

**Testimony on Oversight of the SEC**  
**by**  
**Chair Mary Jo White**

**Before the**  
**U.S. House of Representatives Committee on Financial Services**

**May 16, 2013**

Chairman Hensarling, Ranking Member Waters and Members of the Committee:

Thank you for the opportunity to testify on behalf of the Commission regarding the recent activities of the U.S. Securities and Exchange Commission (SEC). I have been Chair of the SEC for only a month, but in this short period of time I have been extremely impressed by the commitment, talent, and expertise of my fellow Commissioners and the agency's staff. The challenges before us are many, but I am confident that we will work tirelessly together in an effort to fulfill the broad, three-part mission of the SEC: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

The breadth of the SEC's jurisdiction is vast – our Divisions and Offices are responsible for implementing and enforcing the federal securities laws, overseeing thousands of key participants in the securities markets (over 25,000 entities currently),<sup>1</sup> and reviewing disclosures and financial statements of more than 9,100 reporting companies. In recent years, the agency has made significant strides to strengthen its examination and enforcement functions, improve its capacity to assess risks, and enhance its technology, and also has made internal improvements designed to maximize efficiencies and reform its operations. Much more, however, remains to be accomplished.

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Startups Act (JOBS Act), the agency's importance and scope of responsibilities are greater than ever, with the Dodd-Frank Act giving the Commission additional responsibilities for over-the-counter derivatives, hedge fund and other private fund advisers, municipal advisers, security-based swap clearing agencies, and the JOBS Act providing for several new or revised exemptions from the registration requirements of the Securities Act, including a new regime for crowdfunding offerings. Although the SEC has proposed or adopted rules for over 80 percent of the more than 90 Dodd-Frank Act provisions that require SEC rulemaking, there is much Dodd-Frank work that remains. Similarly, the JOBS Act requires significant Commission rulemaking which is not yet finalized. I believe that the SEC must complete, in as timely and smart a way as possible, the rulemaking mandates contained in both the Dodd-Frank Act and JOBS Act.

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<sup>1</sup> These participants include about 10,600 investment advisers, 9,700 mutual funds and exchange traded funds, 4,600 broker-dealers, and 460 transfer agents. We also oversee 17 national securities exchanges, eight active clearing agencies, and 10 nationally recognized statistical rating organizations (each, an NRSRO), 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), and the Financial Accounting Standards Board (FASB).

I also believe that the SEC needs to be in a position to provide expert oversight over today's highly complex and dispersed marketplace so that it can be wisely and optimally regulated. Such oversight must come without undue cost and without undermining market vitality. While this will entail additional investments in technology and expertise, the goal is to help the agency keep better pace with the markets we monitor and regulate while also permitting us to see around corners and anticipate issues that may arise.

Beyond this, I also feel that the Commission needs to further strengthen the enforcement and examination functions of the SEC. Strong enforcement of the securities laws is necessary for investor confidence and is essential to the integrity of our financial markets. Successful enforcement actions result in sanctions that deter and punish wrongdoing and protect investors, both now and in the future. Similarly, our National Examinations Program is critical to improving compliance by regulated entities, preventing and detecting fraud, and monitoring market risks.

My testimony today will highlight the work of each of the SEC's Divisions and many of its Offices, including the SEC's progress implementing the Dodd-Frank Act and JOBS Act. I also will briefly discuss the agency's FY 2014 budget request.<sup>2</sup>

## **Enforcement**

A vigorous enforcement program is at the heart of the SEC's efforts to protect investors and promote the integrity of the marketplace. As the agency's largest division, the Enforcement Division (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 2012, Enforcement continued to perform at a high-level, utilizing its enhanced expertise and specialization capabilities to file tough enforcement actions that sent a strong deterrent message in an increasingly complex and global securities market. In the aftermath of the financial crisis, the SEC obtained orders requiring the payment of \$3.1 billion in penalties and disgorgement in its filed enforcement actions in FY 2012, with a total of \$5.9 billion in penalties and disgorgement in the past two years. The Commission does not, however, set quantitative targets for Enforcement activity, and quantitative metrics alone are not a complete yardstick of the measure of Enforcement's effectiveness. Consistent with Commission guidance, Enforcement considers the quality, breadth and effect of the actions pursued.

Enforcement's specialized units – Asset Management, Market Abuse, Structured and New Products, Foreign Corrupt Practices Act, and Municipal Securities – continue to build institutional knowledge and experience that allow our attorneys to recognize and respond to suspicious activity more quickly. To enhance our knowledge, we have recruited industry experts

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<sup>2</sup> In accordance with past practice, the SEC's FY 2014 Congressional Budget Justification was submitted by the Chair and was not voted on by the full Commission. The budget request can be found at <http://sec.gov/about/reports/secfy14congbudjust.shtml>.

– non-lawyers with specialized experience in sophisticated products, transactions, and industry practices – to assist us in our investigations.

Enforcement’s recent actions reflect an aggressive and continued pursuit of institutions and individuals whose actions contributed to the financial crisis, a focus on exchanges and market structure issues aimed at ensuring a fair securities marketplace, pursuit of investment advisers for fraudulent conduct, and continued efforts to combat insider trading by those who abuse positions of trust and confidence for personal gain. In particular, I would like to highlight the following efforts:

#### *Financial Crisis Cases*

The SEC continues to hold accountable individuals and institutions whose misconduct contributed to the financial crisis. The SEC filed an additional 42 financial crisis-related enforcement actions since the beginning of FY 2012. Over the last two-and-a-half years, the SEC has filed 94 such actions against 157 individuals and entities, including 66 CEOs, CFOs, and other senior corporate executives. These crisis-related enforcement actions have resulted in 36 individuals being barred from serving in the securities industry or as officers or directors of public companies, as well as orders of nearly \$2.7 billion in financial relief for harmed investors.

#### *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, alternative trading platforms, broker-dealers, and other market participants. Noteworthy cases included actions charging:

- the New York Stock Exchange with providing certain customers with favored access to data that could be used to make investment decisions;<sup>3</sup>
- dark pool operator eBX LLC with failing to protect the confidential trading information of its customers;<sup>4</sup>
- brokerage firm Hold Brothers On-Line Investment Services with allowing foreign traders to access the markets and conduct manipulative trading through an illegal practice known as “layering;”<sup>5</sup> and
- Pipeline Trading Systems LLC and two of its top executives with failing to disclose to its customers that most orders placed on the dark pool trading platform were filled by a trading operation affiliated with Pipeline.<sup>6</sup>

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<sup>3</sup> Release No. 34-67857, *In the Matter of New York Stock Exchange LLC, et al.* (September 14, 2012), <http://www.sec.gov/litigation/admin/2012/34-67857.pdf>.

<sup>4</sup> Release No. 34-67969, *In the Matter of eBX, LLC* (October 3, 2012), <http://www.sec.gov/litigation/admin/2012/34-67969.pdf>.

<sup>5</sup> Release No. 34-67924, *In the Matter of Hold Brothers On-Line Investment Services, LLC, et al.* (September 25, 2012), <http://www.sec.gov/litigation/admin/2012/34-67924.pdf>.

<sup>6</sup> Release No. 34-65609, *In the Matter of Pipeline Trading Systems LLC, et al.* (October 24, 2011), <http://www.sec.gov/litigation/admin/2011/33-9271.pdf>.

