

**Testimony on “Oversight of the SEC’s Agenda, Operations and FY 2015 Budget Request”  
by**

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Committee on Financial Services  
United States House of Representatives  
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Chairman Hensarling, Ranking Members Waters, and members of the Committee:

Thank you for inviting me to testify regarding the recent activities of the U.S. Securities and Exchange Commission (SEC), our fiscal year 2015 budget request, and our plans to continue to fulfill our broad, three-part mission: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.<sup>1</sup>

Investors and our markets need a strong, vigilant, and adequately-resourced SEC. Today, there are over 25,000 SEC registrants, including broker-dealers, investment advisers, clearing agents, transfer agents, credit rating agencies, exchanges, and others. From fiscal 2001 to fiscal 2014:

- trading volume in the equity markets more than doubled to a projected \$71 trillion;
- in addition to dramatically increased volume, the complexities of financial products and the speed with which they are traded increased exponentially;
- assets under management of mutual funds grew by 131% to \$14.8 trillion; and
- assets under management of investment advisers jumped almost 200% to \$55 trillion.

During this time of unprecedented growth and transformation in our markets, the SEC also has been given significant new responsibilities for over-the-counter derivatives, private fund advisers, municipal advisers, crowdfunding portals, and more.

Since I first appeared before you last May, the SEC has accomplished a great deal. We adopted or proposed a substantial volume of mandated and other key rules. We aggressively enforced the securities laws, requiring for the first time admissions to hold certain wrongdoers more publicly accountable, and obtaining orders for penalties and disgorgement of \$3.4 billion in fiscal 2013, the highest in the agency’s history. We have taken a data-driven, disciplined approach to addressing complex market structure issues, launching a powerful new analytical tool called MIDAS (Market Information Data Analytics System) that enables us to analyze enormous amounts of trading data across markets almost instantaneously, and intensifying our

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<sup>1</sup> The views expressed in this testimony are those of the Chair of the Securities and Exchange Commission and do not necessarily represent the views the full Commission, or any Commissioner.

review of issues such as high frequency trading and off-exchange trading venues. And we have continued to improve our efficiency and effectiveness by enhancing our technology, bringing in more experts, and deploying more risk-based analytics to allow us to do more with our resources, and to do so more quickly.

Within the last year, we have advanced a significant number of mandated rules and other initiatives across the wide range of our responsibilities as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Startups Act (JOBS Act), proposing or adopting rules concerning, among other things:

- The registration and regulation of nearly a thousand municipal advisors;
- The cross-border application of our security-based swap rules in the global swaps market;
- Lifting the ban on general solicitation in certain private offerings and proposing rules to provide important data and enhanced investor protections for this new market;
- Proprietary trading and investments in private funds by banks and their affiliates, under what is commonly called the “Volcker Rule”;
- Increasing access to capital for smaller companies through securities-based crowdfunding;
- Programs required of broker-dealers, investment companies, and other regulated entities to address risks of identity theft;
- Further safeguarding the custody of customer funds and securities by broker-dealers;
- Updating and expanding the Regulation A exemption for raising capital;
- The retention of a certain amount of credit risk by securitizers of asset-backed securities;
- The removal of references to nationally recognized statistical rating organization ratings in several broker-dealer and investment company regulations;
- Enhancing risk management and other standards for the clearing agencies responsible for the safe and efficient transfer of trillions of dollars of securities each year; and
- Recordkeeping and reporting related to registrants’ security-based swap activities.

In addition, we put forward rule proposals to strengthen and reform the structure of money market funds and require that certain key market participants have comprehensive policies and procedures to better insulate market infrastructure technological systems from vulnerabilities.

We also have taken steps to enhance the SEC's already strong enforcement program, including by modifying the longstanding "no admit/no deny" settlement protocol to require admissions in certain cases. While no admit/no deny settlements still make a great deal of sense in many situations, because admissions can achieve a greater measure of public accountability, they can bolster the public's confidence in the strength and credibility of law enforcement and in the integrity of our markets. Already, the Commission has resolved a number of cases with admissions, and my expectation is that there will be more such cases during 2014 and going forward as the new protocol continues to evolve and be applied. The Commission has continued to bring many significant enforcement cases across our entire regulatory spectrum, including actions against exchanges to ensure they operate fairly and in compliance with applicable rules, actions against investment advisers and broker-dealers for a variety of offenses, including taking undisclosed fees and conflicts of interest, and for disrupting the markets through automated trading, actions against auditors and others who serve as gatekeepers in our financial system, landmark insider trading cases, and additional cases against individuals and entities whose actions contributed to the financial crisis.

In the past year, the Commission also has made great strides to improve its technology, including through the development of tools that permit us to better monitor and protect the integrity of our markets and inform our exam program. In addition to MIDAS, the SEC's Quantitative Analytics Unit in our National Exam Program has developed groundbreaking new technology that allows our examiners to access and systematically analyze massive amounts of trading data from firms in a fraction of the time it has taken in years past. We are laying the technological foundation for unified access to SEC information, applications, and data across the agency, and are making a variety of other technological investments to enable us to fulfill our mission more efficiently and effectively.

We are continuing to address structural concerns about our complex, dispersed marketplace in a thorough and disciplined manner, drawing on data and other empirical evidence, and continuing our review of the SEC's public issuer disclosure rules. While the agency has made significant progress, there is much that the SEC still needs to accomplish. Completing key rulemakings and studies, including those mandated by Congress in the Dodd-Frank and JOBS Acts, remains among my top priorities. We also need to continue to increase our capacity to examine and oversee the entities under the SEC's jurisdiction, as well as hold accountable those that harm investors through securities law violations. We are at a critical point in the deployment of more sophisticated technology tools and platforms, and it is vital that we have the resources necessary to continue modernizing our IT systems and infrastructure.

In the testimony that follows, I will highlight the work of each of the SEC's Divisions and many of its Offices, including information on the SEC's progress implementing the Dodd-Frank Act and JOBS Act, and also discuss the SEC's fiscal year 2015 budget request.

## **Enforcement**

A strong and effective enforcement program is at the heart of the SEC's efforts to protect investors and instill confidence in the integrity of the markets. As the agency's largest division, the Division of Enforcement (Enforcement) investigates and brings civil charges in federal

district court or in administrative proceedings based on violations of the federal securities laws. Successful enforcement actions result in sanctions that deter wrongdoing, protect investors, and result in penalties and the disgorgement of ill-gotten gains that can be returned to harmed investors.

In FY 2013, Enforcement continued to achieve significant results on behalf of investors, using its enhanced expertise to file tough enforcement actions that sent a strong deterrent message in an increasingly complex and global securities market. The SEC filed 686 enforcement actions in the fiscal year that ended in September 2013. The \$3.4 billion in disgorgement and penalties ordered as a result of those actions is 10 percent greater than FY 2012 and 22 percent greater than FY 2011, when the SEC filed the most actions in agency history. Quantitative metrics alone, however, are not the proper yardstick of the measure of Enforcement's effectiveness. Enforcement considers the quality, breadth, and effect of the actions pursued.

