roles, accountabilities and decision rights; and provide improved services to the program offices.

- *Reviewing key processes for efficiency and effectiveness.* Agency working groups have analyzed a broad array of agency activities in an effort to reduce unnecessary steps, improve the distribution of resources to key activities, insert stronger internal controls, and improve responsiveness within the agency and to the public.
- *Locating cost savings opportunities.* A Continuous Improvement Program (CIP) has been created to identify potential program savings and pay constant attention to costs, to date resulting in the identification of opportunities that are projected to save more than \$8.3 million over the next two years.

The SEC's actions with regard to the BCG recommendations are detailed in our most recent semi-annual report.<sup>12</sup>

Having completed the initial stages of review and analysis, it is anticipated that the level of activity related to MAP projects will be reduced in FY 2012. Staff and management time to devote to this initiative will continue to be in short supply, and future phases of implementation are likely to require levels of funding that must be directed at other agency priorities at this time. For this reason, future activity will be focused on a limited number of projects based on an assessment of their relative potential for operational impact or cost savings. In the coming months, the working groups will continue to assess the changes suggested by BCG to refine and identify those that would provide the most benefit to the SEC and the public.

#### **The SEC's FY 2013 Budget Request and Future Priorities**

The SEC is requesting \$1.566 billion for FY 2013, an increase of \$245 million over the agency's FY 2012 appropriation.<sup>13</sup> If enacted, this request would permit us to add approximately 676 positions (196 FTE) for both improvements to core operations and implementation of the agency's new responsibilities.

The FY 2013 funding request would be fully offset by the matching collections of fees on securities transactions. Currently, the fee rate is equal to approximately two cents per every \$1,000 of transactions. Under this mechanism, the SEC is deficit-neutral, as any increase or decrease in the SEC's budget would result in a corresponding rise or fall in offsetting fee collections.

The resources requested for FY 2013 would allow us to achieve four high-priority initiatives: (1) adequately staff mission-essential activities to protect investors; (2) prevent regulatory bottlenecks as new oversight regimes become operational and existing ones are streamlined; (3)

<sup>12</sup> See <http://sec.gov/news/studies/2012/secorgreformreport-2012-df967.pdf>.

<sup>13</sup> A copy of the SEC's FY2013 Budget Congressional Justification can be found on our website at <http://www.sec.gov/about/secfy13congbudgetjust.pdf>.

strengthen oversight of market stability; and (4) expand the agency's information technology systems to better fulfill our mission.

### *Protecting Investors*

Investor confidence in the fairness of financial markets is a critical element in capital formation. The SEC intends to continue its efforts to enhance its investor protection activities by directing significant additional staff resources to our enforcement and examinations programs.

Enforcing the Securities Laws: In FY 2013, we hope to increase the resources dedicated to the enforcement program to help improve our ability to identify hidden or emerging threats to the markets and act quickly to halt misconduct, minimize investor harm, and maximize the deterrent impact of our efforts.

Inspection and Examination Program: The investment industry is rapidly evolving, with the development of new products posing new risks to investors and the increased complexity of the markets posing challenges to regulators. We have implemented, and continue to improve, a risk-based inspection and examination program that continually collects and analyzes a wide variety of data about regulatees using modern quantitative techniques. Nevertheless, only analyzing data offsite is not sufficient in our complex markets. There is no substitute for engaging directly with regulatees through on-site examinations. Examinations provide the most timely, accurate, and reliable information to assist us in fulfilling our mission. They also help us to maintain a critical presence with market participants. In FY 2011 we were only able to examine eight percent of registered investment advisers, managing about 30 percent of total industry assets under management. About forty percent of registered investment advisers have never been examined. In FY 2012 we are adding exam staff to help improve this disparity and we hope to add more in FY 2013 as well. Without additional resources, the increasing complexity of registered firms and the disparity between the number of exam staff and the firms could compromise the effectiveness and credibility of the Commission's inspection and examination program.

