

## House of Representatives Committee on Financial Services

### *“Fixing the Watchdog: Legislative Proposals to Improve and Enhance the Securities and Exchange Commission”*

Thursday, September 15, 2011, 10 am  
2128 Rayburn House Office Building

## Testimony of Stephen J. Crimmins

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### What We Knew When We Doubled the SEC Budget

By last summer, most of the criticisms that are now being thrown at the SEC were already out on the table. All of us had long before heard about the Madoff tragedy. Madoff, who FINRA’s predecessor organization had installed as its own Chairman. Madoff, who the securities industry put on the board of its leading trade group. Madoff, the industry icon and idol who the SEC, FINRA, the New York attorney general, and the firms that dealt with him on a daily basis all failed to realize was really a crook.

It was yesterday’s news to us last summer that some SEC employees, like other public and private sector employees, viewed Internet porn on company time. And it was yesterday’s news that the SEC lacked the private-sector business corporation’s bookkeeping systems and controls that GSA would have liked. So did other federal agencies.

But we also knew that, year after year, through thick and thin, the SEC’s hard-working staff filed almost 700 complex securities cases against almost 2,000 defendants. A figure no private sector law firm of similar size to the SEC could ever dream of matching. And we also heard how the SEC has a very full plate. Just 3,700 employees (counting everyone from Chairman to support staff) examining 11,000 investment advisers, 5,000 broker-dealers with over 160,000 branch offices, and 7,500 mutual funds. Reviewing tens of thousands of disclosure documents each year. Plus riding herd over 500 transfer agents, 15 securities exchanges, 10 ratings agencies, 9 clearing agencies, and for good measure the Public Company Accounting Oversight Board, a collection of SROs, and a market trading over 8.5 billion shares a day.

So having already heard most of the same criticisms we’re hearing today, but considering the SEC’s thousands of successful cases and other activities over just the last five years, and finding itself in the midst of the worst financial crisis in 80 years, what did Congress decide to do? Congress last summer enacted legislation to double the SEC’s budget in specified steps over five years. Importantly, in doubling the SEC’s budget, Congress knew that it was not spending a

dime of taxpayers' money and not having any deficit impact. This is because since bipartisan legislation in 1996 the SEC has always been run entirely on uncontroversial Wall Street user fees and never on tax dollars.

Why did Congress decide to double the SEC's budget last summer? That's easy. Because Congress knew that to get the jobs Americans need, there has to be growth. And to have growth, there needs to be capital formation. And to have capital formation, we need clean markets where investors – large and small – are willing to risk their capital. And this – giving us clean, orderly and well functioning markets – is exactly what the SEC does for a living. After running the SEC on a shoestring for decades, Congress wisely realized that, to get out of the worst downturn since the 1930s, we needed a securities market overseer that had the resources to make a difference.

### **The Cost of a Wall-to-Wall Reorganization: Institutional Paralysis**

Twelve months later, none of this has changed. We still know pretty much what we knew last summer. But are we actually appropriating the doubled SEC budget – paid with Wall Street user fees – that Congress saw as necessary and promised just last summer? No. Instead we're hearing from well-meaning but high-priced management consultants about things like "optimization initiatives"; "time-phased multi-year implementations"; "cross-work-stream integration points"; and an "executive data governance council" to develop "optimized enterprise data architecture." What has this got to do with the active capital formation, efficient trading markets, and fraud detection we need so desperately today? Sadly, we're also hearing about "no regrets" optimization, SEC staff RIFs, closing unspecified numbers of SEC regional offices, and staff demotions – all just great for morale and effectiveness just when we most need the SEC to help us restore our nation's economic growth.

We're forgetting that a wall-to-wall restructuring will effectively paralyze the SEC for a year, two years or longer. Meetings held to plan and re-plan new reporting chains, and reallocations of power and authority among offices. Drafting new job descriptions to match new job titles and structures. Staff members reworking and burnishing their resumes, and spending days pondering how best to handle the internal job interview process. And petty office politics and rivalries playing a much bigger role than the consultants' "no regrets" optimization.

What will happen to the work left unattended during this process – the work of ensuring clean markets and encouraging capital formation, the work of policing the markets to attract investors large and small to put their capital at risk? Will that work become a part-time job while staff cope with massive reorganization? Instead, with our economy in crisis and business activity cycling downward, we should put the org charts and the consultant-speak on the shelf for the time being. We can do those things later when we're sailing on calmer seas.

### **SEC Modernization Act**

Let me turn to the proposed SEC Modernization Act. While it would be a mistake to waste a year, two years or more lost in the dense forest of planning and executing an agency-wide reorganization reaching into every corner, it would be equally a mistake to ignore the

dynamic changes taking place every day in our capital markets. New high speed computerized trading strategies, daily volume going through the roof, complex new investment products that even their creators don't always fully understand. The SEC, like all of us, needs to adapt and change with the times. The last thing we should want is to try to roll the clock back to some imagined golden age of the SEC, and then cement that era's version of the SEC in statutory stone where it could never be changed without an Act of Congress.

