Testimony on "SEC Oversight"
by
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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).[1]

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.

[1] The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the 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).[2] 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

[2] *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.[3] 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;[4]
- Provided guidance regarding – and where appropriate, interim exemptions from – the various pre-Dodd-Frank provisions that would otherwise have applied to security-based swaps;[5] and

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[3] *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.

[4] *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.

[5] *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. [6]

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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[6] *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,[7] 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.[8]

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."[9] 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

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[7] *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.

[8] *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.

[9] *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[10] 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

[10] *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*.[11] 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

[11] *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.[12]

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.[13] 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)

[12] *See* http://sec.gov/news/studies/2012/secorgreformreport-2012-df967.pdf.

[13] A copy of the SEC's FY2013 Budget Congressional Justification can be found on our website at http://www.sec.gov/about/secfy13congbudgjust.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.