

Testimony on the Financial Management, Work Force Management and Internal Operations of the U.S. Securities and Exchange Commission

by Chairman Mary L. Schapiro
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Chairmen McHenry and Platts, Ranking Members Quigley and Towns, and members of the Subcommittees:

Thank you for inviting me to testify today regarding the financial management, work force management and internal operations of the Securities and Exchange Commission.¹

When I arrived at the SEC two years ago, the agency was reeling from a variety of economic events and mission failures that had severely harmed the ability of the agency to achieve its mission of protecting investors, maintaining fair and orderly markets, and facilitating capital formation. The failures of Bear Stearns and Lehman Brothers and other events of the economic crisis had shaken investors' faith in the ability of the agency to supervise some of the nation's largest financial entities. In addition, the failures to discover and act on the devastating financial schemes by Bernard Madoff and Allen Stanford struck directly at the core competencies of the SEC. We needed more experts, our training was deficient, our divisions and offices did not effectively communicate, and the manner in which we processed tips and complaints was critically lacking. These problems were exacerbated by inadequate infrastructure and material weaknesses in financial management and a siloed culture that had failed to keep pace in skills or technology with a rapidly changing and increasingly complex financial marketplace.

Reform was needed across the agency, and we immediately initiated decisive and comprehensive steps to reform the way the Commission operates. We brought in new leadership and senior management in virtually every office, including the Commission's first Chief Operating Officer, revitalized and restructured our enforcement and examination operations, revamped our handling of tips and complaints, took steps to break down internal silos and create a culture of collaboration, improved our risk assessment capabilities, recruited more staff with specialized expertise and real world experience, expanded our training, and, through rulemaking and leveraging of public accounting firms' efforts, enhanced safeguards for investors' assets, among

¹ The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the Commission. Testifying with me today will be Jeffrey Risinger, the Director of the Commission's Office of Human Resources. I have attached biographical information for Mr. Risinger as an appendix to this testimony.

other things. Our goal throughout these many changes has been to create a more vigilant, agile and responsive organization to perform the critical mission of the agency.

It is clear our efforts are paying dividends. Last fiscal year, the SEC returned \$2.2 billion to harmed investors, twice the agency's budget for that year. Similarly, last fiscal year there was \$2.8 billion in disgorgement and penalties ordered in SEC enforcement actions, a 176 percent increase over the amounts ordered in fiscal year (FY) 2008. Our enforcement actions have ranged from complex cases against parties that played significant roles in the recent economic crisis to lesser known cases involving real harm to individual investors. Our examiners and enforcement investigators now collaborate frequently and effectively, resulting in a number of recent enforcement actions generated from examination referrals.

Although we have made progress in reforming the Commission, we continue to seek ways to improve our operations. Section 967 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) directed the agency to engage the services of an independent consultant to study a number of specific areas of SEC operations. During the past four months, our staff has been fully engaged with the Boston Consulting Group (BCG), participating in interviews, providing documentation, and responding to questions. BCG's report will be released to Congress soon, and I expect that it will include recommendations that will identify additional efficiencies for the agency's operations. I look forward to implementing those and any others that will improve the way operate and enhance our ability to fulfil our mission.

New Leadership, Organizational Structures, and Expertise

In the last two years, we have brought in new leadership to run the agency's five largest operating units: the Division of Enforcement, the Office of Compliance Inspections and Examinations, the Division of Corporation Finance, the Division of Trading and Markets, and the Division of Investment Management. We also selected a new General Counsel, Chief Accountant, head of the Office of Investor Education and Advocacy, Chief Freedom of Information Act and Privacy Act Officer, Ethics Counsel, and directors for the New York, Miami, and Atlanta regional offices.

In addition, in May 2010, as mentioned, the Commission hired the agency's first Chief Operating Officer to oversee the operations of the finance and accounting functions of the SEC's Office of Financial Management, including financial reporting internal controls, the Office of Information Technology, and the Office of FOIA, Privacy & Records Management. In addition, we hired the agency's first Chief Compliance Officer in April 2010, and also named a new Chief Information Officer to oversee the Commission's information technology functions in October 2010.

This new and talented leadership team is committed to a culture of collaboration – sharing information and sharing ideas – and is playing a vital role in our efforts to transform the agency.