#### *Admissions Policy*

As referenced above, in FY 2013 the SEC changed its long-standing settlement policy, and now requires admissions of misconduct in certain types of cases where heightened accountability and acceptance of responsibility by a defendant are appropriate and in the public interest. These types of cases include those involving particularly egregious conduct, where a large number of investors were harmed, where investors or the markets were placed at significant risk, where the conduct undermines or obstructs our investigative process, where an admission can send an important message to the market, or where the wrongdoer presents a particular future threat to investors or the markets. The SEC has settled a number of cases using this new protocol, including requiring, for example, a hedge fund manager to admit to misuse of more than one hundred million dollars of fund assets to pay personal taxes, and a global financial institution to admit to massive control failures that resulted in material financial misstatements. I expect that there will be more such cases in the coming year.

#### *Market Structure / Exchanges / Broker-Dealers*

To ensure fair trading and equal access to information in the securities markets, the SEC brought significant actions in the past year against stock exchanges, broker-dealers, and other market participants. Noteworthy cases included actions charging:

- Nasdaq in connection with its inadequate systems and decision-making during the Facebook IPO;
- CBOE with regulatory and compliance breakdowns, including its failure to enforce rules to prevent abusive short selling;
- the Chicago Stock Exchange with failing to detect and prevent violations of Regulation NMS by its member firms;

- Knight Capital Americas with having inadequate market access controls and violating Commission Rule 15c3-5 in connection with an automated trading problem that disrupted the markets;
- brokerage firm Biremis Corporation and two senior executives with failing to supervise overseas day traders who engaged repeatedly in a manipulative trading practice known as “layering”; and
- three brokerage subsidiaries and two former employees of ConvergEx Group with charging many institutional clients substantially higher amounts than disclosed for the execution of trading orders.

### *Insider Trading*

Building on past successes, the SEC has continued to uncover hard-to-detect insider trading violations by a wide variety of market participants, including licensed brokers, sophisticated hedge fund managers, and overseas traders. These actions have exposed serious lapses by senior corporate insiders, board members, and other professionals who unlawfully tipped or traded on material nonpublic information.

Two recent examples of the SEC’s efforts in this area include an action charging the managing clerk of a prominent law firm with tipping confidential information in advance of more than a dozen corporate transactions, and an action charging a former analyst at CR Intrinsic Investors with causing the hedge fund to trade based on inside information concerning a corporate acquisition and a technology company’s quarterly earnings announcements. The SEC’s filing against the CR Intrinsic analyst followed an historic insider trading settlement with CR Intrinsic and its affiliate, SAC Capital Advisors, which agreed last year to pay more than \$600 million in disgorgement and civil penalties. The SEC also brought an administrative proceeding charging these firms’ owner with failing to supervise senior portfolio managers and prevent their insider trading violations.

### *Financial Statement and Accounting Fraud*

Enforcement continues to focus on expanding and strengthening the agency’s efforts to identify securities law violations relating to the preparation of financial statements, issuer reporting and disclosure, and audit failures. For example, we recently charged five executives and finance professionals with falsifying financial statements in connection with a \$150 million fraudulent bond offering by an international law firm, and an agricultural company and its top executives with conducting a massive accounting fraud in which they repeatedly reported fictitious revenues of approximately \$239 million from their China operations.

Last fall, the staff formed the Financial Reporting and Audit Task Force, which is working to identify areas susceptible to fraudulent financial reporting through an on-going review of financial statement restatements and revisions, analysis of performance trends by industry, and the use of technology-based tools. As a result of the work of the Task Force, a number of new investigations and inquiries are underway, including matters focused on both

traditional and emerging financial fraud issues. And as part of the Commission's ongoing efforts to hold gatekeepers accountable for the important roles they play in the securities industry, Enforcement also launched a risk-based initiative, internally designated "Operation Broken Gate," to identify auditors who may have violated the federal securities laws or failed to comply with U.S. auditing standards during their audits and reviews of financial statements for publicly traded companies. Thus far, Operation Broken Gate's efforts have led to actions against five auditors and their affiliated firms, resulting in suspensions from the ability to audit public companies.

### *Investment Advisers*

In FY 2013, the SEC filed 140 actions against investment advisers. Several of these actions resulted from risk-based investigations, which are proactive measures to identify misconduct at an early stage so that timely action can be taken and investor losses minimized. These cases hold to account those finance professionals who abuse their position of trust by engaging in fraudulent conduct, misrepresent investment returns, or otherwise breach their fiduciary duty to their clients. The SEC also filed multiple actions arising from an initiative to identify investment advisers who lacked effective compliance programs and an initiative based on the detection of abnormal performance returns by hedge funds, as well as a number of actions involving violations of the custody rule.

### *FCPA*

The Commission continues to pursue companies that bribe foreign officials to obtain or retain business, and over the last two-and-a-half years, we have obtained over \$679 million in monetary relief from FCPA actions. For example, the SEC has brought FCPA actions charging a company with a bribe scheme involving business with Aluminum Bahrain; another company with various bribes and improper payments in the Middle East and Africa and violations of U.S. sanctions and export control laws involving Cuba, Iran, Syria, and Sudan; and a third company with bribe schemes involving business with the National Iranian Oil Company. The Commission is also focused on holding individuals accountable, with ongoing FCPA-related litigation against former executives of a number of corporations.

### *Municipal Securities*

The Commission has filed a number of significant actions in the area of municipal securities and public pensions, including actions charging the City of Harrisburg with making materially misleading statements in the secondary market; the State of Illinois with misleading investors about the adequacy of its plan to fund its pension obligations; and the City of Miami with misrepresenting its financial health and for violating a prior cease-and-desist order for similar conduct. In addition, Enforcement launched a novel initiative intended to encourage self-reporting and promote improved disclosure and transparency by municipal issuers and improved compliance by underwriters.

## *Office of the Whistleblower*

The SEC's whistleblower program, established pursuant to the Dodd-Frank Act, has significantly contributed to the SEC's receiving a substantial volume of high-quality information about potential securities law violations. The program has allowed our investigative staff to work more efficiently and permitted us to better deploy agency resources. As set forth in the SEC's Office of the Whistleblower Annual Report for 2013, the Commission received 3,238 tips from whistleblowers in the U.S. and 55 other countries. In September 2013, the Commission made its largest-ever award (over \$14 million) to a whistleblower whose information led to an SEC enforcement action that recovered substantial investor funds.

## **Inspection and Examination Program**

The Office of Compliance Inspections and Examinations (OCIE) is responsible for the Commission's examination and inspection program. OCIE examines securities firms registered with the Commission, including broker-dealers, municipal securities dealers, self-regulatory organizations (SROs), clearing agencies, transfer agents, investment advisers, and investment companies. Additionally, the Dodd-Frank Act increased OCIE's responsibilities to include examinations of, among others, municipal advisors, investment advisers to certain private funds, security-based swap dealers, security-based swap data repositories, major security-based swap participants, and securities-based swap execution facilities. The examination program plays a critical role in supporting and enhancing compliance within the securities industry, which in turn also helps to protect investors and the securities markets generally.

