

Testimony of Gary Gensler
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Committee on Financial Services
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Good afternoon, Chairwoman Waters, Ranking Member McHenry, and members of the Committee. I'm honored to appear before you today for the second time as Chair of the Securities and Exchange Commission. As is customary, I will note that my views are my own, and I am not speaking on behalf of my fellow Commissioners or the staff.

We are blessed with the largest, most sophisticated, and most innovative capital markets in the world. The U.S. capital markets represent 38 percent of the globe's capital markets.¹ This exceeds even our impact on the world's gross domestic product, where we hold a 24 percent share.²

Furthermore, companies and investors use our capital markets more than market participants in other economies do. For example, debt capital markets account for 80 percent of financing for non-financial corporations in the U.S. In the rest of the world, by contrast, nearly 80 percent of lending to such firms comes from banks.³

Our capital markets continue to support American competitiveness on the world stage because of the strong investor protections we offer.

We keep our markets the best in the world through efficiency, transparency, and competition. These features lower the cost of capital for issuers, raise returns for investors, reduce economic rents, and democratize markets. That focus on competition is in every part of the SEC's work, particularly with respect to market structure.

We can't take our remarkable capital markets for granted, though. New financial technologies continue to change the face of finance for investors and businesses. More retail investors than ever are accessing our markets. Other countries are developing deep, competitive capital markets as well.

The SEC is a remarkable organization. In just under five months, I have gotten to know many of the dedicated 4,400 people across 12 offices. Our agency covers nearly every part of the \$110 trillion capital markets. Those markets touch many Americans' lives, whether they're investing for their future, borrowing for a mortgage, taking out an auto loan, or taking a job with a company that's tapping our capital markets. We engage with companies raising money and with

¹ See Securities Industry and Financial Markets Association, "2021 SIFMA Capital Markets Fact Book," *available at* <https://www.sifma.org/wp-content/uploads/2021/07/CM-Fact-Book-2021-SIFMA.pdf>.

² See World Bank data: <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD>

³ *Ibid.*

the key parties that sit in between businesses and investors, including accountants, auditors, and investment managers.

While in August we authorized voluntary return to office, we've largely been remote for about 19 months now, and will keep this posture until at least Jan. 3, 2022. I cannot compliment the dedication of this staff enough for their service to the American public.

In this testimony, I will cover some of the broad themes from the SEC's unified agenda,⁴ before closing with a few words on our Enforcement and Examinations divisions and our resources.

- Market Structure
- Predictive Data Analytics
- Issuers and Issuer Disclosure
- Funds and Investment Management

Market Structure

I'll start with market structure. In every generation, we have to look at how we can revisit our rule sets to better enhance efficiency and competition in our markets.

Markets work best when they are transparent and competitive. Issuers and investors alike benefit from that competition because it lowers the cost of capital.

I have asked staff to take a look at five market structure-based projects across our \$110 trillion capital markets: the Treasury market, non-Treasury fixed income markets, equity markets, security-based swaps, and crypto asset markets.

Treasury Market

First, let me turn to the Treasury market. This \$22 trillion market⁵ is integral to our overall capital markets as well as to global markets. It is the base upon which so much of our capital markets are built. Treasuries are embedded in money market funds; myriad other markets and financial products are priced off of Treasuries; and they are an essential part of our central bank's toolkit. They are called the "risk-free asset" not just here in the U.S. but globally. They are how we, as a government and as taxpayers, raise money: We are the issuer.

During the start of the Covid crisis, liquidity conditions in the Treasury market deteriorated significantly. This wasn't the first time we observed challenges in this market, though. Back in

⁴ See <https://www.sec.gov/news/press-release/2021-99>.

⁵ Statistics from Securities Industry and Financial Markets Association: <https://www.sifma.org/resources/archive/research/statistics/>

October of 2014, there was the Treasury “Flash Crash.” In the fall of 2019, we had significant dislocations in Treasury funding markets, called the Treasury repo market.

I’ve asked staff to work with our colleagues at the Department of the Treasury and the Federal Reserve on how we can better enhance resiliency and competition in these markets.

To the extent that this market is more efficient, that could potentially save money for U.S. taxpayers and lower the cost of our debt. To the extent that this market is more resilient, it is less likely to add to systemic risks during times of stress.