## *Insider Trading*

The SEC continued its aggressive pursuit of individuals who unlawfully traded on material, non-public information. Many of these actions have involved financial professionals, hedge fund managers, corporate insiders and board members, attorneys or other service professionals who unlawfully tipped or traded on material, non-public information.

Recent examples of insider trading actions include an action against a former senior audit partner at KPMG for tipping his friend with confidential details about five of KPMG's audit clients;<sup>7</sup> a portfolio manager at hedge fund advisory firm Sigma Capital Management who traded on inside information ahead of quarterly earnings announcements by two prominent publicly-traded technology companies;<sup>8</sup> and a former portfolio manager of CR Intrinsic Investors LLC in a \$276 million insider trading scheme involving a clinical trial for an Alzheimer's drug.<sup>9</sup>

## *Investment Advisers*

In FY 2012, the SEC filed 147 actions against investment advisers, the most ever in a single year. 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. The SEC also filed multiple actions arising from an initiative to identify investment advisers who lacked effective compliance programs<sup>10</sup> as well as an investigative initiative into abnormal performance returns by hedge funds.<sup>11</sup>

## *Cross Border Working Group*

Another risk-based initiative that resulted in significant recent actions is the Cross Border Working Group,<sup>12</sup> which focuses on U.S. companies with substantial foreign operations, particularly in China. Through the Cross Border Working Group, the SEC has filed fraud cases involving more than 40 issuers and executives, and deregistered the securities of more than 50 companies. In February, the SEC charged Keyuan Petrochemicals, a China-based company, and

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<sup>7</sup> Litigation Release No. 22670, *SEC v. Scott London, et al.* (April 11, 2013), <http://www.sec.gov/litigation/litreleases/2013/lr22670.htm>.

<sup>8</sup> *SEC v. Michael Steinberg* (March 29, 2013), <http://www.sec.gov/litigation/complaints/2013/comp-pr2013-49.pdf>.

<sup>9</sup> Litigation Release No. 22539, *SEC v. CR Intrinsic Investors, LLC, et al.* (November 20, 2012), <http://www.sec.gov/litigation/litreleases/2012/lr22539.htm>.

<sup>10</sup> Release No. IA-3324, *In the Matter of Asset Advisors, LLC* (November 28, 2011), <http://www.sec.gov/litigation/admin/2011/ia-3324.pdf>; Release No. 34-65838, *In the Matter of Feltl & Company, Inc.* (November 28, 2011), <http://www.sec.gov/litigation/admin/2011/34-65838.pdf>; Release No. 34-65837, *In the Matter of OMNI Investment Advisors Inc., et al.* (November 28, 2011), <http://www.sec.gov/litigation/admin/2011/34-65837.pdf>.

<sup>11</sup> Litigation Release No. 22176, *SEC v. Michael R. Balboa, et al.* (December 2, 2011), <http://www.sec.gov/litigation/litreleases/2011/lr22176.htm>; Litigation Release No. 22151, *SEC v. Chetan Kapur, et al.* (November 10, 2011), <http://www.sec.gov/litigation/litreleases/2011/lr22151.htm>; Litigation Release No. 22167, *SEC v. Patrick G. Rooney, et al.* (November 22, 2011), <http://www.sec.gov/litigation/litreleases/2011/lr22167.htm>; Release No. 34-65750, *In the Matter of LeadDog Capital Markets, LLC, et al.* (November 15, 2011), <http://www.sec.gov/litigation/admin/2011/33-9277.pdf>.

<sup>12</sup> The Cross Border Working Group is an intra-agency group with representatives from each of the SEC's major divisions and offices.

its former CFO with accounting and disclosure violations, resulting in penalties of more than \$1 million.<sup>13</sup>

### *FCPA Manual*

In November 2012, the staff of the SEC and the Department of Justice issued a 120-page guide providing detailed analysis of the U.S. Foreign Corrupt Practices Act.<sup>14</sup> The guide details the SEC and DOJ approach to FCPA enforcement and addresses a wide variety of topics relevant to compliance with the law. The guide, which is available on the SEC's website at <http://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf>, is a helpful resource to companies doing business overseas and should further our goals of education and deterrence.

### *Guidance on the Use of Social Media by Public Companies*

In early April, the SEC provided guidance to public companies about the use of social media for company announcements. In a report issued pursuant to Section 21(a) of the Securities Exchange Act of 1934, the SEC made clear that companies can use social media, such as Facebook and Twitter, to announce key information in compliance with the federal securities laws so long as investors have been alerted about which social media outlets will be used to disseminate such information.<sup>15</sup> The report clarified that issuer communications through social media channels require careful Regulation FD analysis comparable to communications through more traditional channels, and that the principles outlined in the Commission's earlier guidance on Regulation FD apply with equal force to corporate disclosures made through social media channels.<sup>16</sup>

### *Cooperation*

The SEC's Cooperation Program provides incentives to individuals and companies who come forward and provide valuable information in our investigations. The program gives us access to high-quality evidence, resulting in stronger cases that shut down fraudulent schemes earlier than would otherwise be possible. Last month, the Commission announced a non-prosecution agreement with Ralph Lauren Corporation in which the SEC decided not to charge the company with FCPA violations because of its extensive, thorough, and real-time self-reporting and cooperation with the SEC's investigation, thereby demonstrating the substantial and tangible benefits of cooperation.<sup>17</sup>

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<sup>13</sup> Litigation Release No. 22627, *SEC v. Keyuan Petrochemicals, Inc., et al.* (February 28, 2013), <http://www.sec.gov/litigation/litreleases/2013/lr22627.htm>.

<sup>14</sup> *SEC and Justice Department Release FCPA Guide (November 14, 2012)*, <http://www.sec.gov/news/press/2012/2012-225.htm>.

<sup>15</sup> Release No. 34-69279, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings* (April 2, 2013), <http://www.sec.gov/litigation/investreport/34-69279.htm>.

<sup>16</sup> *Id.*, at 5.

<sup>17</sup> *SEC Announces Non-Prosecution Agreement with Ralph Lauren Corporation Involving FCPA Misconduct* (April 22, 2013), <http://www.sec.gov/news/press/2013/2013-65.htm>.

## *Office of the Whistleblower*

The SEC's whistleblower program established pursuant to the Dodd-Frank Act has resulted in investigative staff receiving a substantial volume of high quality information about potential securities laws violations. It has allowed our investigative staff to work more efficiently and permitted us to better utilize agency resources. As set forth in the SEC's Office of the Whistleblower Annual Report for 2012,<sup>18</sup> the Commission received 3,001 tips from whistleblowers in the U.S. and 49 other countries. In August 2012, the Commission made its first award under the whistleblower program.<sup>19</sup>

## **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 compliance within the securities industry, which in turn also helps to protect investors and the securities markets generally.