Risk Data and Analysis: As the industries we regulate use increasingly sophisticated technology and high-frequency trading algorithms, our ability to use statistical and trend analyses to identify potentially inappropriate or risky industry practices is essential to help inform our enforcement, examination, and rulemaking efforts. Our Division of Risk, Strategy and Financial Innovation plans to continue to develop and implement robust analytical models to identify regulated entities with high-risk profiles.

*Preventing Regulatory Bottlenecks*

As we continue to implement the Dodd-Frank Act and begin our JOBS Act rulemaking, we will need additional resources, including new subject matter experts, to help make the transition to new rule regimes as smooth as possible and to streamline existing processes for market participants, while still maintaining essential protections for investors.

Over-the-Counter Derivatives: In FY 2013, the Commission's regulatory responsibilities will significantly expand by the addition of new categories of registered entities (including security-based swap execution facilities, security-based swap data repositories, security-based swap dealers, and major security-based swap participants); the required regulatory reporting and public dissemination of security-based swap data; and the mandatory clearing of security-based swaps. To avoid any unintended market disruptions as the new requirements become operational, the agency will need additional staff with technical skills and experience to process and review on a timely basis requests for interpretations as well as registrations or other required approvals. New staff also will be needed to help conduct risk-based supervision of registered security-based swap dealers and participants, including by using newly-available data to identify excessive risks or other threats to security-based swap markets and investors.

JOBS Act: The rulemaking required for implementation of many new JOBS Act provisions will be complex. Additionally, the JOBS Act requires the Commission to undertake a number of studies and complete several reports. Because many of the rulemakings, studies, and reports are subject to near-term deadlines, resources will need to be shifted to these projects. Longer term, certain of the changes in the federal securities laws caused by the JOBS Act will require ongoing staff resources, including for the review of confidential draft registration statements submitted by emerging growth companies and supervision of intermediaries in crowdfunding transactions.

SRO Rule Approvals: The Commission is responsible for reviewing and processing proposed rule changes of SROs to evaluate their impact on the protection of investors, the public interest, and the national market system. The Dodd-Frank Act's imposition of new procedural requirements with respect to the SEC's processing of proposed SRO rule changes has placed further demands on an already complex and resource-intensive process. The volume of annual requests has increased by over 80 percent in the last five years, with the Commission receiving over 2,000 requests for approval or guidance in 2011. We hope to be in a position to dedicate additional resources to these approvals so that market participants do not face greater uncertainty, costs, and delays in obtaining Commission action on new products, trading rules, and platforms.

Economic Analysis: As the Commission undertakes additional rulemaking and evaluates existing rules, continued access to robust, data-driven economic analyses is necessary to develop efficient rules and evaluate the effectiveness of our existing regulations. The Division of Risk, Strategy and Financial Innovation will need additional economists and industry experts to support these efforts.

Providing Interpretive Advice: As the Commission implements the rules required under the Dodd-Frank Act and the JOBS Act, there will be a need for additional staff to respond to the

demand from companies, investors, and their advisors for interpretive advice about the new rules. In FY 2013, for example, we expect a heightened number of interpretive inquiries from public companies on new rules relating to listing standards for executive compensation, disqualification of felons and other bad actors from certain exempt offerings, and specialized disclosure rules. In addition, we expect the need for interpretive advice for JOBS Act related matters will only increase, particularly as rulemakings related to a number of the more complicated provisions, like crowdfunding and the new \$50 million offering exemption, are completed.

#### *Strengthening Oversight of Market Stability*

The rapidly expanding size and complexity of the financial markets presents enormous oversight challenges. For FY2013, the SEC is requesting funding for additional specialists in a number of areas to strengthen our oversight of the markets, protect against known risks, and best enable our markets to facilitate economic growth.

Clearing: Currently, the average transaction volume cleared and settled by clearing agencies is approximately \$6.6 trillion a day. The SEC estimates six new clearing entities will register with the SEC in FY 2013, totaling fourteen active registered clearing agencies. The SEC has approximately thirteen examiners devoted to the eight currently active registered clearing agencies, with limited on-site presence in only three of the eight entities. Additionally, the SEC has only approximately twelve other staff principally focused on monitoring and evaluating risk management systems used by existing clearing agencies. We will need to expand these efforts to address the expected increase in the number of clearing agencies and rule filings raising risk management issues.