We will seek to consider some of the recommendations that external groups, like the Group of Thirty⁶ and Inter-Agency Working Group for Treasury Market Surveillance,⁷ have offered around potential central clearing for both cash and repo Treasuries.

Further, I’ve asked staff to reconsider some initiatives on Treasury trading platforms, and also to consider how to level the playing field by ensuring that firms that significantly trade in this market are registered as dealers with the SEC.

Non-Treasury Fixed Income Market

Additionally, I’ve asked staff for recommendations on how we can bring greater efficiency and transparency to the non-Treasury fixed income markets — corporate bonds, a \$11 trillion market; municipal bonds, a \$4 trillion market; and asset-backed securities (which back mortgages, automobiles, and credit cards), a \$13 trillion market.⁸ This market is so critical to issuers. It is nearly 2.5 times larger than the commercial bank lending of about \$10.5 trillion in our economy.⁹

Equity Market

Next, I’d like to discuss equity market structure.

Every so often, in response to new technologies, the SEC updates its rules around market structure. After the internet came along, buyers and sellers could meet in new trading venues. An earlier Commission created a new rule in the 1990s to facilitate that. In 2005, the Commission further addressed this fragmented structure under Regulation National Market Structure.

⁶ See Group of Thirty, “U.S. Treasury Markets: Steps Toward Increased Liquidity,” *available at* <https://group30.org/publications/detail/4950>.

⁷ See Brian Smith, “Remarks at the Federal Reserve Bank of New York’s Annual Primary Dealer Meeting” (April 8, 2021), *available at* <https://home.treasury.gov/news/press-releases/jy0116>.

⁸ Statistics from Securities Industry and Financial Markets Association: <https://www.sifma.org/resources/archive/research/statistics/>

⁹ See Federal Reserve, “Assets and Liabilities of Commercial Banks in the United States,” *available at* <https://www.federalreserve.gov/releases/h8/current/default.htm>.

In the last 16 years, though, technology has expanded by leaps and bounds. It has changed how market makers interact, how trading platforms compete, how investors access those markets, and the economic incentives amongst these various market participants. Retail investors can trade over commission-free brokerage apps. Telecommunication has transformed the speed of high-frequency trading. That wasn't the case even a few years ago.

Despite these new technologies and developments affecting the structure of equity markets, we are often relying on rules written in an earlier period. Rules mostly adopted 16 years ago do not fully reflect today's technology.

I believe it's appropriate to look at ways to freshen up the SEC's rules to ensure that our equity markets reflect our mission and are as efficient and competitive as they could be.

I think it's time we take a broad view about what the market structure should look like today. The Commission started this exercise with regard to market data under former Chairman Jay Clayton. I've asked staff for recommendations, particularly around two key questions:

First, how do we facilitate greater competition and efficiency on an order-by-order basis — when people send each order into the marketplace?

While there is fragmentation amongst trading platforms, past reforms and new technologies may have led to more segmented markets and higher concentration amongst market makers. Nearly half of the volume transacted is executed in “dark pools” or by wholesalers. One firm has publicly stated that it executes nearly half of all retail volume.¹⁰ Further, I wonder whether this means that the consolidated tape — the so-called National Best Bid and Offer — fully reflects the full range of activity on exchanges.

Second, how do we address financial conflicts in the market? As I have stated previously, I believe payment for order flow and exchange rebates may present a number of conflicts of interest.

Around those two key principles, I've asked staff for recommendations as to how we can ensure a more level playing field, enhance competition, and improve resiliency in our markets.

Moreover, I believe shortening the standard settlement cycle could reduce costs and risks in our markets. I've directed the SEC staff to put together a draft proposal for the Commission's review on this topic.

Security-Based Swaps

¹⁰ See Citadel Securities, “Equities & Options,” available at <https://www.citadelsecurities.com/products/equities-and-options/>.

The security-based swaps market is not a large market compared to the fixed income and equity markets, but it was at the core of the 2008 financial crisis. More recently, total return swaps were at the heart of the failure of Archegos Capital Management, a family office.

This year, the SEC is implementing rules related to securities-based swaps. Security-based swap dealers and major security-based swap participants will begin registering with the Commission by Nov. 1.