OCIE conducts examinations across the country through its National Examination Program (NEP) and has adopted a risk-based approach for selecting which firms, areas, and issues to examine. In FY 2013, examiners conducted approximately 1,615 examinations, including 438 broker-dealers, 964 investment advisers, 99 investment company complexes, 42 transfer agents, 17 clearing agencies, and five municipal advisors. The staff also conducted 50 market oversight program inspections.

### *Never-Before Examined Advisers Initiative and Presence Exam Initiative*

In 2014, the NEP launched an initiative to engage with the roughly 20% of investment advisers that have been registered for three years or more, but have never been examined (the never-before examined initiative). This initiative includes both risk-assessment and focused reviews. The risk-assessment approach is designed to obtain a better understanding of a registrant and may include a high-level review of an adviser's overall business activities. The focused review approach includes conducting comprehensive, risk-based examinations of one or more higher-risk areas, which could include, among others, the compliance program, portfolio management, or safety of client assets.

In addition, since the effective date of the Dodd-Frank Act, approximately 1,800 advisers to hedge funds and private equity funds have registered with the SEC for the first time. Throughout 2013 and continuing into 2014, Commission staff has launched an initiative to conduct focused, risk-based exams of newly registered private fund advisers. These "presence"

examinations are more streamlined than typical examinations, and are designed both to engage with the new registrants to inform them of their obligations as registered entities and to permit the Commission to examine a higher percentage of new registrants. Some of the common deficiencies from the examinations of these advisers that the staff has identified included: misallocating fees and expenses; charging improper fees to portfolio companies or the funds they manage; disclosing fee monitoring inadequately; and using bogus service providers to charge false fees in order to kick back part of the fee to the adviser. Ongoing presence exams and continued identification of these types of deficiencies inform the NEP's analysis of new and emerging risks, OCIE is on track to complete its goal of examining 25% of these newly registered advisers by the end of 2014. It should be noted that many of the investors in these funds are public and private pension funds as well as charities, academic institutions, and foundations.

### *Large Firm Monitoring*

The Large Firm Monitoring Program (LFM) also enhances the NEP's risk-based examination strategy. The LFM focuses on certain large and complex firms that could pose significant risk to the various markets and to their customers, due to their size, complexity, and connectivity with other large firms and financial institutions. The LFM coordinates closely with other divisions to monitor and examine these large firms and provide regulatory scrutiny, particularly in areas of financial and operational importance.

### *Innovative Data Analytics and Technology*

Over the past several years, OCIE has recruited industry experts to enhance the NEP's technology and data analytics and thus advance its risk-based examination approach. In 2014, OCIE introduced the National Exam Analytics Tool (NEAT), which empowers examiners across the NEP to access and systematically analyze years of trading data in minutes. Such reviews previously were limited to months of trading data and took examiners weeks or more to complete.

Additionally, in FY 2013 OCIE's Risk Analysis Examination (RAE) initiative – which leverages technology to conduct cross-firm review involving large quantities of data – collected and analyzed millions of trading records from over 500 firms. Using this data, the RAE team identified a wide range of problematic behavior including, among other things: unsuitable recommendations, misrepresentations, inadequate supervision, churning, and reverse churning.

Enhanced technology will also be used to enhance the NEP's Anti-Money Laundering (AML) reviews. Rather than a simple verification of an anti-money-laundering program's existence, examiners can now perform nuanced assessments of the quality of an AML program. For example, examiners will begin using complex data analytics and pattern recognition to test the reasonableness of a firm's suspicious activity and monitoring programs, which could include, among other things, evaluating the parameters of a firm's monitoring tools to determine the firm's ability to detect patterns of suspicious customer activity.

The Technology Controls Program, which became part of OCIE in 2014, is currently

charged with conducting inspections of the exchanges and certain other SEC registered entities including clearing agencies and FINRA. These examinations review a wide array of issues such as, for example, information security and networking, physical security, contingency planning, and systems development methodology.

The NEP also has indicated it will focus on various technology-related trading issues in 2014, including algorithmic and high frequency trading, information leakage, and cyber security, among other things.

## **Issuer Disclosure and Capital Formation**

The Division of Corporation Finance (Corporation Finance) regularly and systematically reviews the disclosures and financial statements of reporting companies as required by the Sarbanes-Oxley Act of 2002, and selectively reviews documents that companies file when they engage in public offerings, business combination transactions, and proxy solicitations to ensure that investors have access to material information to accurately inform their investment and voting decisions. During fiscal year 2013, Corporation Finance staff reviewed the annual and periodic reports of over 4,500 companies and, in addition to other selective reviews of transactional filings, almost 600 registration statements by new issuers. Corporation Finance also maintains specialized offices with legal and accounting experts that support filing reviews, undertake reviews of specialized filings, provide interpretive guidance on rules and regulations, participate in Commission rulemaking projects, provide specialized expertise in enforcement matters, evaluate the outcomes of our filing review program and conduct ongoing assessments to evaluate the effectiveness of our internal supervisory controls. Below is an overview of several key Corporation Finance initiatives.

### *Dodd-Frank Act Rulemakings*

Since its passage, the Commission has adopted Dodd-Frank Act rules regarding accredited investors, say-on-pay, asset-backed securities, compensation committee listing standards and disclosure, and conflict minerals. Most recently, the Commission adopted rules regarding disqualifications for felons and other bad actors and proposed a rule regarding the disclosure of the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer. Corporation Finance, along with other Commission staff and the Commission continue to work to implement provisions of the Dodd-Frank Act relating to asset-backed securities, executive compensation matters, credit risk retention in asset-backed securities and payments by resource extraction issuers. Finally, Corporation Finance and other Commission staff are currently conducting the review of the accredited investor definition as it relates to natural persons, as mandated by Section 413 of the Dodd-Frank Act.

### *JOBS Act Rulemakings*

Corporation Finance is responsible for several Commission mandates under the JOBS Act, which rule writing teams in the Division have been working to complete.

- In July 2013, pursuant to Title II of the JOBS Act, the Commission adopted the final rules to allow general solicitation and general advertising for offers and sales made under Rule 506, provided that all securities purchasers are accredited investors and issuers take reasonable steps to verify that purchasers are accredited investors. The rules became effective in September 2013. In conjunction with the adoption of these final rules, the Commission also issued a rule proposal that would enhance the Commission's ability to assess the development of market practices in Rule 506 offerings and that would address concerns that may arise with the use of general solicitation by issuers in these types of offerings.
- In October 2013, as mandated by Title III of the JOBS Act, the Commission proposed rules to implement the new exemption for the offer and sale of securities through crowdfunding, an evolving method to raise capital using the Internet.
- In December 2013, as mandated by Title IV of the JOBS Act, the Commission proposed rules that would build upon Regulation A, which is an existing exemption from registration for small offerings of securities, to enable companies to offer and sell up to \$50 million of securities within a 12-month period.
- Corporation Finance also is developing the rulemaking mandated by Titles V and VI with respect to the changes to the thresholds for registration and deregistration under Section 12(g) of the Exchange Act.