OCIE has adopted a risk-based examination approach to select firms for examination, the areas of the firm examined, and the issues covered. These examinations are conducted across the country through the Commission's National Examination Program (NEP). In FY 2012, examiners conducted approximately 1,600 examinations, including 443 broker-dealer, 974 investment adviser, 104 investment company complex, 42 transfer agent, and five clearing agency examinations. The staff also conducted 38 market oversight program inspections. Some of the NEP's recent key efforts include the following:

### *Presence Examinations of Newly Registered Investment Advisers*

Initiated in FY 2012 (and more fully integrated in FY 2013), the NEP launched a coordinated national examination initiative designed to establish a meaningful presence with newly registered advisers (the "presence exam initiative").<sup>20</sup> Since the effective date of the Dodd-Frank Act, approximately 1,500 advisers to hedge funds and private equity funds have registered with the SEC for the first time. The presence exam initiative hopes to reach a significant percentage (at least 15 to 25 percent) of these advisers by the end of FY 2014 and is intended, among other things, to assess their commitment to compliance and to meeting their

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<sup>18</sup> The 2012 report is available at <http://www.sec.gov/about/offices/owb/annual-report-2012.pdf>.

<sup>19</sup> Release No. 34-67698, *In the Matter of the Claim for Award in connection with [Non-Public]* (August 21, 2012), <http://www.sec.gov/rules/other/2012/34-67698.pdf>.

<sup>20</sup> The letter sent to registrants describing the presence exam initiative is available at <http://www.sec.gov/about/offices/ocie/letter-presence-exams.pdf>.

obligations under the federal securities laws; raise firms' awareness about certain higher-risk areas identified; and generate a proactive effort in firms' compliance departments to strengthen controls and policies on issues beyond the scope of these limited-focus examinations.

Beyond this, the NEP seeks to prioritize examinations where the staff's analytics indicate higher risks to investors relative to the rest of the registrant population, or find indicia of fraud or other serious wrongdoing. OCIE recently issued a risk alert on compliance with the SEC's custody rule for investment advisers.<sup>21</sup> The alert came after a review of recent examinations that identified significant custody-related issues in about one-third of the firms examined.

### *Developing Examination Staff Expertise*

Following the establishment in the NEP in FY 2011 of specialized working groups in key areas including derivatives, hedge funds, private equity, valuation, new and structured products, market structure and trading practices, fixed income and municipal securities, risk management, quantitative analytics and technology, OCIE has continued recruitment of industry experts who bring deep technical experience to our exam program in these areas. A new Quantitative Analytics Unit (QAU) also gives the NEP the expertise to engage and examine the most sophisticated investment firms and programs, including the expertise to identify and understand risks in the algorithms, models, and software on which our registrants increasingly rely for investment decision-making and trading. Additionally, the NEP continued developing a Certified Examiner Training program that will enhance examiner skills, expertise and provide ongoing technical and leadership training.

### *Other Initiatives*

Beyond this, the NEP, among other things:

- recently issued the first public annual statement of examination program goals, setting forth examination priorities and focus areas for the exam program;<sup>22</sup>
- recently implemented a new internal compliance and ethics program to monitor performance and ensure quality and accountability;
- continued to streamline and automate the exam process through the updating of a web-based exam documentation and workpaper retention program; and
- continued to improve coordination with other regulators, including other federal and state regulators as well as counterparts in other countries.

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<sup>21</sup> *Significant Deficiencies Involving Adviser Custody and Safety of Client Assets* (March 4, 2013), <http://www.sec.gov/about/offices/ocie/custody-risk-alert.pdf>.

<sup>22</sup> *Examination Priorities for 2013* (February 21, 2013), <http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2013.pdf>.

## 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 for informed investment and voting decisions. 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, and provide specialized expertise in enforcement matters. 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,<sup>23</sup> say-on-pay,<sup>24</sup> asset-backed securities,<sup>25</sup> compensation committee listing standards and disclosure,<sup>26</sup> conflict minerals,<sup>27</sup> and payments by resource extraction issuers.<sup>28</sup> Corporation Finance and other Commission staff and the Commission continue to work to implement provisions of the Dodd-Frank Act relating to asset-backed securities,<sup>29</sup>

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<sup>23</sup> See Section 413(a) of the Dodd-Frank Act and Release No. 33-9287, *Net Worth Standard for Accredited Investors* (December 21, 2011), <http://www.sec.gov/rules/final/2011/33-9287.pdf>.

<sup>24</sup> See Section 951 of the Dodd-Frank Act and Release No. 33-9178, *Shareholder Approval of Executive Compensation and Golden Parachute Compensation* (January 25, 2011), <http://www.sec.gov/rules/final/2011/33-9178.pdf>.

<sup>25</sup> See Section 942(a) of the Dodd-Frank Act and Release No. 34-65148, *Suspension of the Duty to File Reports for Classes of Asset-Backed Securities under Section 15(d) of the Securities Exchange Act of 1934* (August 17, 2011), <http://www.sec.gov/rules/final/2011/34-65148.pdf>; Section 943 of the Dodd-Frank Act and 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>; Section 945 of the Dodd-Frank Act and Release No. 33-9176, *Issuer Review of Assets in Offerings of Asset-Backed Securities* (January 20, 2011), <http://www.sec.gov/rules/final/2011/33-9176.pdf>.

<sup>26</sup> See Section 952 of the Dodd-Frank Act and Release No. 33-9330, *Listing Standards for Compensation Committees* (June 20, 2012), <http://www.sec.gov/rules/final/2012/33-9330.pdf>.

<sup>27</sup> See Section 1502 of the Dodd-Frank Act and Release No. 34-67716, *Conflict Minerals* (August 22, 2012), <http://www.sec.gov/rules/final/2012/34-67716.pdf>.

<sup>28</sup> See Section 1504 of the Dodd-Frank Act and Release No. 34-67717, *Disclosure of Payments by Resource Extraction Issuers* (August 22, 2012), <http://www.sec.gov/rules/final/2012/34-67717.pdf>.

<sup>29</sup> See Release No. 34-64148, *Credit Risk Retention* (March 30, 2011), <http://www.sec.gov/rules/proposed/2011/34-64148.pdf> and Release No. 34-65355, *Prohibition against Conflicts of Interest in Certain Securitizations* (September 19, 2011), <http://www.sec.gov/rules/proposed/2011/34-65355.pdf>.



disqualifications for felons and other bad actors,<sup>30</sup> executive compensation matters,<sup>31</sup> and credit risk retention in asset-backed securities.<sup>32</sup>

### *JOBS Act Rulemakings*

Corporation Finance is responsible for several Commission mandates under the JOBS Act. Rulewriting teams have been working on recommendations for the Commission's consideration with respect to JOBS Act rulemakings concerning general solicitation, crowdfunding, a new small offering exemption for up to \$50 million, and thresholds for registration and deregistration under Section 12(g) of the Exchange Act.<sup>33</sup>

In August 2012, pursuant to Title II of the JOBS Act, the Commission proposed 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.<sup>34</sup> The comment period for the proposal ended in October 2012. The Commission and Corporation Finance staff continue to work on implementing this provision of the JOBS Act.