Further, on Nov. 8, new post-trade transparency rules will go into effect, requiring transaction data to be reported to a swap data depository and thus available to the SEC and, under appropriate circumstances, other regulators. Then, beginning on Feb. 14, 2022, the swap data repositories will be required to disseminate data about individual transactions to the public, including the key economic terms, price, and notional value.

In addition, the Commission has yet to finish the rules for the registration and regulation of security-based swap execution facilities. I've asked staff for recommendations on how the Commission can finalize mandates to stand up the regime established under the Dodd-Frank Act and to consider whether it would be best to do this consistent with the regime established by the Commodity Futures Trading Commission (CFTC) for security-based swap execution facilities. The CFTC has had swap execution facility rules that have worked well since they were adopted nearly a decade ago.

Further, to allow the Commission and the public to see aggregate positions, Congress under Exchange Act Section 10B gave us authority to mandate disclosure for positions in security-based swaps and related securities. I've asked staff to think about potential rules for the Commission's consideration under this authority. As the collapse of Archegos showed, this may be an important reform to consider.

Crypto Assets Market

Next, I'll turn to a newer market structure issue: crypto assets.

Right now, large parts of the field of crypto are sitting astride of — not operating within — regulatory frameworks that protect investors and consumers, guard against illicit activity, and ensure for financial stability.

Currently, we just don't have enough investor protection in crypto finance, issuance, trading, or lending. Frankly, at this time, it's more like the Wild West or the old world of "buyer beware" that existed before the securities laws were enacted. This asset class is rife with fraud, scams, and abuse in certain applications. We can do better.

I have asked SEC staff, working with our fellow regulators, to work along two tracks:

One, how can we work with other financial regulators under current authorities to best bring investor protection to these markets?

Two, what gaps are there that, with Congress's assistance, we might fill?

At the SEC, we have a number of projects that cross over both tracks:

- The offer and sale of crypto tokens
- Crypto trading and lending platforms
- Stable value coins
- Investment vehicles providing exposure to crypto assets or crypto derivatives
- Custody of crypto assets

With respect to investor protection, we're working with our sibling agency, the CFTC, as our two agencies each have relevant, and in some cases, overlapping jurisdiction in the crypto markets. With respect to a broader set of policy frameworks, we're working with not only the CFTC, but also with the Federal Reserve, Department of Treasury, Office of the Comptroller of the Currency, and other members of the President's Working Group on Financial Markets, on these matters.¹¹

Further, I've suggested that platforms and projects come in and talk to us. Many platforms have dozens or hundreds of tokens on them. While each token's legal status depends on its own facts and circumstances, the probability is quite remote that, with 50, 100, or 1,000 tokens, any given platform has zero securities. Make no mistake: To the extent that there are securities on these trading platforms, under our laws they have to register with the Commission unless they qualify for an exemption.

I am technology-neutral. I think that this technology has been and can continue to be a catalyst for change, but technologies don't last long if they stay outside of the regulatory framework. I believe that the SEC, working with the CFTC and others, can stand up more robust oversight and investor protection around the field of crypto finance.

Predictive Data Analytics

The second theme is predictive data analytics.

We are living in a transformational time, perhaps as transformational as the internet itself. Artificial intelligence, predictive data analytics, and machine learning are shaping and will continue to reshape many parts of our economy.

To take just one example, I believe we're in an early stage of a transition toward driverless cars. Policymakers already are thinking through how to keep passengers and pedestrians safe, if and when these changes take hold.

Finance is not immune to these developments. Here, too, policymakers must consider what rules of the road we need for modern capital markets and for the use of predictive data analytics.

¹¹ See "Readout of the Meeting of the President's Working Group on Financial Markets to Discuss Stablecoins" (July 19, 2021), available at <https://home.treasury.gov/news/press-releases/jy0281>.

Today, trading platforms have new capabilities to tailor marketing and products to individual investors. While this can increase access and choice, such differential marketing and behavioral prompts raise new questions about potential conflicts within the brokerage, wealth management, and robo-advising spaces, particularly if and when brokerage or investment advisor models are optimized for the platform's revenue and data collection.

These models also could inadvertently reflect historical biases embedded in data sets that may be proxies for protected characteristics, like race and gender.