### *Study and Review of Public Company Disclosure Requirements*

In addition to requiring the Commission to conduct rulemakings, the JOBS Act required that several studies be conducted. Beyond those completed in prior years, in December 2013 SEC staff submitted to Congress a report that reviewed Regulation S-K to determine how it may be modernized, made more effective and simplified to reduce the costs and other burdens for emerging growth companies.

Following the issuance of the report, Corporation Finance has been leading the SEC staff's efforts to develop specific recommendations for updating the Regulation S-K rules that specify what a company must disclose in its filings. The staff plans to seek input from a broad range of companies, investors, and other market participants on how the Commission might update and enhance its disclosure rules and filing requirements to make them more meaningful for investors. In addition, SEC staff is coordinating with the Financial Accounting Standards Board to identify ways to improve the effectiveness of disclosures in corporate financial statements and to minimize duplication with other existing disclosure requirements.

### **Trading and Markets**

The Division of Trading and Markets (Trading and Markets) supervises the major participants in the U.S. securities markets including securities exchanges, broker-dealers, clearing agencies, transfer agents, the Financial Industry Regulatory Authority (FINRA), security futures product exchanges, and securities information processors. Trading and Markets also

works closely with the Office of Credit Ratings on rulemaking efforts to implement areas of the Dodd-Frank Act regarding the supervision of nationally recognized statistical rating organizations (NRSROs) and with the Office of Municipal Securities to supervise the Municipal Securities Rulemaking Board (MSRB) and municipal advisors.

Trading and Markets is also continuing significant rulemaking efforts to implement other key areas of the Dodd-Frank Act and the JOBS Act. Additionally, Trading and Markets is responsible for more than 30 separate rulemaking initiatives and studies under the two statutes, including a number that upon completion will create new ongoing supervisory responsibilities. Within the SEC, the Division is also leading significant interagency projects mandated by the Dodd-Frank Act, including the designation of systemically important non-bank financial entities and financial market utilities under the auspices of the Financial Stability Oversight Council (FSOC) and, in conjunction with the Board of Governors of the Federal Reserve (FRB) and the Federal Deposit Insurance Corporation (FDIC), mechanisms for the orderly liquidation of certain large financial companies, including certain large broker-dealers under the new liquidation authority established by the Dodd-Frank Act.

### *OTC Derivatives*

Trading and Markets has continued to engage in rulemaking to establish a new oversight regime for the OTC derivatives marketplace. To date, the Commission has proposed all of the core rules required by Title VII of the Dodd-Frank Act, adopted a number of final rules and interpretations, provided a “roadmap” for implementation of Title VII, and taken other actions to provide legal certainty to market participants during the implementation process. Our most recent efforts include proposing rules relating to books and records and reporting requirements for security-based swap dealers and major security-based swap participants (April 2014) and rules to enhance the oversight of clearing agencies that are deemed to be systemically important or that are involved in complex transactions, such as security-based swaps (March 2014). The staff continues to work to develop recommendations for final rules required by Title VII.

### *Review of Equity Market Structure*

The Commission’s continued focus on equity market structure was enhanced by the roll-out in October 2013 of its equity market structure website. The website is intended to promote a market-wide dialogue and fuller empirical understanding of the equity markets. It serves as a central location for SEC staff to publicly share evolving data, research, and analysis.

- The website includes detailed analyses of trading data by the Division’s Office of Analytics and Research (OAR). OAR has implemented a Market Information Data Analytics System (MIDAS) to collect and analyze market data from both the public consolidated data feeds and the “proprietary” data feeds provided by the exchanges to their customers. OAR has analyzed MIDAS data to address key issues raised by the current market structure, including trading speed, quote lifetimes, trade-to-order volume ratios, hidden volume ratios, and odd-lot rates.

- The website also includes the first two of an ongoing series of research papers prepared by the Division of Economic and Risk Analysis (DERA). These papers use order audit trail data to provide basic descriptive statistics about off-exchange trading venues, which currently account for more than 1/3 of volume in exchange-listed equities.
- The website also includes reviews of economic research on equity market structure authored by academics, regulators, and others. These reviews summarize papers that analyze recent data (2007 and later) relating to a variety of financial markets and products, both in the U.S. and globally.

The equity market structure website reflects the Commission's data-driven approach to a wide range of important and pressing market structure concerns. We particularly are focusing on whether market structure rules and regulatory arrangements continue to meet their objectives of investor protection, fair and orderly markets, and capital formation. Continued evaluation and, as appropriate, advancing initiatives to address market structure concerns is a priority for the Commission in 2014.

#### *Strengthening Critical Market Infrastructure*

Recent market events demonstrate the need to bolster resilience throughout critical market systems. In particular, after the August 2013 interruption in the trading of Nasdaq-listed securities, the equities and options exchanges, FINRA, and the clearing corporations have been working together with other market participants to identify a series of concrete measures designed to address specific areas where robustness and resilience of market systems could be improved. They have provided the Commission with their actions plans for addressing these issues and are working to implement them, including through several measures that should be completed in the near future.

In addition to these initiatives, the Commission continues its efforts to foster robust market infrastructure and reduce the number of systems disruptions through a focus on systems compliance and integrity. For example, in March 2013, the Commission proposed Regulation SCI, which, among other things, would require that exchanges and other key market players maintain policies and procedures reasonably designed to meet certain technology standards and ensure compliance with relevant laws and rules, and that these entities take appropriate corrective action if problems occur. Commission staff is working to prepare a recommendation for the Commission's consideration with respect to the adoption of Regulation SCI this year. In addition, in March 2014, the Commission conducted a Cybersecurity Roundtable, which addressed the cybersecurity landscape and the cybersecurity issues faced by financial market participants today.

#### *Tick Size Pilot for Smaller Companies*

In 2014, the Commission expects to continue its evaluation of decimalization rules that allow (but do not require) market participants to quote security prices in increments as low as a penny and its impact on smaller companies. Since 2001 when decimalization was first

implemented, the structure of the market, the nature of trading and the roles of market participants have changed significantly.

The Commission initiated this recent evaluation on decimalization's impact on smaller companies in 2012 after the passage of Section 106(b) of the JOBS Act, which required the Commission to conduct a study and report to Congress on how decimalization affected the number of initial public offerings and the trading of small and middle capitalization company securities. The Commission submitted the study to Congress on July 20, 2012.

Thereafter, in February 2013, the staff held a three-panel Decimalization Roundtable to gather industry and the public's views on the impact of decimalization. There was broad support across the panels for the Commission to implement a pilot that would widen ticks for small and middle capitalization companies so that data could be generated, though some were concerned about the potential costs of wider ticks.

Since the roundtable, the staff has worked on developing a pilot along carefully defined parameters that would widen the quoting and trading increments and test, among other things, whether a change like this improves liquidity and market quality. A pilot program would allow the Commission to gather data so that analysis could be conducted on the impact of wider quoting and trading increments on liquidity and trading.