Yet the proposed SEC Modernization Act would do exactly that. It rolls back the clock 25 years. It pulls out the SEC's org chart from about the mid-1980s, and would decree by statute that this org chart may never be changed. Our Constitution obviously did not freeze Congress's committee structure. In recently bailing out major financial and business enterprises, Congress did not freeze their organizational structure by statute. Nor should Congress freeze the structure of the SEC, a step that would prevent the SEC from being what Congress wants – a nimble and flexible agency that can quickly “modernize” itself on an ongoing basis to meet new challenges in our markets. Even the management consultants tell us this. They specifically direct the SEC to petition Congress for “flexibility” to design the SEC's own structure to “improve operational performance” and “locate efficiencies.”

Instead of endless reorganization hell – instead of just thinking about how to think about what to do – the SEC needs to get to work today on its three core missions: Encouraging capital formation. Assuring clean and efficient trading markets. And policing the markets to rout the fraudsters.

### **Capital Formation / Small Business**

Talking about capital formation in last week's Joint Session, the President spoke for both parties in urging that we “cut away the red tape that prevents too many rapidly growing startup companies from raising capital and going public.” The President saw that America's startups are often being starved of the capital they need to grow due to the cost and delay of a traditional stock offering. As a work-around, some startups try going public through so-called “reverse mergers” where they must give stock promoters a huge portion of their company's ownership to get folded into a defunct listed company the promoters control, with the promoters then dumping the stock on unsuspecting public investors with little or no disclosure beyond the promoters' own glowing press release.<sup>1</sup>

As the President recognized, there is a better way. The SEC can write rules to give us cheap and efficient procedures for America's small businesses to raise capital, but procedures that are still squeaky clean and that tell prospective investors what then need to know to make an informed investment decision. Perhaps a system built entirely on an electronic platform that provides for independent professional verification of key information, as well as some form of corporate monitoring during the startup company's early phase and control over any significant commitment of investor funds until investors can be sure the company is legitimate.

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<sup>1</sup> Obviously not all reverse mergers are bad, and we all know that the New York Stock Exchange itself went public through a reverse merger. But in the wrong hands, reverse mergers can be toxic – bad for the original entrepreneurs and bad for investors.

## **SEC Regulatory Accountability Act**

But we can forget about such rulemaking to streamline capital formation or anything else if we keep handing opponents of all political and ideological persuasions more and more tools to block anything the SEC tries to do. This will inevitably be the unintended consequence of the proposed SEC Regulatory Accountability Act. While well meaning, the Act would have the effect of letting any SEC rule opponent litigate in federal court over whether the SEC had appropriately assessed a laundry list of amorphous factors in any SEC rulemaking. Indeed, the Act is drafted so broadly that it could be applied even to the SEC's enforcement "orders," and not just to rulemakings. And beyond this, the Act would consume vast amounts of SEC staff time with periodic reviews of the existing substantial body of federal securities regulations to find anything deemed "outmoded, ineffective, insufficient or excessively burdensome."

Just as America's businesses need new SEC rules to streamline capital formation and traders need new SEC rules to streamline markets, so also we must give the SEC itself a streamlined process for issuing those rules. The SEC already has to include dozens of pages of detailed cost-benefit and other economic analysis every time it writes a rule, and we don't need to pile on more requirements.

## **Market Surveillance Technology**

We also need to give the SEC the technology it needs to monitor the markets in real time. This will let the SEC spot stock manipulations in progress and shut them down before honest stock traders get fleeced. It will also let the SEC reconstruct market data to support its enforcement cases and to intelligently write trading rules that deal with what actually happens in the markets, not what people guess may possibly happen.

We need to start by immediately giving the SEC the market analysis software already used by Wall Street firms and exchanges, and the hardware to run it on. Beyond this, we need to develop more sophisticated systems and possibly link them with the other regulators and exchanges to assure comprehensive policing of our markets.

## **Conclusion**

A back-to-basics focus on core SEC missions of capital formation, market surveillance, and antifraud enforcement is what these difficult times demand. Not micromanaging the SEC. Not paralyzing it by piling on mandated "multi-year" reorganizations, studies, and new requirements and procedures. It's time to let the SEC get to work.



Finally, we need to recognize that the SEC is an agency filled with people who could be making a lot more money – sometimes multiples of their present salaries – in the private sector. What keeps them going during the years they choose to spend at the SEC is their enthusiasm for its mission. With SEC staff morale withering under the current barrage of criticism, if we really want to retain top talent, we all need to stop using the SEC and its staff as a piñata. Last summer, with all the recent criticisms already out on the table, Congress made the sound decision to double the SEC budget – again, using Wall Street user fees that are already available

and no tax dollars – to help get us out of the present crisis and do what we can to avoid future crises. It's time to deliver on that promise.

United States House of Representatives  
Committee on Financial Services

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Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

<b>1. Name:</b> Stephen J. Crimmins	<b>2. Organization or organizations you are representing:</b> Federal Reserve Association, Senior Vice President General
<b>3. Business Address and telephone number:</b> 	
<b>4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>  <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<b>5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>  <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.</b>  N/A	
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