Market Structure Improvements: The Commission is continuing its efforts to monitor and respond to significant market events, such as the severe market disruption of May 6, 2010. In response to market structure issues, the Commission is currently evaluating a proposed “limit-up/limit-down” mechanism that would help enhance market stability by preventing trades in individual securities from occurring outside of a specified price band. The Commission also continues to review proposed amendments to the existing market-wide circuit breakers designed to address extraordinary volatility across the markets and to make the circuit breakers more useful in the fast-paced electronic trading dynamics of today’s markets. Importantly, the Commission also is likely to move forward on the establishment of a consolidated system for tracking trading activity in the equity markets, which will enhance the data available to securities regulators for a range of critical analytical and regulatory purposes.

Money Market Funds: I have asked Commission staff to prepare recommendations on structural reforms to money market funds to lessen their susceptibility to runs and to enhance the protections afforded investors. These reforms would supplement the rules limiting the portfolio risk in money market funds that the Commission adopted in FY 2010. The Division of Investment Management plans to expand and improve its monitoring and oversight of money market funds and bring on additional staff with industry and data analysis expertise in this highly specialized area.

Exchange Traded Funds: Exchange Traded Funds, or ETFs, are rapidly growing, increasingly complex financial products whose activities raise significant disclosure, conflict of interest, market structure, and macro-prudential issues. The SEC plans to augment its ability to respond effectively to product innovation and potential market stresses in this area. Staff with specialized industry expertise are needed to assist in evaluating novel and complex ETF products, structures, trading mechanisms, and index replication methodologies.

Cybersecurity: Financial entities are recognized as particular targets for attempted cyber attacks. The SEC already has a program in place that monitors cybersecurity at the various securities exchanges, but the growing number of trading and clearing platforms will require additional staff to further enhance this function.

#### *Leveraging Information Technology Systems*

The preceding discussion demonstrates that growth in both the size and complexity of U.S. markets requires that the SEC leverage technology to continuously improve its productivity, as well as identify and address the most significant threats to investors. The SEC's budget request for FY 2013 would support IT investments of approximately \$100 million. This level of funding would enable the Office of Information Technology to dedicate adequate resources to new or ongoing projects in areas such as data management, integration and analysis; document management; disclosure review; and internal accounting and financial reporting. Additionally, the SEC plans to continue multi-year initiatives to improve the enforcement and examinations programs' capabilities to intake and process thousands of tips, complaints, and referrals received annually, as well as massive amounts of electronic evidence. The SEC also plans to make additional investments in electronic discovery, its forensics laboratory, and reporting tools.

As part of our effort to improve key technology, the SEC is also using the Reserve Fund established by the Dodd-Frank Act to address important multi-year technology initiatives. This year and next we plan to use the Reserve Fund to make vital investments to modernize our EDGAR Filer system and external website, SEC.gov, which directly serve investors and public companies. The EDGAR database is used by companies and individuals to file periodic reports and information with the SEC and allows SEC staff and the public to search the filings. With approximately 20 million daily page hits, SEC.gov is one of the Federal Government's most viewed web sites and a critical gateway for both businesses and individuals to access massive amounts (13.5 terabytes) of financial filer information maintained by the SEC. However, both EDGAR and SEC.gov were developed in the 1990s and use outdated software design and scripting language. We intend to invest in overhauling EDGAR and SEC.gov to create new, modernized systems that would improve the agency's ability to meet Commission requirements and satisfy public needs; simplify the interchange between filers and the SEC to reduce filer burdens; and reduce the long-term costs of operating and maintaining the systems. We will also be working to improve data structure and database performance, verify data, and construct a single data repository and central staging area for all EDGAR and other SEC data.

In addition, in FY 2013 we plan to use the Reserve Fund to develop Market Oversight and Watch Systems that will provide the SEC with automated analytical tools to review and analyze market events, complex trading patterns, and relationships; develop fraud analysis and fraud prediction analytical models; and deploy natural speech, text, and word search tools to assist our fraud

detection efforts. Additionally, we will continue to enhance our analytical tools, databases, and intake systems for market data, mathematical algorithms, and financial data.