In addition to requiring the Commission to conduct rulemakings, the JOBS Act required the Commission to conduct several studies. The Commission was required to examine its authority to enforce the anti-evasion provisions of Exchange Act Rule 12g5-1 and submit recommendations to Congress.<sup>35</sup> A report on the study was submitted to Congress in October 2012.<sup>36</sup> Corporation Finance also assisted in conducting a study on the transition to trading and quoting securities in one penny increments – also known as decimalization – and the impact decimalization has had on the number of initial public offerings since its implementation.<sup>37</sup> The report was submitted to Congress in July 2012.<sup>38</sup> Finally, the JOBS Act required a review of Regulation S-K to determine how it may be modernized and simplified to reduce the costs and

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<sup>30</sup> See Section 926 of the Dodd-Frank Act and Release No. 33-9211, *Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings* (May 25, 2011), <http://www.sec.gov/rules/proposed/2011/33-9211.pdf>.

<sup>31</sup> See Sections 953(a), 953(b), 954 and 955 of the Dodd-Frank Act.

<sup>32</sup> See Section 941 of the Dodd-Frank Act. This was a joint rulemaking with other federal agencies.

<sup>33</sup> See Titles II, III, IV, V and VI of the JOBS Act, respectively.

<sup>34</sup> See Section 201(a) of the JOBS Act and Release No. 33-9354, *Eliminating the Prohibition against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings* (August 29, 2012), <http://www.sec.gov/rules/proposed/2012/33-9354.pdf>.

<sup>35</sup> See Section 504 of the JOBS Act.

<sup>36</sup> See *Report on Authority to Enforce Exchange Act Rule 12g5-1 and Subsection (b)(3)* (October 15, 2012), <http://www.sec.gov/news/studies/2012/authority-to-enforce-rule-12g5-1.pdf>. The staff concluded that the current enforcement tools available to the Commission are adequate to enforce the anti-evasion provision of Rule 12g5-1 and determined not to make any legislative recommendations regarding enforcement tools relating to Rule 12g5-1(b)(3).

<sup>37</sup> See Section 106(b) of the JOBS Act.

<sup>38</sup> See *Report to Congress on Decimalization* (July 2012), <http://www.sec.gov/news/studies/2012/decimalization-072012.pdf>.

other burdens for emerging growth companies.<sup>39</sup> The staff is in the process of preparing its recommendations and is working to complete its review in the near future.

## **Trading and Markets Oversight and Rulemaking**

The Division of Trading and Markets (Trading and Markets) seeks to establish and maintain standards for fair, orderly, and efficient markets, while fostering investor protection and confidence in the markets. Trading and Markets supervises the major participants in the U.S. securities markets, and also works closely with the Commission's Office of Credit Ratings to supervise 10 nationally recognized statistical rating organizations (NRSROs) and with the Office of Municipal Securities to supervise the Municipal Securities Rulemaking Board (MSRB) and municipal advisors.

The Dodd-Frank Act and the JOBS Act added substantial new responsibilities to Trading and Market's portfolio, with the division being responsible for more than 30 separate rulemaking initiatives and studies under the two statutes, including a number that will create new ongoing supervisory responsibilities upon completion. I would like to highlight several of these activities.

### *Market Structure*

Addressing Extraordinary Market Volatility. In the wake of the May 6, 2010 "Flash Crash," Trading and Markets took the lead on several Commission actions to address extraordinary market volatility. Most recently, these actions included approval of a National Market System (NMS) Plan to implement a "limit up-limit down" mechanism to create "speed bumps" to limit abrupt market movements in individual securities,<sup>40</sup> and amendments to the market-wide circuit breakers to provide for brief, coordinated, cross-market trading halts during a sharp decline in the

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<sup>39</sup> See Section 108 of the JOBS Act.

<sup>40</sup> See Release No. 67091, *Order Approving, on a Pilot Basis, the National Market System Plan to Address Extraordinary Market Volatility* by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Incorporated, Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The Nasdaq Stock Market LLC, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc. (May 31, 2012), <http://www.sec.gov/rules/sro/nms/2012/34-67091.pdf>; Release No. 34-68953, *Notice of Filing and Immediate Effectiveness of the Second Amendment to the Limit Up-Limit Down Plan* (February 20, 2013), <http://www.sec.gov/rules/sro/nms/2013/34-68953.pdf>; Release No. 34-69287, *Order Approving the Third Amendment to the Limit Up-Limit Down Plan* (April 3, 2013), <http://www.sec.gov/rules/sro/nms/2013/34-69287.pdf>.

securities market.<sup>41</sup> The market-wide circuit breakers and phase I of the NMS Plan relating to the limit up-limit down mechanism were implemented on April 8, 2013.<sup>42</sup>

Enhancing Access to Market Data. Trading and Markets also has facilitated a number of important initiatives to significantly improve the Commission’s access to market data, including:

- rules to require SROs to submit a plan to create, implement, and maintain a consolidated audit trail (CAT) that would allow regulators to track all activity throughout the U.S. markets in exchange-traded equity securities (approved July 2012);<sup>43</sup>
- rules to capture additional information on certain large traders (approved July 2011), with phase I of the reporting and recordkeeping requirements becoming effective on November 30, 2012;<sup>44</sup>
- establishing a new Office of Analytics and Research (OAR), which is responsible for developing new market data sources and analyses to aid the Commission’s supervision of the securities markets; and
- implementation by OAR of a new Market Information Data Analytics System (MIDAS) to collect and analyze market data from both the public consolidated data feeds and the “proprietary” data feeds offered by the exchanges to their customers.

Preserving Technological Integrity. In addition to reducing effects of individual disruptions, the Commission is committed to attacking the causes and reducing the number of disruptions by fostering a robust infrastructure through a focus on systems compliance and integrity. Among other steps taken to strengthen technology standards among exchanges and other key participants, in March 2013 the Commission proposed Regulation SCI, which, among other things, would require that exchanges and other key market players maintain policies and

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<sup>41</sup> See Release No. 34-67090, *Notice of Filing of Amendments No. 1 and Order Granting Accelerated Approval of Proposed Rule Changes as Modified by Amendments No. 1, Relating to Trading Halts Due to Extraordinary Market Volatility* (May 31, 2012), <http://www.sec.gov/rules/sro/bats/2012/34-67090.pdf>. The operative date of the revised circuit breakers was delayed from February 4, 2013 to April 8, 2013. See, e.g., Release No. 34-68784, *Notice of Filing and Immediate Effectiveness of Proposed Rule Change Delaying the Operative Date of A Rule Change to NYSE Rule 80B, Which Provides for Methodology for Determining When to Halt Trading in All Stocks Due to Extraordinary Market Volatility, From the Date of February 4, 2013, Until April 8, 2013* (January 31, 2013), <http://www.sec.gov/rules/sro/nyse/2013/34-68784.pdf>.

<sup>42</sup> Phase I applies the limit up-limit-down mechanism to stocks in the S&P 500, the Russell 1000, and to select exchange-traded products. Phase II, currently scheduled for implementation in November 2013, will apply to all remaining exchange-traded equity securities, and will be implemented six months following the implementation of Phase I.

<sup>43</sup> See Release No. 34-67457, *Consolidated Audit Trail* (July 18, 2011), <http://www.sec.gov/rules/final/2012/34-67457.pdf>.