#### *The Volcker Rule*

On December 10, 2013, the SEC, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Commodities Futures Trading Commission adopted a final rule under the Bank Holding Company Act to implement Section 619 of the Dodd-Frank Act, generally referred to as the "Volcker Rule." The final rule applies to "banking entities," which are generally defined to include insured depository institutions and their affiliates.

Consistent with Section 619, the final rule generally prohibits banking entities from engaging in proprietary trading and limits their ability to sponsor or invest in hedge funds and private equity funds – termed "covered funds." At the same time, the final rule preserves certain essential financial services that are necessary to capital raising and the healthy functioning of our securities markets, such as underwriting, risk-mitigating, hedging, and market making. Further, the final rule helps preserve banking entities' traditional asset management and advisory businesses by allowing banking entities to continue conducting certain activities in connection with organizing and offering a covered fund.

Banking entities generally have until July 21, 2015 to bring their activities and investments into conformance with the final rule, with additional time allotted for certain collateralized loan obligations. The largest banking entities, however, become subject to a metrics recordkeeping and reporting requirement this summer. Commission staff continues to coordinate with staffs on implementation of the final rule, including responses to interpretive questions, an approach to metrics data submission, compliance and enforcement.

## **Investment Management Oversight and Rulemaking**

The SEC's Division of Investment Management (Investment Management) primarily administers the SEC's regulatory and disclosure-review functions for mutual funds, other investment companies, and investment advisers. As part of these functions, the Commission and the Division oversee funds with a combined \$15 trillion in assets under management and registered investment advisers with over \$61 trillion in assets under management.

### *Money Market Funds*

In June 2013, the Commission proposed additional money market fund reforms. These reforms included two alternative proposals. One is a floating net asset value (NAV) for prime institutional money market funds – the type of funds that experienced the most significant redemptions during the financial crisis. The other proposal would provide for the use of liquidity fees and redemption gates in times of stress. These proposals could be adopted alone or together, and are designed to lessen money market funds' susceptibility to runs, improve their ability to manage and mitigate potential contagion from high levels of redemptions, and increase the transparency of their risks while preserving many of the benefits of money market funds for investors and the short-term funding markets. Staff has reviewed closely the more than 1,400 letters that were submitted, and adopting a final rule in this area is a priority for the Commission in 2014.

### *Private Fund Adviser Regulation*

Title IV of the Dodd-Frank Act directed the Commission to implement a number of provisions designed to enhance the oversight of private fund advisers, including registration of advisers to hedge funds, private equity funds and other private funds that were previously exempt from SEC registration. The SEC's implementation of required rulemaking under Title IV is complete. As a result of the Dodd-Frank Act and the SEC's new rules, the number of SEC-registered private fund advisers has increased by more than 50% to 4,153 advisers. Even after accounting for the shift of mid-sized advisers to state registration pursuant to the Dodd-Frank Act, the total amount of assets managed by SEC-registered advisers has increased significantly from \$43.8 trillion in April 2011 to \$55.7 trillion in March 2014.

For private fund advisers required to be registered with the Commission, pursuant to the Dodd-Frank Act, the Commission adopted confidential systemic risk reporting requirements on Form PF in October 2011 to assist the Financial Stability Oversight Council (FSOC) in systemic risk oversight. As required by the Dodd-Frank Act, Form PF was designed in consultation with the FSOC, and the data filed on Form PF has been made available to the Office of Financial Research within the Department of the Treasury. To date, approximately 2,400 investment advisers have filed reports on approximately 7,000 hedge funds, 66 liquidity funds and 6,000 private equity funds. As required by the Dodd-Frank Act, Commission staff transmitted a report to Congress last year on the Commission's use of Form PF data.

We recognize that the Dodd-Frank Act mandates, for the first time, registration, reporting and compliance responsibilities for many private fund advisers. During the past year,

Commission staff has consulted with numerous private fund industry groups, investors and investment advisers regarding their concerns and questions. These outreach efforts have culminated in the publication of several guidance and interpretative updates by Commission staff on issues for private fund advisers, including one from August 2013 on the custody of private stock certificates.

### *Risk Monitoring*

Pursuant to Section 965 of the Dodd-Frank Act, Investment Management has established a new risk and examinations office (REO). REO monitors trends in the asset management industry and carries out the Division's inspection and examination program. REO is also assisting in a larger Commission-wide initiative to obtain and analyze data consistent with market trends and operational integrity issues, inform policy and rulemaking, and assist the staff in examinations of registrants. Staff from REO and other SEC staff have met with the senior management of several large asset management firms as part of the staff's ongoing outreach efforts.

As part of our continuing efforts to monitor risks, Investment Management staff and other Commission staff are considering ways to improve the information we receive about mutual funds, closed-end funds and exchange-traded funds (ETFs). To that end, staff is actively engaged in developing a recommendation to enhance and modernize the information that funds are reporting to the Commission to give us more timely and useful information about fund operations and portfolio holdings, similar to the information we currently receive on money market fund portfolio holdings. In pursuing this initiative, the goal is to not only improve the quality of the data we receive and to inform our efforts to monitor risk, but also to reduce unnecessary burdens and eliminate unnecessary filings.

### *Target Date Funds*

On April 3, 2014, the Commission issued a release reopening the period for public comment on proposed rule amendments concerning target date fund names and marketing. The release requested comment on the Investor Advisory Committee's recommendation that the Commission develop a glide path illustration for target date funds that is based on a standardized measure of fund risk as a replacement for, or supplement to, the asset allocation glide path illustration the Commission proposed in 2010.

## **Economic Analysis, Risk Assessment, and Data Analytics**

The Division of Economic and Risk Analysis (DERA, previously, the Division of Risk, Strategy, and Financial Innovation) participates in a broad range of Commission activities, providing key technical expertise across a wide variety of matters. The Division has grown significantly since its inception, having more than doubled since its creation in late 2009. A further major expansion is anticipated in fiscal year 2014, with plans to hire 45 additional staff, including additional financial economists and other experts, who will strengthen the already significant Divisional support for rulemaking and policy development; enforcement and inspection activities; and data analytics and processing.

## *Economic Analysis*

DERA plays a central role in the development of Commission rules and policy initiatives. Staff, including Ph.D. financial economists with sophisticated knowledge of the financial markets, provides extensive technical advice and input into a wide range of policy initiatives and directly participate in the rulemaking process.

Over the past year, staff has focused on performing complex data analyses to facilitate rule development. For example, DERA provided information regarding the current approaches to capital raising in the United States to inform rules mandated by the JOBS Act, including the proposal to permit equity-based crowdfunding, the proposal for a new small issue exemption under Section 3(b) of the Securities Act, and the elimination of the ban on general solicitation. DERA is an active participant in a cross-agency group that is monitoring the effect of JOBS Act implementation, including the incidence and level of various types of offerings. Division staff has also continued its examination of the current state of the security-based swap market, providing data analyses of activities and entities participating in that market.