### **Conclusion**

I fully recognize that it is incumbent upon the SEC to maximize our efficiencies and continue our organizational modernization efforts. As we protect investors, we have an obligation to be good stewards of the resources provided to us. We are carefully reviewing our activities to identify ways to improve efficiency and productivity. These ongoing efforts, along with continued congressional support, will be essential to enable the SEC to fulfill its mission even as the financial markets continue to grow in size and complexity.

Thank you for your support for the agency's mission and for allowing me to be here today to discuss the many initiatives and operational reforms taking place at the SEC. I am happy to answer any questions you may have.

## Lawyer Skewers Boston Fed Chief's Money Fund Comments

By Beagan Wilcox Volz April 24, 2012

Boston Fed president Eric Rosengren's recent remarks on the need for further money market fund reforms have drawn fire from an industry supporter.

Melanie Fein, a former Fed attorney now in private practice, disputes Rosengren's contentions in a recent speech that prime money funds are susceptible to runs and are a source of systemic risk.

Fein says in a 21-page letter to Rosengren dated April 18 that she has been "greatly troubled" by Fed officials' statements that she believes "distort the facts" about money funds and their role in the financial system.

"In particular, I am concerned about proposals advocated by yourself and other Fed officials that do not appear to be supported by the level of economic analysis that is called for given what is at stake...." writes Fein.

"Some of the proposals and public statements seem disingenuous and have an amateurish 'shooting from the hip' quality that I feel is beneath the dignity of the nation's central bank."

Joan Ohlbaum Swirsky, of counsel at Stradley Ronon, says the comments about insufficient economic analysis are "fighting words," given that the Securities and Exchange Commission has lost several legal challenges on the issue of cost-benefit analysis, most recently with its rule that sought to expand proxy access.

In her letter, Fein takes several of Rosengren's contentions and parses them, pointing to what she says are gaps in logic or insufficient facts to warrant his conclusions.

Fein also sent the letter to the Financial Stability Oversight Council and the SEC, which filed it as a comment letter.

For example, Fein calls attention to Rosengren's comments regarding more than 100 capital support agreements between money funds and their sponsors during 2007 and 2008 and his conjecture that, in the absence of this support, many of the funds would not have been able to maintain a stable net asset value.

This led Rosengren to conclude that regulators should impose a capital requirement or other structural changes on money funds, Fein says.

But the facts don't support this conclusion, Fein asserts, noting that bank-affiliated sponsors of money market funds provided the majority of these bailouts.

She also refers to a Federal Reserve paper that found that money funds with bank-affiliated sponsors were “significantly” more likely to hold distressed asset-backed commercial paper than other money funds.

The Fed paper said that these support arrangements for bank-affiliated money funds created moral hazard and systemic risk.

“The history of sponsor support for [money market funds] suggests not that MMFs need to maintain capital but rather that banking organizations that provide support to their affiliated MMFs need to maintain capital and that the Federal Reserve should refocus its concerns about MMF risk-taking to risk-taking by bank-affiliated MMFs,” writes Fein.

Fein goes a step further and says that perhaps the Fed should first consider changes to rules within its own jurisdiction rather than suggesting changes to rules within the SEC’s regulatory scope.

John Hunt, partner at McLaughlin & Hunt, says that Fein turns Rosengren’s statements about the risks of prime money funds on their head by arguing that it’s likely there are more risks in bank-affiliated money funds “because the banks are on both sides – they’re both buyers and sellers of money market fund instruments.”

Fein is challenging Rosengren and the Fed to back up the “bald statements” made about money market funds, he says.

Fein’s letter quotes at length from the President’s Working Group Report on Money Market Fund Reform to bolster her argument that making money funds risk-free “is not a sound policy aim.”

Fein includes several sentences from the report in bold, including this one: “Making each individual MMF robust enough to survive a crisis of the size of that experienced in 2008 may not be an appropriate policy objective because it would unduly limit risk-taking.”