<sup>44</sup> See Release No. 34-64976, *Large Trader Reporting* (July 27, 2011), <http://www.sec.gov/rules/final/2011/34-64976.pdf>.

procedures reasonably designed to meet certain technology standards and that these entities take appropriate corrective action if problems do occur.<sup>45</sup>

### *OTC Derivatives*

Trading and Markets also has continued to engage in rulemaking to establish a new oversight regime for the OTC derivatives marketplace. To date, the Commission has proposed substantially 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” to implementation of Title VII, and taken other actions to provide legal certainty to market participants during the implementation process. Recent initiatives include:

- proposed rules regarding the application of Title VII in the cross-border context (May 2013);<sup>46</sup>
- proposed core financial responsibility rules for security-based swap dealers and major security-based swap participants (October 2012);<sup>47</sup>
- final rules and interpretations adopted jointly with the CFTC regarding key product definitions under Title VII (July 2012);<sup>48</sup>
- final rules and interpretations adopted jointly with the CFTC regarding entity definitions under Title VII (April 2012);<sup>49</sup>
- final rules adopted to establish operational and risk management standards for clearing agencies, including clearing agencies that clear security-based swaps (October 2012);<sup>50</sup> and

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<sup>45</sup> See Release No. 34-69077, *Regulation Systems Compliance and Integrity* (March 8, 2013), <http://www.sec.gov/rules/proposed/2013/34-69077.pdf>.

<sup>46</sup> See Release No. 34-69490, *Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants* (May 1, 2013), <http://www.sec.gov/rules/proposed/2013/34-69490.pdf>.

<sup>47</sup> See Release No. 34-68071, *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers* (October 18, 2012), <http://www.sec.gov/rules/proposed/2012/34-68071.pdf>.

<sup>48</sup> See Release No. 33-9338, *Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”*; *Mixed Swaps; Security-Based Swap Agreement Recordkeeping* (July 18, 2012), <http://www.sec.gov/rules/final/2012/33-9338.pdf>.

<sup>49</sup> See Release No. 34-66868, *Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant* (April 27, 2012), <http://www.sec.gov/rules/final/2012/34-66868.pdf>.

<sup>50</sup> See Release No. 34-68080, *Clearing Agency Standards* (October 22, 2012), <http://www.sec.gov/rules/final/2012/34-68080.pdf>.

- final rules adopted to establish procedures for the Commission’s review of certain actions undertaken by clearing agencies (June 2012).<sup>51</sup>

Trading and Markets expects in the near term to make recommendations to the Commission regarding a rule proposal relating to books and records and reporting requirements for security-based swap dealers and major security-based swap participants. It also is likely that the Commission will consider the application of mandatory clearing requirements to single-name credit default swaps, starting with those that were first cleared prior to the enactment of the Dodd-Frank Act.<sup>52</sup>

Trading and Markets staff is also continuing to develop recommendations for final rules required by Title VII that have been proposed but not yet adopted.

### *The Volcker Rule*

Section 619 of the Dodd-Frank Act generally prohibits banks and their affiliates from engaging in proprietary trading, and also prohibits these entities from sponsoring or investing in a hedge fund or private equity fund. Also known as the Volcker Rule, the statute provides limited exceptions to the prohibition on proprietary trading for: (1) underwriting; (2) market making-related activities; (3) risk-mitigating hedging; (4) trading in certain government obligations; and (5) trading on behalf of customers.

In October 2011, the federal banking agencies and SEC jointly proposed rules to implement the Volcker Rule.<sup>53</sup> In January 2012, the CFTC issued a substantially similar proposal. To date, we have received over 19,000 comment letters in response to the proposal. Going forward, SEC staff will continue to engage in regular and active consultation with the staffs at our fellow federal financial regulators in order to develop recommendations for implementing Section 619 of the Dodd-Frank Act.

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<sup>51</sup> See Release No. 34-67286, *Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations* (June 28, 2012), <http://www.sec.gov/rules/final/2012/34-67286.pdf>.

<sup>52</sup> Clearing of credit default swaps commenced in 2009. The Commission issued a series of temporary conditional exemptions to help provide legal certainty to facilitate those clearing activities, in light of issues regarding the potential that cleared credit default swaps would be “securities” subject to the Commission’s authority under the Exchange Act. *See, e.g.*, Release No. 34-63387, *Order Extending and Modifying Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection with Request of ICE Trust U.S. LLC Related to Central Clearing of Credit Default Swaps and Request for Comment* (November 29, 2010) (temporary exemption in connection with clearing by ICE Trust, now ICE Clear Credit), <http://www.sec.gov/rules/exorders/2010/34-63387.pdf>; Release No. 34-63389, *Order Extending Temporary Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection with Request on Behalf of ICE Clear Europe, Limited Related to Central Clearing of Credit Default Swaps and Request for Comment* (November 29, 2010) (temporary exemption in connection with clearing by ICE Clear Europe), <http://www.sec.gov/rules/exorders/2010/34-63389.pdf>.

<sup>53</sup> See Release No. 34-65545, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds* (October 12, 2011), <http://www.sec.gov/rules/proposed/2011/34-65545.pdf>.

Future Initiatives. Trading and Markets staff expects to engage in the following initiatives, among others, to address developments and issues in the exchange and OTC markets for securities:

- publishing reports concerning liquidity, volatility, and other market characteristics both to expand the amount of publicly available information on these topics and to establish a more sound empirical basis for future market structure initiatives;
- considering what, if any, actions to take concerning trading, liquidity, transparency, and other market characteristics under the current market structure;
- monitoring the SROs in their implementation of the CAT;
- monitoring the impact of the limit up-limit down mechanism and market-wide circuit breakers, including working with the SROs to determine whether additional measures may be necessary to address extraordinary market volatility;
- evaluating how to improve the market structure for trading fixed income securities generally, including the trading of municipal and corporate bonds;
- reevaluating Trading and Market's approach in reviewing new exchange-traded products;
- continuing to monitor broker-dealers that use value-at-risk models to calculate net capital, which includes the largest and most systemically important firms, and expanding risk oversight to include security-based swap dealers; and
- expanding the Commission's oversight of existing clearing agencies, particularly those that are designated as systemically important by the Financial Stability Oversight Council (FSOC).

### **Investment Management Oversight and Rulemaking**

The SEC's Division of Investment Management (Investment Management) works to protect investors, promote informed investment decisions, and facilitate appropriate innovation in investment products and services through oversight and regulation of the asset management industry. Investment Management primarily administers the SEC's regulatory and disclosure-review functions for mutual funds, other investment companies, and investment advisers, including registration requirements. 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 \$50 trillion in assets under management. The Commission already implemented the vast majority of the Dodd-Frank Act's mandates related to funds and advisers, including rules to effectuate private fund adviser registration and reporting,<sup>54</sup> implementing new

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<sup>54</sup> Release No. IA-3221, *Rules Implementing Amendments to the Investment Advisers Act of 1940* (June 22, 2011), <http://www.sec.gov/rules/final/2011/ia-3221.pdf>.

registration exemptions for certain advisers,<sup>55</sup> reallocating responsibility for smaller advisers to the state securities authorities,<sup>56</sup> and amending requirements for advisers that charge performance fees.<sup>57</sup>

### *Private Fund Adviser Regulation*

The staff has been actively engaged with advisers to hedge funds and other private funds as they register with the SEC pursuant to the rules the Commission adopted to implement the Dodd-Frank Act's adviser registration mandate. The SEC now has an adviser population that includes approximately 40 percent of SEC-registered advisers managing at least one private fund, which presents several challenges, including the fact that these advisers generally are more complex and require greater resources to examine. Additionally, the staff is examining many of the SEC's existing rules applicable to advisers that were not written with private fund advisers necessarily in mind.