DERA economists also have authored a range of additional data-driven analyses of economic issues. This work, which is available to the public, demonstrates the expertise of DERA's staff, and is intended to inform the public and the Commission on important aspects of the financial markets. For example, DERA staff authored papers that provide detailed data regarding the current state of the private offering market and contributed original and previously unavailable analyses of off-exchange trading of National Market System stocks to the SEC's new Market Structure website.

## *Risk Assessment and Litigation Support*

DERA provides ongoing risk assessment and data analytic support to a range of Commission activities. These activities are intended to help focus the agency's limited resources on the highest risk areas in examinations, registrant reviews, and litigation. For example, DERA has worked to assist OCIE to more efficiently allocate its resources through its work on the broker-dealer risk assessment program, which aids in prioritizing inspections according to risk scores assigned to registrants.

In addition, over the past year, the SEC has been working to enhance the system for handling tips, complaints, and referrals (TCR), focusing on the approach the SEC takes towards gathering, storing, and querying the TCR data. DERA provided analytical and technical leadership throughout this ongoing and important project.

DERA also provides ongoing expert support to the Division of Enforcement, and its work directly contributed to a number of successful investigations. For example, last year, economists assisted in several market manipulation investigations, creating algorithms to analyze the order and transaction files of high-speed traders and quantify the extent of suspicious trading. Staff also provided expert testimony to assist with the freezing of assets in a \$150 million fraud

scheme, and also aided Federal prosecutors in charging insider trading by analyzing evidence of materiality.

### *Information Technology and Data Analytics*

DERA also is central to the SEC's ongoing support of the production and use of structured data. The Division is both a consumer of structured data drawn from multiple sources – relying on this data to perform sophisticated analyses to support rulemakings and risk assessment activities – and a leader in on-going efforts to enhance the availability and usefulness of data collected by the Commission. For example, as part of the rulewriting process, staff regularly assists other divisions and offices with structuring forms to facilitate data collection from filers. DERA staff is also continuously engaged in outreach to the filer community, particularly those who file in XBRL and those vendors who support the filers, to educate and assist with any questions.<sup>2</sup>

In addition, over the past year, the Commission has devoted considerable resources to DERA's launch of the Quantitative Research Analytical Data Support (QRADS) program in September 2013. This ground-breaking initiative enables the structuring and processing of vast quantities of financial market data in order to make it broadly accessible to users across the agency. The program is intended to support Commission staff's use of high-quality financial market data and robust analytical processes relevant to a variety of risk assessment programs and economic analyses. Importantly, it will increase the Commission's ability to link important financial market information originating from a wide variety of sources, allowing staff to make connections across markets and entities not previously possible.

### **Office of Credit Ratings**

The Office of Credit Ratings (OCR) is charged with administering the rules of the Commission with respect to NRSROs, promoting accuracy and enhanced disclosures in credit ratings issued by NRSROs, and helping to ensure that credit ratings are not unduly influenced by conflicts of interest. The Dodd-Frank Act requires OCR to conduct an examination of each NRSRO at least annually and the Commission to make available to the public an annual report summarizing the essential exam findings. The third annual report of the staff's examinations was published in December 2013. The staff will continue to focus on completing the annual examinations of each NRSRO, including follow-up from prior examinations, to promote compliance with statutory and Commission requirements. OCR also has established "colleges" of regulators to provide a framework for information exchange and collaboration with foreign counterparts regarding large, globally-active credit rating agencies.

Under the Dodd-Frank Act, the Commission is required to undertake a number of rulemakings intended to strengthen the integrity of credit rating by, among other things, improving their transparency. These rules are a priority for the Commission in 2014. The Dodd-

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<sup>2</sup> See <http://xbrl.sec.gov/>. This page, in addition to providing extensive information regarding filing in XBRL, also provides contact information to permit the public to reach directly out to staff in DERA who can assist with questions.

Frank Act also mandated three studies relating to credit rating agencies, two of which were published in 2012, and one of which was published in 2013.

Additionally, the Dodd-Frank Act required the Commission to review its regulations that require use of credit ratings as an assessment of the credit-worthiness of a security and undertake rulemakings to remove these references and replace them with other standards of credit-worthiness as the Commission determines to be appropriate. In 2013, the Commission adopted rules to remove references to credit ratings applicable to investment companies and broker-dealers.

### **Office of the Investor Advocate**

Section 915 of the Dodd-Frank Act required the SEC to establish an Office of the Investor Advocate to assist retail investors in resolving significant problems they may have with the Commission or with SROs. The Investor Advocate also will analyze the potential impact on investors from proposed Commission regulations or SRO rules; identify problems that investors have with financial service providers and investment products; and propose to Congress any legislative, administrative, or personnel changes that may be appropriate to promote the interests of investors.

The first Investor Advocate, appointed in February of this year, is in the process of hiring staff, including an Ombudsman as required by Section 919D of the Dodd-Frank Act. The Office of the Investor Advocate will submit its first report to Congress not later than June 30, and the report will set forth the objectives of the Investor Advocate for the upcoming fiscal year. The Office also will provide staff support to the Investor Advisory Committee that was established pursuant to Section 911 of the Dodd-Frank Act.

### **Office of Minority and Women Inclusion**

The Office of Minority and Women Inclusion (OMWI) is responsible for all matters related to diversity in management, employment, and business activities at the SEC. OMWI is responsible for developing standards for equal employment opportunity and diversity of the workforce and senior management of the SEC, the increased participation of minority-owned and women-owned businesses in the SEC's programs and contracts, and assessing the diversity policies and practices of entities regulated by the SEC. OMWI also is required to submit an annual report to Congress on specific actions taken by the agency and OMWI related to minority and women contracting awards, outreach programs, and employee and contractor hiring challenges. Its most recent report was submitted to Congress on April 18, 2014.

#### *SEC Diversity Efforts*

In fiscal year 2013, OMWI initiated an enhanced national outreach and engagement program with several minority- and women-serving organizations and institutions, with the aim of developing strategic relationships to attract a diverse talent pool for current and future employment opportunities at all levels of the agency. OMWI also continued to collaborate with leading organizations focused on developing employment opportunities for minorities and

women in the financial services industry. There remains more that can be done with respect to diversity in our hiring, however, particularly for minority and women attorneys and accountants, and for women compliance examiners. In FY 2014, OMWI will continue to engage SEC hiring officials, minority and women professional organizations representing securities and financial services industry participants, and educational institutions to develop tailored recruitment strategies for minorities and women in these occupations and fields.

### *SEC Programs and Contracts*

The OMWI Director is required to advise the Commission on the impact of the SEC's policies and regulations on minority-owned and women-owned businesses. Of the total \$323.5 million the SEC awarded to contractors in FY 2013, \$93.0 million (28.7%) was awarded to minority-owned and women-owned businesses, an increase over the \$78 million (20.6%) awarded to minority-owned and women-owned businesses in FY 2012. OMWI also continues to move forward with respect to policies relating to contracting. OMWI, working with the SEC's Office of Acquisitions and the Office of the General Counsel, developed a contract standard for SEC services contracts relating to the obligation of contractors to ensure the fair inclusion of women and minorities in their workforces. The contract standard will be incorporated in all SEC contracts for services that exceed the Federal Acquisition Regulation Simplified Acquisition Threshold amount (currently \$150,000). OMWI is finalizing the contract standard for formal agency review and approval.