Fein also draws upon the President’s Working Group report when making the case that neither reform being considered by the SEC – a floating NAV or capital buffers, along with redemptions restrictions – is a good idea.

She says that experience shows capital requirements are a “weak guard” against taking risk.

“The bank capital rules actually encouraged excessive risk-taking by banks and contributed to the build-up of toxic assets in the financial system that ultimately caused the financial crisis, as pointed out in my paper.”

The idea that MMFs should maintain capital is not supported by any economic analysis that I am aware of,” she says.

At the beginning of her letter, Fein refers Rosengren to a study she conducted that dissects Fed statements on money funds and concludes that the Fed is pushing for additional reforms of the funds to bolster the banking industry.

She also notes that she has represented both money fund and bank clients.

Fein has previously written comment letters on SEC-proposed regulations on behalf of Federated Investors.

At the end of the letter, Fein tells Rosengren that, although she has been critical of his statements and proposals regarding money funds, she hopes he will not take her comments personally or as an attack on the Fed.

She adds that she believes the Fed acted admirably during the financial crisis.

“I firmly believe, however, that it is unnecessary and potentially dangerous for the Fed to become involved in regulating an industry with which it has little regulatory experience or expertise, especially one that is well-regulated by another independent federal agency and that historically has operated with little risk to investors or the financial system,” writes Fein.

Media relations contacts at the Boston Fed did not respond to requests for comment by deadline.



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

June 1, 2012

The Honorable Michael G. Grimm  
U.S. House of Representative  
1511 Longworth House Office Building  
Washington, DC 20515

Dear Representative Grimm:

At the April 25, 2012 hearing on SEC Oversight before the Capital Markets and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services, you asked about the effective date of the amendment to Exchange Act Section 12(g)(1) included in the Jumpstart Our Business Startups Act (P.L. 112-106) regarding an increase in the trigger number of holders of record at which registration is required.

Prior to enactment of the JOBS Act, Exchange Act Section 12(g)(1) provided that an issuer was required to register a class of equity securities under Section 12(g) if that class was held of record by 500 or more persons and the issuer had more than \$10 million in assets as of the end of its most recent fiscal year. Section 501 of the JOBS Act amended Exchange Act Section 12(g)(1) to raise the holders of record trigger from 500 or more persons to either: (1) 2,000 persons; or (2) 500 persons who are not accredited investors. The staff has taken the view that Section 501 took effect upon enactment.

If you have any further questions or comments, please contact me at (202) 551-2100, or have your staff contact Eric Spittler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010.

Sincerely,

Mary L. Schapiro  
Chairman



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

June 27, 2012

The Honorable Jeb Hensarling  
U.S. House of Representatives  
129 Cannon House Office Building  
Washington, DC 20515

Dear Representative Hensarling:

At the April 25, 2012 hearing on SEC Oversight before the Capital Markets and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services, you asked for the breakdown between attorneys and economists on the SEC staff.

As a law enforcement agency, we clearly have more attorneys than economists. Specifically, we currently have approximately 1,653 individuals classified as attorneys and 44 as economists. We are engaged in an ongoing effort to hire additional economists. In Fiscal Year 2012 we have already hired an additional 16 Ph.D. economists for our Division of Risk, Strategy and Financial Innovation to work on various aspects of economic analysis such as rulewriting, and we are continuing our efforts to recruit economists generally. In our Fiscal Year 2013 request, we are requesting 20 more economists.

If you have any further questions or comments, please contact me at (202) 551-2100, or have your staff contact Eric Spittler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010.

Sincerely,

Mary L. Schapiro  
Chairman



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

June 6, 2012

The Honorable Robert Hurt  
U.S. House of Representatives  
1516 Longworth House Office Building  
Washington, DC 20515

Dear Representative Hurt:

At the April 25, 2012 hearing on SEC Oversight before the Capital Markets and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services, you asked about the status of interpretative guidance that would assist advisers to private equity funds in complying with their obligations as registered advisers under the Investment Advisers Act. In particular, you also inquired whether this guidance makes clear that there are differences between private equity and other types of investment funds. You also asked about the transition requirements for bank holding companies whose reporting obligations to investors have been terminated under Section 601 of the Jumpstart Our Business Startups Act (P.L. 112-106).