Throughout the past year, SEC staff has been assisting private fund advisers as they file their initial Form PF data. Form PF is a confidential data reporting form providing data about private funds' risk characteristics.<sup>58</sup> The form was developed by the SEC and the CFTC, in consultation with FSOC, pursuant to a Dodd-Frank Act mandate. We are starting to use the data collected on Form PF to assist us in carrying out our regulatory mission, and going forward, we will seek to expand and improve our use of it, while also sharing the information with FSOC for their systemic risk analysis functions as contemplated by the Dodd-Frank Act.

### *Money Market Funds*

A rule proposal pertaining to money market mutual fund reform is well underway at the SEC and has been the product of a comprehensive and collaborative process. Any proposal that results would seek to preserve many of the benefits of money market funds for investors and the short-term funding markets while lessening money market funds' susceptibility to runs; improving their ability to manage and mitigate potential contagion from high levels of redemptions; and increasing the transparency of their risks.

### *Identity Theft Red Flags*

On April 10, 2013, my first day as Chair, the Commission unanimously voted to adopt a joint rule with the CFTC that fulfilled the Dodd-Frank Act mandate to transfer regulatory and enforcement authority for identity theft red flag programs from the Federal Trade Commission to

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<sup>55</sup> Release No. IA-3222, *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than \$150 Million in Assets under Management, and Foreign Private Advisers* (June 22, 2011), <http://www.sec.gov/rules/final/2011/ia-3222.pdf>.

<sup>56</sup> Release No. IA-3221, *Rules Implementing Amendments to the Investment Advisers Act of 1940* (June 22, 2011), <http://www.sec.gov/rules/final/2011/ia-3221.pdf>.

<sup>57</sup> Release No. IA-3372, *Investment Adviser Performance Compensation* (February 15, 2012), <http://www.sec.gov/rules/final/2012/ia-3372.pdf>.

<sup>58</sup> 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>.

the SEC and CFTC for the entities each agency regulates.<sup>59</sup> The rule will help protect investors from identity theft by requiring that broker-dealers, mutual funds, and certain other SEC-regulated entities create programs to detect and respond appropriately to red flags.

### *Updated Valuation Guidance*

Investment Management also is seeking to update and put in one place guidance available to funds and their boards of directors as they value portfolio holdings and calculate a daily net asset value – the price at which most mutual funds transact. The bulk of the existing Commission guidance in this area was issued in 1970, long before the advent of significant derivatives investing, the emergence of pricing services, or the development of complex pricing techniques.<sup>60</sup> Investment Management and other SEC staff have been meeting with interested parties to develop a recommendation of updated fund valuation guidance for the Commission’s consideration.

### *Risk and Exam Office*

Investment Management recently established a new Risk and Exam Office (REO) dedicated to risk analysis and examination of funds and investment advisers. Examiners are included within REO to give effect to the Dodd-Frank Act’s mandate that examiners be included within the Division of Investment Management. It is expected that the work of the REO’s new examiners will inform the division’s regulatory initiatives. In addition, REO’s mission is to conduct rigorous quantitative and qualitative financial analysis of the investment management industry. This should greatly improve the staff’s analytical capability with respect to asset managers.

### **Risk Data and Economic Analysis**

The Division of Risk, Strategy, and Financial Innovation (RSFI) was formed in September 2009 in part to integrate rigorous data analytics into the core mission of the SEC. RSFI has a broad role in Commission activities, interacting with nearly every Division and Office. Much of RSFI’s staff time is dedicated to developing economic analysis in connection with Commission rulemaking. In addition, the Division provides economic research, risk assessment, and data analysis to help focus the agency’s resources on matters presenting the greatest perceived risks in litigation, examinations, and registrant reviews.

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. Over the past year, the SEC has refocused its efforts on ensuring that rigorous and transparent economic analysis is incorporated

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<sup>59</sup> Release No. IA-3582, *Identity Theft Red Flag Rules* (April 10, 2013), <http://sec.gov/rules/final/2013/34-69359.pdf>.

<sup>60</sup> Release No. IC-6295, *Accounting for Investment Securities by Registered Investment Companies* (Dec. 23, 1970), <http://www.sec.gov/rules/interp/1970/ic-6295.pdf>; Release No. IC-5847, *Statement Regarding “Restricted Securities”* (Oct. 21, 1969), <http://www.sec.gov/rules/interp/1969/ic-5847.pdf>.



throughout the rulewriting process. For example, last year RSFI analyzed voluminous data to examine the amount of CDS dealing activity that would be covered by a Dodd-Frank Act-mandated rule further defining “security-based swap dealer” and “major security-based swap participant,” and the amount of dealing activity that would be unregulated under various de minimis thresholds.<sup>61</sup> This analysis was the foundation for the Commission’s decision to provide a de minimis threshold of the size included in the final rule.<sup>62</sup>

RSFI economists also have made important contributions to pre-proposal rule development. For example, RSFI economists performed qualitative and quantitative analyses to study money market funds in order to respond to a series of questions posed by Commissioners. This analysis has assisted the Commission in its deliberations as it considers the scope of any future rulemaking relating to money market funds.<sup>63</sup>

In addition, 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. RSFI has already shown great success with the development of an analytical model that uses performance data to identify hedge fund advisers worthy of further review by Enforcement or OCIE. Currently, RSFI is developing a new data analytics model that could be used across the SEC to assess the degree to which registrants’ financial statements appear anomalous. This “Accounting Quality Model” is intended to be useful to many offices and divisions within the SEC, such as in helping the Division of Enforcement target their investigations and informing the filings review process by the Division of Corporation Finance. Going forward, RSFI plans to continue to develop and implement robust analytical models to identify regulated entities with high-risk profiles.

## **New Commission Offices**

In addition to Enforcement’s Office of the Whistleblower discussed above, the Dodd-Frank Act required the Commission to create four new offices: the Office of Credit Ratings, Office of the Investor Advocate, Office of Minority and Women Inclusion, and Office of Municipal Securities.

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<sup>61</sup> RSFI’s memorandum, laying out its analysis, was then included in the comment file to ensure its availability for public comment. See Memorandum from the Division of Risk, Strategy, and Financial Innovation, *Information regarding activities and positions of participants in the single-name credit default swap market* (March 15, 2012), <http://sec.gov/comments/s7-39-10/s73910-154.pdf>.

<sup>62</sup> Release No. 34-66868, *Further Definition of “Swap Dealer,” “Security-based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant”* (April 27, 2012), <http://sec.gov/rules/final/2012/34-66868.pdf>.

<sup>63</sup> See Memorandum from the Division of Risk, Strategy, and Financial Innovation, *Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher* (November 30, 2012), <http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf>.

## *Office of Credit Ratings*

As required by Section 932 of the Dodd-Frank Act, the Commission established an Office of Credit Ratings (OCR) in June 2012. OCR is charged with administering the rules of the Commission with respect to the practices of NRSROs in determining credit ratings, promoting accuracy in credit ratings issued by NRSROs, and ensuring that (1) credit ratings are not unduly influenced by conflicts of interest and (2) firms provide greater disclosure to investors. In support of this mission, OCR monitors the activities and conducts examinations of NRSROs to assess and promote compliance with statutory and Commission requirements.