Advances in predictive data analytics also could raise some systemic risk issues when we apply new models and artificial intelligence across our capital markets. This could lead to greater concentration of data sources, herding, and interconnectedness, and potentially increase systemic risk. We put out a request for comment on digital engagement practices. The comment period closed last week.

Issuers and Issuer Disclosure

The third theme relates to issuers and issuer disclosure.

Disclosures

Since the 1930s, when Franklin Delano Roosevelt and Congress worked together to reform the securities markets, there's been a basic bargain in our capital markets: investors get to decide what risks they wish to take. Companies that are raising money from the public have an obligation to share information with investors on a regular basis.

Those disclosures changes over time. Over the years, we've added disclosure requirements related to management discussion and analysis, risk factors, executive compensation, and much more.

Today's investors are looking for consistent, comparable, and decision-useful disclosures around climate risk, human capital, and cybersecurity. I've asked staff to develop proposals for the Commission's consideration on these potential disclosures. These proposals will be informed by economic analysis and will be put out to public comment, so that we can have robust public discussion as to what information matters most to investors in these areas.

Companies and investors alike would benefit from clear rules of the road. I believe the SEC should step in when there's this level of demand for information relevant to investors' investment decisions.

Special Purpose Acquisition Companies, China, and 10b5-1 Plans

There are three other important topics relating to issuers that we have prioritized at the SEC.

First, given the surge in special purpose acquisition companies (SPACs), I have asked staff for recommendations about enhancing disclosures in these investments. There are a lot of fees and potential conflicts inherent within SPAC structures, and investors should be given clear information so that they can better understand the costs and risks.

Second is related to China. We have another basic bargain in our securities regime, which came out of Congress on a bipartisan basis under the 2002 Sarbanes-Oxley Act. If you want to issue public stock in the U.S., the firms that audit your books have to be subject to inspection by the Public Company Accounting Oversight Board (PCAOB). While more than 50 jurisdictions have complied with this requirement, two do not: China and Hong Kong.

Once again on a bipartisan basis, Congress last year said that it's time for all jurisdictions around the world to comply with Sarbanes-Oxley. The SEC has acted quickly to meet our requirements under the Holding Foreign Companies Accountable Act of 2020 (HFCAA).

In September, the PCAOB adopted a rule to fulfill its obligations under the HFCAA. This was an important step to meet its requirements under the bill to protect U.S. investors. I expect that the Commission will promptly consider this rule with the hope that we remain on track to finalize its required rulemaking before the end of the year. As is customary, the SEC will seek public comment on the rulemaking and will consider whether to approve it after taking into account the comments that we receive. I believe it is critical that the Commission and the PCAOB work together to ensure that the audits of foreign companies accessing U.S. capital markets play by the same rules.

Further, we are working to enhance disclosures with regard to how Chinese companies issue securities in the U.S. Chinese companies conducting business in certain industries, such as internet and technology, are prohibited from selling their ownership stake to foreigners. As a workaround, they use structures called variable interest entities to raise capital on U.S. exchanges through shell companies in the Cayman Islands and other jurisdictions. We are working to ensure that the heightened risks related to these structures and other risks related to operating in China are clearly and prominently disclosed to investors.

The last priority area with respect to issuers is trading by corporate insiders. I have asked staff for recommendations on how we might tighten Rule 10b5-1 to modernize this 20-year-old safe harbor and fill perceived gaps in our insider trading regime.

Funds and Investment Management

The fourth theme I will discuss is the potential reforms we are exploring in the funds and investment management space. Last week, we held an open Commission meeting to vote on

enhancing the proxy voting disclosures that registered funds provide to shareholders. I was pleased to support those amendments. I'd like to discuss a number of other initiatives in this space.

First of all, we've seen a growing number of funds market themselves as "green," "sustainable," "low-carbon," and so on.

I've asked staff to consider ways to determine what information stands behind those claims and how we can ensure that the public has the information they need to understand their investment choices among these types of funds.

Additionally, staff are developing a proposal for the Commission's consideration on cybersecurity risk governance, which could address issues such as cyber hygiene and incident reporting.

The third topic centers on private funds, and in particular the conflicts of interest their managers may have and the information they are providing investors about the fees they charge. I believe we can enhance disclosures in this area, better enabling pensions and others investing in these private funds to get the information they need to make investment decisions. Ultimately, every pension fund investing in these private funds would benefit if there were greater transparency and competition in this space.