I first will address your inquiries about private equity advisers. To assist in the transition to registration, the staff of the Division of Investment Management has responded to thousands of informal inquiries. The staff also has provided the following written guidance for advisers to private equity funds and other private funds:

- Private equity advisers that operate a single advisory business through multiple entities - a common business structure in private equity - can use a streamlined application and registration process, thereby mitigating duplicative filings and reporting obligations. We estimate that over 950 private fund advisers, including private equity advisers, have elected this filing option:
- Private equity advisers need not amend pre-existing advisory contracts between them and their clients if such contracts were entered into prior to registration with the Commission and the adviser operates in compliance with the Advisers Act requirements. This mitigates disruptions to private equity advisers' businesses, but acknowledges that investors benefit from the protections under the Advisers Act;
- Employees and other personnel of certain companies in which private equity funds invest are not subject to reporting obligations on the adviser's registration form, thus simplifying the reporting process for these advisers; and

The Honorable Robert Hurt  
Page 2

- Private fund advisers can complete new private fund reporting requirements on their registration forms by looking to informal Commission staff guidance in the form of "frequently asked questions." This is readily available to the larger industry and is designed to clarify certain reporting obligations.

I also understand that the staff of the Division of Investment Management continues to engage in discussions with representatives of the private equity industry concerning interpretative and other issues that are unique to these advisers. For instance, the staff met with a leading trade group for private equity advisers in May to continue the dialogue regarding the requirements under the Advisers Act.

With respect to your question regarding bank holding companies that become eligible to terminate reporting to investors, it may be helpful to recap the requirements prior to enactment of the JOBS Act. Exchange Act Section 12(g)(4) provided that an issuer with a class of equity securities registered under Section 12(g) could terminate its reporting obligations if the class of securities was held of record by fewer than 300 persons. Such termination would occur 90 days after the filing of a certification with the Commission. Until that date of termination, the issuer was required to file all reports required by the Exchange Act.

To help implement Section 12(g)(4), the Commission adopted Exchange Act Rule 12g-4 in 1976. Rule 12g-4 provides, in relevant part, that an issuer with a class of equity securities registered under Section 12(g) of the Exchange Act can terminate its reporting obligations pursuant to Rule 12g-4 if the class of securities is held of record by fewer than 300 persons. An issuer relying on this Rule is required to file a Notice of Termination of Registration on Form 15. Upon filing the Form, the issuer's obligation to file future periodic and current reports is immediately suspended, although the Exchange Act deregistration does not take effect until 90 days after filing of the Form.

Section 601 of the JOBS Act amended Exchange Act Section 12(g)(4) to provide that a bank holding company with a class of equity securities held of record by fewer than 1,200 persons could terminate its reporting obligations under Section 12(g). The Act did not amend Rule 12g-4, which still contains the 300 person threshold and provides for the immediate suspension of the requirement to file Exchange Act reports. Therefore, until such time as the Commission amends Rule 12g-4 to incorporate the 1,200 person threshold, bank holding companies are not eligible to rely on the Rule and must instead rely on the statute to exit Exchange Act reporting. Section 12(g)(4) still provides that the issuer must file all reports required by the Exchange Act until the registration is terminated 90 days after the filing of a certification with the Commission. Since investors in bank holding companies that become eligible to terminate reporting may benefit from the 90-day notice required under Section 12(g)(4), until rulemaking is completed, the staff has concluded that it would not be appropriate to eliminate the 90-day notice requirement by staff action.

The Honorable Robert Hurt  
Page 3

If you have any further questions or comments, please contact me at (202) 551-2100, or have your staff contact Eric Spitler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010.

Sincerely,

A handwritten signature in cursive script, reading "Mary L. Schapiro".

Mary L. Schapiro  
Chairman



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

July 24, 2012

The Honorable Brad Miller  
U.S. House of Representatives  
1127 Longworth House Office Building  
Washington, DC 20515

Dear Representative Miller:

At the April 25, 2012 hearing on SEC Oversight before the Capital Markets and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services, you asked about the valuation of second liens in banks' financial statements.