Under the Dodd-Frank Act, the Commission is required to undertake a number of rulemakings related to NRSROs. The staff is continuing to work to finalize a series of proposed rules intended to strengthen the integrity of credit ratings by, among other things, improving their transparency. The Dodd-Frank Act also mandated three studies relating to credit rating agencies, two of which were published last year,<sup>64</sup> and one of which is due later in 2013.<sup>65</sup>

Additionally, the Dodd-Frank Act required every federal agency 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 that the agency determines are appropriate. Beyond the steps the Commission took in 2011 to fulfill this requirement,<sup>66</sup> in 2012 the Commission issued an Interpretive Release that removes references to credit ratings by NRSROs in two definitions in the Exchange Act.<sup>67</sup>

## *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 identify areas in which investors would benefit from changes in Commission regulations or SRO rules; identify problems that investors have with financial service providers and investment products; and analyze the potential impact on investors of proposed Commission regulations and SRO rules. The Investor Advocate also must hire an Ombudsman, whose activities will be included in the Advocate's reports to Congress. The Commission is in the process of filling the position of Investor Advocate.

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<sup>64</sup> See *Credit Rating Standardization Study* (September 2012), [http://www.sec.gov/news/studies/2012/939h\\_credit\\_rating\\_standardization.pdf](http://www.sec.gov/news/studies/2012/939h_credit_rating_standardization.pdf); *Report to Congress on Assigned Credit Ratings* (December 2012), <http://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf>. For the latter topic, the Commission will be holding a roundtable scheduled for May 14, 2013.

<sup>65</sup> See Dodd-Frank Act § 939C.

<sup>66</sup> *Report on Review of Reliance on Credit Ratings* (July 2011), <http://www.sec.gov/news/studies/2011/939astudy.pdf>.

<sup>67</sup> See Release No. 34-67448, *Commission Guidance Regarding Definitions of Mortgage Related Security and Small Business Related Security* (July 17, 2012), <http://www.sec.gov/rules/interp/2012/34-67448.pdf>.

## *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. The OMWI Director 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.<sup>68</sup> 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.<sup>69</sup>

SEC Diversity Efforts. Under a broad outreach strategy developed by OMWI, the SEC has sponsored and/or attended more than 40 career fairs, conferences, and business matchmaking events to market the SEC to diverse suppliers and jobseekers. OMWI also continued to partner with leading organizations focused on developing employment opportunities for minorities and women at the SEC and in the financial services industry. As a result of these efforts, the SEC saw an increase in the percentages of new hires in FY 2012 over FY 2011 for the following demographic groups: African-American/Black; Asian-American; and American Indian/Alaskan Native. There remains more that can be done with respect to diversity in our hiring, however, particularly for attorneys, accountants, and examiners.

SEC Programs and Contracts. OMWI continues to move forward with respect to policies relating to contracting and regulated entities. OMWI staff is preparing to incorporate good faith contract language in the SEC's contracts that seeks to ensure the fair inclusion of women and minorities in the workforce of the contractor. The language will be incorporated in all SEC contracts for services that exceed a certain threshold amount. The OMWI Director also 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 \$302.4 million awarded to contractors in FY 2012, \$64.1 million (21.2%) was awarded to minority-owned and women-owned businesses.

Practices of Regulated Entities. During FY 2012, the OMWI Director and staff participated in roundtable discussions with regulated entities, representative trade associations, community groups, and other interested parties to obtain information about existing diversity policies and leading practices, and to hear their perspectives and suggestions. In FY 2013, OMWI is working with key agency staff to develop proposed standards to assess the diversity policies and practices of SEC-regulated entities, and to solicit feedback from securities and financial services industry groups on the impact of the proposed standards on the entities regulated by the agency.

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<sup>68</sup> See Dodd-Frank Act, § 342(b)(2).

<sup>69</sup> *Office of Minority and Women Inclusion Annual Report* (April 24, 2013), <http://www.sec.gov/news/studies/2013/omwi-annualreport-2013.pdf>.

## *Office of Municipal Securities*

Pursuant to Section 979 of the Dodd-Frank Act, the Commission established a separate Office of Municipal Securities (OMS) to administer the Commission's rules on practices of broker-dealers, 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.

The highest immediate priority project for OMS is to finalize permanent rules for the registration of municipal advisors with the SEC pursuant to Section 975 of the Dodd-Frank Act. This new registration requirement, which became effective on October 1, 2010, applies broadly to persons that provide advice to municipal entities on municipal financial products or the issuance of municipal securities or that solicit municipal entities. In September 2010, the Commission adopted, and subsequently extended, temporary rules for municipal advisor registration.<sup>70</sup> In December 2010, the Commission proposed permanent rules for municipal advisor registration.<sup>71</sup> The SEC received over 1,000 comment letters on the proposal. Many expressed concern that the proposed rules were overbroad, including well-publicized concerns about their potential impact on appointed board members of municipal entities, municipal investments unrelated to municipal securities, and traditional banking products and services. The staff is developing a recommendation for final rules that we anticipate will address these concerns.

OMS's current priorities also include initiatives to assist with the ongoing consideration of disclosure and market structure recommendations in the Commission's Report on the Municipal Securities Market, issued in July 2012.<sup>72</sup> Recently, a Commission roundtable discussed, among other things, potential ways to improve the transparency and efficiency of the municipal securities market.

### **International Affairs**

The Office of International Affairs (OIA) advances international enforcement and regulatory cooperation, promotes high quality regulatory standards worldwide, and formulates technical assistance programs to strengthen investor protection and regulatory infrastructure globally. OIA partners with Enforcement to facilitate the assistance of foreign regulators to obtain evidence for use in Enforcement investigations, as well as to trace, freeze and repatriate proceeds of fraud transferred outside the United States. For example, in the Nexen case filed last

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<sup>70</sup> See Release No. 34-62824, *Temporary Registration of Municipal Advisors* (September 1, 2010), <http://www.sec.gov/rules/interim/2010/34-62824.pdf>.

<sup>71</sup> See Release No. 34-63576, *Registration of Municipal Advisors* (December 20, 2010), <http://sec.gov/rules/proposed/2010/34-63576.pdf>.

<sup>72</sup> See *Report on the Municipal Securities Market* (July 31, 2012), <http://www.sec.gov/news/studies/2012/munireport073112.pdf>.

year, crucial assistance from the Hong Kong Securities and Futures Commission enabled the SEC to pursue traders who reaped more than \$13 million in illegal profits by trading in advance of an acquisition.<sup>73</sup> The assistance also allowed the SEC to file insider trading charges and obtain an emergency freeze of assets held by traders in Hong Kong and Singapore. At the time the case was filed by the SEC, it was only four days after the acquisition announcement, and the SEC did not know the identities of most of the traders. Following a request facilitated by OIA, the Hong Kong authorities quickly provided the bank, brokerage, and business records necessary to identify the traders and the details of the trades. To date, we have already obtained more than \$17 million in disgorgements and monetary penalties in this case as a direct result of international collaboration.