### *Practices of Regulated Entities*

During fiscal year 2013, the OMWI Directors of the Securities and Exchange Commission, Federal Deposit Insurance Corporation, National Credit Union Administration, Federal Reserve Board, Consumer Finance Protection Bureau, and the Office of the Comptroller of the Currency (the Agencies) collaborated to develop a *Proposed Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies*. The joint standards are intended to promote transparency and awareness of diversity policies and practices within regulated entities and provide guidance for assessing these policies and practices. The joint standards cover four key areas: 1) organizational commitment to diversity and inclusion; 2) workforce profile and employment practices; 3) procurement and business practices and supplier diversity, and 4) practices to promote transparency of organizational diversity and inclusion.

The Policy Statement was published in the Federal Register on October 25, 2013 and was available for a 60 day comment period. In an effort to ensure adequate time for interested parties to share their views, the comment period was extended for an additional 45 days and closed on February 7, 2014. Staff of the agencies are now in the process of reviewing the more than 200 comments received.

### **Office of Municipal Securities**

The Office of Municipal Securities (OMS) administers the Commission's rules on practices of broker-dealers, municipal advisors, investors, and issuers with respect to municipal

securities and to coordinate with the MSRB on rulemaking and enforcement actions. OMS advises the Commission and other SEC offices on policy matters, enforcement, current market issues, and other issues affecting the municipal securities market. OMS also serves as the Commission's liaison to the MSRB, FINRA, the IRS Office of Tax-Exempt Bonds, and various industry groups and regulators on municipal securities issues.

In September 2013, pursuant to Section 975 of the Dodd-Frank Act, the Commission issued final rules for the registration of "municipal advisors." The final rules provide guidance on the statutory definition of the term "municipal advisor," the statutory exclusions from that definition, and certain additional regulatory exemptions. The new registration requirements and regulatory standards are intended to mitigate some of the problems observed with the conduct of some municipal advisors, including "pay to play" practices, undisclosed conflicts of interest, advice rendered by financial advisors without adequate training or qualifications, and failure to place the duty of loyalty to their clients ahead of their own interests. Compliance with the final rules will be required on July 1, 2014, with a phased-in compliance period for registration under the final forms beginning on that day and ending on October 31, 2014.

Over the next year, OMS expects to devote significant attention to implementing these final rules, and providing ongoing legal advice and technical support to the Enforcement Division on enforcement matters in the municipal securities area. Further, OMS also will continue to monitor current issues in the municipal securities market (such as pension disclosure, accounting, and municipal bankruptcy issues) and to assist in considering further recommendations to the Commission with respect to disclosure, market structure, and price transparency in the municipal securities markets.

### **Office of International Affairs**

The Office of International Affairs (OIA) advances international enforcement and supervisory cooperation, supports the SEC's mission through promoting high quality regulatory standards worldwide, and conducts technical assistance programs to strengthen investor protection and regulatory infrastructure globally.

OIA cooperates with foreign counterparts to enable our Enforcement Division to obtain information and evidence located abroad for use in investigations and litigation and to assist the Division in tracing, freezing, and repatriating proceeds of fraud outside the United States. Working with Enforcement, OIA also assists foreign securities regulators with their cases, as assisting foreign counterparts enhances the SEC's ability to obtain reciprocal cooperation from those foreign authorities. OIA partners with Commission staff in other divisions and offices conducting on-site examinations of foreign-domiciled registrants and addressing cross-border registration issues; facilitates cooperation between the Commission and its counterparts in the oversight of globally active entities; and negotiates supervisory memoranda of understanding on behalf of the Commission with foreign regulators.

In addition, OIA develops strategy for and conducts internal coordination of the SEC's engagement in multilateral organizations such as the International Organization of Securities Commissions (IOSCO) and Financial Stability Board (FSB), among others, as well as

for the Commission's bilateral cross-border engagements, such as the US-EU Financial Markets Regulatory Dialogue and US-China Strategic and Economic Dialogue. This past year, SEC staff led or participated in a wide array of international policy workstreams, including reforms related to the OTC derivatives markets, financial market infrastructures, and financial benchmarks. OIA also coordinated the SEC's participation in systemic risk workstreams in IOSCO and the FSB, as well with regard to the global Legal Entity Identifier system for effectively identifying parties to financial transactions.

In addition, OIA, together with other divisions, analyzes the potential impact of SEC rules and actions on foreign market participants active in U.S. markets and on the cross-border activities of U.S. issuers and financial service providers and of foreign regulators' actions on U.S. market participants and the U.S. markets.

OIA also employs technical assistance programs designed to promote the development of high quality regulatory standards. During fiscal year 2013, OIA held four major international institutes in Washington, D.C. covering market development, enforcement, examinations, and anti-corruption. OIA also provided training in regional and bilateral programs on a wide array of topics, such as regulation and supervision of algorithmic trading, anti-money laundering, and risk-based supervision.

### **Office of the Chief Accountant**

The Commission's Office of the Chief Accountant, which serves as the principal advisor to the Commission on accounting and auditing matters, oversees the Financial Accounting Standards Board's (FASB) process for setting accounting standards for public companies, and the Public Company Accounting Oversight Board (PCAOB), which oversees the audits of public companies. The Commission also plays an important role in connection with International Financial Reporting Standards (IFRS), which foreign private issuers can use in their filings with the Commission, including through interaction with the International Accounting Standards Board (IASB) and the Commission's participation on the IFRS Foundation Monitoring Board.

Commission staff continued in fiscal year 2013 to monitor and support the activities of the FASB and the IASB as they made progress in their efforts to converge U.S. GAAP and IFRS. Commission staff reviews these and all major standard-setting and interpretive efforts of the FASB and the IASB to ensure the appropriateness of accounting standards used by issuers in U.S. markets.

The Commission's oversight over the PCAOB includes appointing board members, approving PCAOB rules, reviewing PCAOB disciplinary actions and disputes regarding inspection reports, and approving the PCAOB's budget and accounting support fee. The PCAOB has an active standard-setting agenda, including projects to update numerous standards that address important aspects of the performance of audits and a project to consider changes to the content of the auditor's report on a company's financial statements.

## **Office of Investor Education and Advocacy**

The Office of Investor Education and Advocacy (OIEA) seeks to provide individual investors with the information they need to avoid fraud and make sound decisions concerning investments in the securities markets. OIEA advances this mission by communicating daily with investors, responding to their complaints and inquiries, and providing educational programs and materials.