As part of its disclosure review program, the SEC's Division of Corporation Finance staff devotes significant attention to the disclosures made by large financial institutions. In connection with our review program, in August 2009, SEC staff issued a "Dear CFO" letter to a number of these banks requesting enhanced disclosures in the area of higher risk loan products, such as junior lien mortgages, high loan-to-value mortgages and interest only mortgages. The purpose of the "Dear CFO" letter was to assist these banks in providing more transparent disclosures to investors about the impact of their lending practices on the financial condition and results of operations of these institutions. In reviewing the 2010 Form 10-K annual reports filed by the large financial institutions, the staff noted that home equity lines of credit (HELOCs) and second lien loans continued to present potentially significant areas of exposure to those firms and ultimately to investors. During the review, the staff noted that the banks holding the second lien position were not aware of the performance status of the senior lien unless they held or serviced the senior lien themselves. The staff found that this situation presented one of the more significant risks in developing the allowance for loan losses for these loans because the second liens were performing even though the senior lien did not. In some instances, the second lien holder had not received notification that the senior lien loan was in default until the occurrence of a foreclosure sale.

As a result, the staff issued comments requesting that the banks provide increased disclosure of the amount of HELOCs and loans in the second lien position. The staff asked the banks to provide explanations that included the extent to which, and if so, how, they tracked whether the first lien that sits ahead of their second lien loan was in default, regardless of whether they held or serviced the first lien. The staff also requested expanded disclosure about how the banks factored in the lack of any information about the senior lien in developing their allowance for loan losses and a more robust description of the methodology they used to determine the allowance that they reported in their financial statements.

The Honorable Brad Miller  
Page 2

Following the staff's comments, all of the large financial institutions have significantly increased their disclosures about the performance and impact of second lien mortgages on their balance sheets. This level of increased transparency provides investors with a clearer understanding of loan valuations and how the banks account for them. Additionally, following the SEC staff's efforts in this area, in January 2012, the U.S. Banking Regulators issued Interagency Supervisory Guidance on *Allowance for Loan and Lease Losses Estimation Practices for Loans and Lines of Credit Secured by Junior Liens on 1-4 Family Residential Properties*. Following the issuance of this guidance, several large financial institutions have implemented changes to their nonaccrual policies regarding how they classify certain of their performing second lien loans that reside behind a delinquent senior lien loan.

I appreciate your interest in this issue. If you have any further questions or comments, please call me at (202) 551-2100, or have your staff call Timothy Henseler, Acting Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010.

Sincerely,



Mary L. Schapiro  
Chairman



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

June 1, 2012

The Honorable David Schweikert  
U.S. House of Representative  
1205 Longworth House Office Building  
Washington, DC 20515

Dear Representative Schweikert:

At the April 25, 2012 hearing on SEC Oversight before the Capital Markets and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services, you asked about the timeframe for completion of crowdfunding rulemaking required by the Jumpstart Our Business Startups Act (P.L. 112-106).

As you are aware, Title III of the JOBS Act provides an exemption from Section 5 of the Securities Act of 1933 for crowdfunding transactions that meet certain requirements, including the total amount that may be raised by an issuer in a twelve-month period, maximum individual investment amounts, and how sales of securities may be made (i.e. through a broker or a funding portal). The Commission is required to issue rules to implement the crowdfunding exemption within 270 days of enactment of the JOBS Act. The rulemaking process will include development and issuance of rule proposals for public comment and, following careful consideration of the public comment, development and issuance of final rules.

The Divisions of Corporation Finance and Trading and Markets have rulemaking teams in place, which are actively working to develop recommendations for proposed rules for the Commission's consideration. Our priority is to develop and adopt thoughtful, workable rules that are faithful to the intent of the statute and that include strong investor protections. As part of this process, the staff and Commission also will fully consider the economic impact of the rules, including their costs and benefits. While it will be very challenging to complete the rulemaking process within 270 days, we are making every effort to do so.