OIA also assists Commission staff in conducting examinations of foreign-domiciled registrants and addressing cross-border registration issues. OIA further facilitates cooperation between the Commission and its counterparts in the oversight of globally active entities, and negotiates supervisory memoranda of understanding (MOUs) on behalf of the Commission with foreign regulators.

OIA seeks to advance the SEC's interests by participating in a wide array of international organizations, including the International Organization of Securities Commissions and the Financial Stability Board. OIA assists the SEC efforts to deal with cross-border regulatory issues by, among other things, analyzing 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 the possible effect that foreign regulators' actions might have on the SEC, the U.S. market and market participants. OIA also monitors foreign regulatory reform efforts to alert the Commission of potential conflicts and opportunities for cross-border coordination.

### **Accounting and Auditing Oversight**

The federal securities laws authorize the Commission to set accounting standards for public companies, and the Commission has recognized the standards set by the Financial Accounting Standards Board (FASB). The Commission's Office of the Chief Accountant, which serves as the principal advisor to the Commission on accounting and auditing matters, oversees the FASB's standard-setting process. 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 in the IFRS Foundation Monitoring Board.

The FASB and the IASB are working together on several projects to set high-quality converged accounting standards in the areas of revenue recognition, financial instruments, leases, and insurance contracts. During 2013, the FASB and the IASB issued proposals for public comment on financial instruments, expect to issue proposals for public comment on leases and

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<sup>73</sup> Litigation Release No. 22428, *SEC v. Well Advantage Ltd. et al.*, (July 30, 2012), <http://www.sec.gov/litigation/litreleases/2012/lr22428.htm>.

insurance contracts, and expect to issue a final standard on revenue recognition. Commission staff is monitoring progress on the projects and remains committed to assuring that the process operates in a fair and open way and that the results serve the interests of investors.

The Public Company Accounting Oversight Board (PCAOB) oversees the audits of issuers and registered broker-dealers to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The PCAOB accomplishes its objectives through registration, standard setting, inspection, and discipline. The Commission has oversight over the PCAOB, which 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.

## **Investor Education**

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 administers three primary programs to promote this mission: assisting individual investors with complaints and inquiries; conducting educational outreach; and providing the Commission and staff with input from the perspective of the individual investor.

During FY 2012, OIEA processed almost 30,000 complaints, questions, and other contacts from investors received, and to date in FY 2013 has published 11 alerts and bulletins. OIEA communicates with investors regarding how to invest wisely and avoid fraud through various media, publishes educational materials, leads educational seminars and investor-oriented events, and partners with federal agencies, state regulators, consumer groups, and self-regulatory organizations. OIEA also produces investor alerts and bulletins in coordination with the other offices and divisions, provides input into rulemaking, administers the Investor Advisory Committee, and conducts investor testing, most recently on the usefulness of disclosures in standard SEC disclosure documents. In August 2012, OIEA issued a Dodd-Frank mandated report entitled *Study Regarding Financial Literacy Among Investors*.<sup>74</sup>

## **Internal Operations**

The Office of the Chief Operating Officer (OCOO) leads and coordinates the activities of the Offices of Financial Management (OFM), Information Technology, Acquisitions, Human Resources (OHR), and Support Operations (OSO).

In FY 2012, OFM continued to focus on strengthening internal controls over financial reporting, with the SEC achieving its best ever result in its FY 2012 Government Accountability Office (GAO) financial controls audit. For the second consecutive year, GAO noted no material

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<sup>74</sup> *Study Regarding Financial Literacy Among Investors* (August 2012), <http://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf>.

weakness and the number of significant deficiencies identified in the SEC's financial operations was reduced. These results occurred during the complex midyear migration of the SEC's financial system to a Federal Shared Services Provider hosted by the Department of Transportation.

Additional activities during FY 2012 included:

- overseeing the reorganizations of OFM, OHR, and the creation of a new OSO organization, all intended to improve customer support and internal operational controls and effectiveness;
- working closely with the General Services Administration to complete the transfer of excess property and on other leasing-related matters;
- coordinating business process redesign efforts in all OCOO offices in an effort to improve efficiency and effectiveness; and
- automating processes that historically have been manual in nature in areas such as filing fees and disgorgements and penalties.

### **Leveraging Technology**

While the agency has made significant progress over the past few years in modernizing our technology systems, it also is important that the SEC continue leveraging technology to streamline operations and increase the effectiveness of the agency's programs. The SEC's FY 2014 budget request includes additional funds for technology to support a number of key Information Technology (IT) initiatives, including enhancements to the system for receiving tips, complaints, and referrals, improvements to IT security, data analysis tools, improvements in our e-Discovery systems, and infrastructure upgrades aimed at achieving efficiencies in business operations and reducing long-term costs.

In FY 2014, the SEC also plans to continue using the SEC Reserve Fund, established by statute, to fund large, multi-year, mission-critical technology projects. Among other projects, the agency would continue overhauling the Electronic Data Gathering, Analysis and Retrieval (EDGAR) system to create a new, modernized system that will meet Commission requirements for real-time system updates, reduce filer burden, improve data capture, and reduce the long term costs of operating and maintaining the system. In addition, we plan to continue construction and enhancement of the Enterprise Data Warehouse (EDW). The EDW is a critical step in combining currently disparate sources of data from EDGAR filings, exam reports, investigations, external vendors, and many other sources. An organized central data repository should allow enhanced analytical capabilities, predictive modeling, and strengthened governance of data controls and quality standards.

### **FY 2014 Budget Request**

The securities markets we oversee are continuously evolving, and the technology of today is most certainly not the technology of tomorrow. Fast-paced and constantly changing

markets – fueled by financial firms whose annual technology budgets exceed what the SEC spends on its entire operations – require constant monitoring and analysis. When issues are identified, the investing public deserves appropriate and timely regulatory and enforcement responses. The securities industry also has been growing rapidly in size. In the last decade, trading volume in the equity markets has more than doubled, as have assets under management by investment advisers. It is expected that these trends will continue in the foreseeable future. At the same time, the SEC’s jurisdiction has grown to cover significant new aspects of the securities markets.

Although the agency has made significant strides forward to strengthen its oversight over markets that are so critical to the savings of American families and to the growth potential of American businesses, much work remains.

The SEC’s current level of resources presents significant challenges as we seek to keep pace with the growing size and complexity of the securities markets and fulfill our broad mandates and responsibilities. The FY 2014 budget request – all of which would be fully offset by matching collections of fees on securities transactions and will not increase the Federal budget deficit – seeks to address these challenges directly, to better position the agency to provide the kind of market oversight that the public expects and deserves.

The SEC is requesting \$1.674 billion for FY 2014. If enacted, this request would permit us to add approximately 676 new staff positions, which are needed today both to improve core operations and implement the agency’s new responsibilities. The budget request would provide additional funding for the following key areas:

- expanding oversight of investment advisers and improving their regulation and compliance;
- bolstering enforcement;
- economic and risk analysis to support rulemaking and oversight;
- building oversight of derivatives and clearing agencies;
- enhancing reviews of corporate disclosures, including supporting implementation of the JOBS Act;
- leveraging technology, including enhancing the tips, complaints, and referrals system, building data analysis tools, improving our e-Discovery systems, and bolstering IT security; and
- enhancing training and development of SEC staff.

## **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.