During fiscal year 2013, OIEA processed almost 23,000 complaints, questions, and other contacts from investors, and published 26 investor alerts and bulletins, the most ever in a single year, to educate investors about possible risks to their investment portfolios. The alerts and bulletins warned investors of possible fraudulent scams, including Ponzi schemes using Bitcoin and other virtual currencies and the effect of market interest rates on bond prices and yield. The alerts also are used to educate investors on a variety of current investment-related topics, including by providing information concerning advertising for unregistered offerings as permitted by the JOBS Act. In addition, OIEA staff worked with other regulators to issue joint alerts and bulletins, including an SEC-CFTC investor alert on binary options, an SEC-FINRA alert on pump-and-dump stock schemes, and an SEC-FINRA bulletin on pension and settlement income streams.

## **Internal Operations**

The Office of the Chief Operating Officer (OCOO) leads and coordinates the activities of the Offices of Acquisitions, Financial Management, Human Resources, Information Technology, and Support Operations. The OCOO is leading a coordinated, ongoing and successful effort to improve agency performance and shift resources from back-office to mission-critical functions by upgrading the SEC's technology infrastructure, streamlining agency operations and more effectively training and managing its dedicated and talented staff.

The SEC continues to place a high priority on strong internal controls over the dollars entrusted to the agency and in 2013 – the first full year after migrating financial operations to a shared Federal Services Provider – the SEC successfully eliminated two previously identified significant deficiencies by tightening the controls over budgetary resources and agency assets and had no material weaknesses. This year, the SEC is focusing on strengthening information security, the one remaining significant deficiency, and continuing to modernize its suite of financial systems and enhance reporting and management of disgorgements and penalties. For the past three years, the SEC has had no material weaknesses in its annual financial audits from the Government Accountability Office. These positive results represent very important improvements over past years, but we must continue to work to enhance all aspects of our internal controls.

The SEC also has:

- Realized savings through a new acquisitions strategy based on greater competition, strategic sourcing and longer performance periods. Improved performance in key areas such as contracting oversight and procedures led to significant cost savings in fiscal year

2013. Savings will continue in 2014 as the SEC works with the General Services Administration to reduce its leased space inventory.

- Received and responded to a record number of Freedom of Information Act (FOIA) requests while reducing the backlog and shortening response times, by implementing comprehensive internal controls.
- Streamlined human capital management efforts through use of a new, automated HR Portal that provides a single, authoritative location for managing all critical content and achieving cost and time savings across an array of human resources-related functions.
- Enhanced the agency's internal controls processes, financial systems and operational effectiveness by eliminating manual processing of filing fees, disgorgements, and penalties.

### **Leveraging Technology**

As one of our highest priorities, the SEC continues to modernize its technology systems, both enhancing internal operational effectiveness and improving external oversight of the financial markets. In fiscal year 2013, the SEC introduced the multi-year technology transformation plan, called "Working Smarter," to improve core operations and implement the agency's new post Dodd-Frank responsibilities. "Working Smarter" is already delivering better services and more effective tools for employees, investors, companies, and the public by:

- Standardizing enterprise-wide platforms;
- Modernizing the SEC.gov and the Electronic Data Gathering, Analysis and Retrieval (EDGAR) filer systems;
- Integrating structured and unstructured data sources;
- Improving internal search and discovery capabilities and providing complex, predictive analytical capabilities;
- Assisting with automated triage and early detection of fraud or abuse at the earliest possible stage; and
- Allowing access to information required for investigations, examinations and enforcing actions with previously unachievable speed and accuracy.

In addition, agency-wide technology initiatives delivered \$18 million in cost avoidance in fiscal year 2013 while also freeing up staff time for examinations, enforcement investigations, and other core aspects of the agency's mission.

## **Fiscal Year 2015 Budget Request**

As I have summarized, the SEC has vast and important responsibilities to investors, our markets, and to the facilitation of capital formation. As you know, the SEC's funding mechanism is deficit-neutral, and thus the amount Congress appropriates to the agency does not have an impact on the nation's budget deficit, nor will it impact the amount of funding available for other agencies.<sup>3</sup> Our appropriation also does not count against the caps set in the bi-partisan Congressional budget framework for 2014 and 2015. This structure should allow for an appropriation that provides the agency the resources to fulfill the responsibilities Congress has given it.

I want to be very clear that, irrespective of the agency's funding mechanism, I deeply appreciate that I have a serious responsibility to be an effective and prudent steward of the funds we are appropriated, and since my arrival we have made every effort to effectively and efficiently deploy our funds to accomplish our mission and the goals that Congress has set for us. While the SEC makes increasingly effective and efficient use of its limited resources, we nevertheless were in a position to only examine 9% of registered investment advisers in fiscal year 2013. In 2004, the SEC had 19 examiners per trillion dollars in investment adviser assets under management. Today, we have only 8. More coverage is plainly needed, as the industry itself has acknowledged. The SEC's fiscal year 2015 budget request would permit the SEC to increase its examination coverage of investment advisers who everyday investors are increasingly turning to for investment assistance with retirement and family needs. It also would allow the SEC to build upon its strong efforts and accomplish other key and pressing priorities, including:

- Strengthening our enforcement program's efforts to detect, investigate, and prosecute wrongdoing;
- Continuing the agency's investments in the technologies needed to keep pace with today's high-tech, high-speed markets; and
- Enhancing the agency's oversight of the rapidly changing markets and ability to carry out its increased regulatory responsibilities.

The additional resources we seek are to enable us to keep pace with the growing size and complexity of the securities markets and the agency's broad responsibilities. The SEC currently oversees more than 25,000 market participants, including over 11,000 investment advisers, approximately 10,000 mutual funds and exchange-traded funds, 4,450 broker-dealers, 450 transfer agents, 18 securities exchanges, as well as the PCAOB, FINRA, MSRB, the Securities Investor Protection Corporation, and the FASB. The SEC also has responsibility for reviewing the disclosures and financial statements of approximately 9,000 reporting companies, and has new and expanded responsibilities over the derivatives markets, an additional 2,500 reporting

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<sup>3</sup> Section 991 of the Dodd-Frank Act requires the SEC to collect transaction fees from self-regulatory organizations in an amount designed to directly offset our appropriation. The current fee rate is about \$0.02 per every \$1,000 transacted.

advisers to hedge fund and other private funds, close to 1,000 municipal advisors, ten registered credit rating agencies, and seven registered clearing agencies. And, as you know, between the Dodd-Frank and the JOBS Acts, the SEC was given nearly 100 new rulemaking responsibilities.

The funding we are seeking is fully justified by our existing and growing responsibilities to investors, companies, and the markets. With what I believe is a thoughtful and targeted approach to our resource challenges, the FY 2015 budget request of \$1.7 billion would allow the SEC to hire additional staff in critical, core areas and enhance our information technology and training.

## **Conclusion**

Thank you for your support for the agency's mission and for inviting me to be here today to discuss the many initiatives of the SEC. Your continued support will allow us to better protect investors and facilitate capital formation, more effectively oversee the markets and entities we regulate, and build upon the significant improvements we have made to date.

I am happy to answer any questions you may have.