If you have any additional questions or comments on this matter, please contact me at (202) 551-2100, or have your staff contact Eric Spitler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010.

Sincerely,

A handwritten signature in cursive script that reads "Mary L. Schapiro".

Mary L. Schapiro  
Chairman



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

THE CHAIRMAN

June 5, 2012

The Honorable Brad Sherman  
U.S. House of Representatives  
2242 Rayburn House Office Building  
Washington, DC 20515

Dear Representative Sherman:

At the April 25, 2012 hearing on SEC Oversight before the Capital Markets and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services, you raised several issues about which you asked for further information. First, you inquired about the status of the Commission's prior efforts to establish a web-based tool to allow investors to access a list of companies that disclose that they conduct business in countries that sponsor terrorism. You also asked about the development of Commission rules to require disclosure by companies of activities that may subject them to sanctions under the Iran Sanctions Act of 1996. Finally, you asked about the status of the Financial Accounting Standards Board's standards for lease accounting.

As you know, in 2007, the Commission briefly provided on its website portions of companies' most recent annual reports that described their business activities in any of the countries then-designated by the State Department as state sponsors of terrorism. Because of concerns expressed about the web tool, including concerns that the linked reports were not always the companies' most recent disclosure, the tool was discontinued pending consideration of issues regarding access to disclosures about activities in or with state sponsors of terrorism. In the fall of 2007, the Commission issued a concept release requesting public comment about whether to develop mechanisms, including, as one alternative, an improved web-based tool, to facilitate greater public access to companies' disclosures about their business activities in or with countries designated as state sponsors of terrorism. Comments received in response to the concept release did not support development of a web tool for this information, and the Commission has not developed such a tool. However, the information continues to be publicly available through word searches of companies' filings in the Commission's EDGAR database. The EDGAR database may be accessed through the Commission's website, [www.sec.gov](http://www.sec.gov). As you may be aware, the Commission is undertaking a major effort to modernize the EDGAR filer system and the sec.gov website. I expect that these modernized systems will make EDGAR searches of all kinds easier, and permit interested parties to identify directly disclosures about business activities in state sponsors of terrorism.

Regarding the development of Commission rules to require disclosure by companies of activities that may subject them to sanctions under the Iran Sanctions Act of 1996, Commission staff is currently working on a disclosure rule in response to congressional direction that the

The Honorable Brad Sherman  
Page 2

Commission issue rules that require an issuer to disclose activities that may subject it to sanctions under section 5 of the Iran Sanctions Act. We have not yet determined an expected completion date for this rulemaking; however, the staff is actively working to develop recommendations for the Commission.

Finally, with respect to your inquiry about the FASB's current standards for lease accounting, although generally well understood in practice, the standards result in significantly different accounting treatment for economically similar transactions. In addition, many constituents agree that current lease accounting standards result in consistent underreporting of assets and liabilities, such that a number of classes of users routinely adjust reported financial statements for the estimated effects of uncapitalized leases. In an effort to improve lease accounting, the FASB, in a joint project with the IASB, issued an exposure draft on lease accounting in August 2010. The FASB and the International Accounting Standards Board have conducted joint redeliberations on the proposals and have engaged in significant discussion on fundamental issues in light of comments from constituents.

In connection with the Commission's oversight role of the FASB, Commission staff monitors whether proposed new or revised accounting standards will result in more accurate, transparent, and useful information for investors and other users. The staff also monitors whether the standard setter has given appropriate consideration to comments by constituents about operational concerns or costs of implementing new standards, in light of the expected benefits. Commission staff has been actively monitoring the FASB's redeliberation process and is hopeful that many of the changes to the lease proposals discussed by the FASB and the IASB to date will simplify the application of the proposed model while retaining benefits for investors and other users through improved financial reporting for leases. The FASB and the IASB expect to issue a new joint exposure draft for public comment in the second half of 2012.

If you have any additional questions or comments on these matters, please contact me at (202) 551-2100, or have your staff contact Eric Spittler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010.

Sincerely,



Mary L. Schapiro  
Chairman