Fourth, following the challenges of the spring of 2020, I believe we can build greater resiliency in both money market funds and open-end bond funds. I've asked staff for recommendations to address those issues, building upon feedback we received on the President's Working Group report as well as other information.

Given the disruptions in the nearly \$5 trillion money market fund sector in spring 2020, particularly amongst prime money market funds, I believe it is time to reflect upon the reforms of 2014 and 2010 to see if we can further improve resiliency, particularly in times of stress.

Given significant growth in open-end funds and some lessons learned last spring, I believe it also is appropriate to take a close look at this \$5-plus trillion sector, to enhance resiliency during periods of stress.

Enforcement and Examinations

Beyond the new policy areas we are exploring, we also have robust enforcement and examinations regimes. About half of SEC staff work in the Divisions of Examinations and Enforcement, ensuring that firms are inspected and wrongdoers are held accountable for their misconduct. These functions are essential to protecting investors, maintaining fair, orderly, and efficient markets, facilitating capital formation, protecting the competitiveness of our capital markets, and holding those who violate our securities laws accountable.

Our Division of Enforcement continues to be the cop on the beat, build on its successes, and focus on matters important to investors and the marketplace in order to ensure that investors are being protected. We cover the entire securities waterfront — investigating and litigating every

type of case within our remit. Despite our remote work posture, the Division of Enforcement during the just-completed fiscal year is on track to exceed the number of stand-alone actions against wrongdoers, while total actions are expected to be slightly down.

Moreover, our Division of Examinations continues to play the role of the “eyes and ears of the Commission.” This staff is dedicated to protecting investors and working families through examinations of investment advisers, investment companies such as mutual funds and exchange traded funds, broker-dealers, and other SEC registrants. This just-finished fiscal year, this division exceeded the previous year’s numbers by completing more than 3,000 examinations and hundreds of non-exam registrant engagements responding to market events. These exam and outreach efforts are critical to ensuring that firms comply with our federal securities laws and regulations and to monitoring significant market events.

Resources

Having started at the SEC in the spring, I have been struck by the sheer breadth and scope of the operations of this great agency and remarkable staff. The SEC’s employees oversee 28,000 registered entities, more than 3,700 broker-dealers, 24 national securities exchanges, and seven clearing agencies.¹² A record 67 million U.S. families held direct and indirect stock holdings in 2019.¹³

As our capital markets have grown and technology continues to shape the face of finance, though, the SEC has not grown to meet the needs of the 2020s. At the end of fiscal year 2016, the SEC had 4,650 people on board. Nearly five years later, though, that number had decreased by about 4 percent.

In fiscal year 2020, the Division of Enforcement’s staff had 6 percent fewer staff on board than it did in fiscal year 2016. As another example, the SEC’s Division of Corporation Finance is currently 20 percent smaller than it was five years ago. Since 2016, the Division of Examinations’ total staff has remained relatively flat despite growth of more than 20 percent in the population of registered investment advisers and a 65 percent increase in the assets managed by these firms. Other divisions are similarly stretched thin.

Though I’m appreciative of the House’s decision to support a fiscal year 2022 budget of about \$2 billion, this would get us back to only a headcount of 4,859. I’m hoping to continue to work with Congress to build back to where we were in 2016, but also to have the resources reflective of the growth and evolution of the capital markets.

¹² See Securities and Exchange Commission, “Fiscal Year 2021 Congressional Budget Justification | Annual Performance Plan,” available at <https://www.sec.gov/files/secfy21congbudjust.pdf>. Numbers from fiscal year 2019. See Securities and Exchange Commission, “National Securities Exchanges,” available at <https://www.sec.gov/fast-answers/divisionsmarketregmrexchangesshtml.html>.

¹³ Data drawn from the public version of triennial Survey of Consumer Finances (SCF): <https://www.federalreserve.gov/econres/scfindex.htm>. The SCF is sponsored by the Board of Governors of the Federal Reserve System with the cooperation of the U.S. Department of the Treasury. The 2019 SCF is the most recent survey.

As more Americans are accessing the capital markets, we need to be sure that the Commission has the resources to protect them.

Thank you and I look forward to answering your questions.