The scope and breadth of this agency's responsibilities is extraordinary. We are responsible for examining more than 11,000 investment advisers, over 5,000 broker-dealers with in excess of

160,000 branch offices, and 7,500 mutual funds. We are tasked with enforcing the securities laws governing the largest markets in the world and in which millions of Americans participate. We also are responsible for the review of nearly 10,000 public companies, including tens of thousands of disclosure documents each year, plus initial public offerings and other public capital markets transactions of corporate issuers, public asset-backed securities offerings, and proxy statements, public mergers, acquisitions and tender offers. The SEC also oversees approximately 500 transfer agents, 15 national securities exchanges, 10 nationally recognized statistical ratings organizations (NRSROs), as well as the Public Company Accounting Oversight Board (PCAOB), Financial Industry Regulatory Authority (FINRA), Municipal Securities Rulemaking Board (MSRB), and other self-regulatory organizations (SROs). We also are responsible for examining 9 clearing agencies.

Creation of RiskFin to Provide Sophisticated and Interdisciplinary Analysis

In September 2009, we created and staffed a new division – the Division of Risk, Strategy, and Financial Innovation (RiskFin) – to bore through the silos that for too long have compartmentalized and limited the impact of our institutional expertise. Because today’s financial markets and their participants are dynamic, fast-moving, and innovative, the regulators who oversee them must continue to improve their knowledge and skills in order to regulate effectively. RiskFin provides the Commission with sophisticated analysis that integrates economic, financial, and legal disciplines, and is re-focusing the agency’s attention on and response to new products, trading practices, and risks. RiskFin has attracted renowned experts in the financial, economic, and legal implications of the financial innovations being crafted on Wall Street.

Enforcement Division Reforms

The SEC’s Enforcement Division (Enforcement) has implemented a series of fundamental structural reforms designed to improve its performance and responsiveness. Highlights of the initiatives currently being implemented include:

Specialization. Enforcement created five new national specialized investigative groups dedicated to high-priority areas of enforcement: Asset Management (hedge funds and investment advisers), Market Abuse (large-scale insider trading and market manipulation), Structured and New Products (various derivative products), Foreign Corrupt Practices Act violations, and Municipal Securities and Public Pensions. These groups conduct “deep dives” into their respective subject areas, thus increasing their knowledge of products, markets, transactions and practices where fraud and misconduct are most likely to occur. With this knowledge, they are better able to detect patterns and trends that lead to wrongdoing and investor harm, and make it less likely that wrongdoers can conceal their misconduct in complex structures or practices. To accomplish this goal, the groups, as well as various specialization initiatives in the SEC’s regional offices, are utilizing enhanced training, specialized industry experience and skills, and targeted investigative approaches to better detect links and patterns suggesting wrongdoing, ultimately leading to more efficient and effective investigations. In addition to investigative

work, the specialized units are engaged in a number of initiatives with colleagues in our examination unit and other Divisions to develop risk analytics that proactively identify red flags for further examination and investigation.

Management Restructuring. Enforcement adopted a flatter, more streamlined organizational structure under which it has reallocated a number of staff who were first line managers to the mission-critical work of conducting front-line investigations. Although a layer of management has been eliminated, Enforcement is maintaining staff-to-manager ratios that will allow for close substantive consultation and collaboration, resulting in a management structure that facilitates timeliness, quality, and staff development.

Office of the Managing Executive. Also essential to Enforcement’s success is a strong “back office” function with the expertise to handle important support areas such as information technology, workflow, management processes, data collection and analysis, human resources and other administrative responsibilities. For that reason, Enforcement launched an Office of the Managing Executive, which is leading the division’s efforts to create and collect data, including a “dashboard” of quantitative and qualitative metrics, and to incorporate this data into our regular review process. Enforcement also hired its first Managing Executive, who is focused on the Division’s administrative, operational, and infrastructure functions, thus freeing up valuable investigative resources for mission-critical work.

Office of Market Intelligence. Enforcement established an Office of Market Intelligence to serve as a central office for the handling of tips, complaints and referrals (TCRs) received by Enforcement; coordinate Enforcement’s risk assessment activities; and support Enforcement’s strategic planning activities. This office will allow the division to have a unified, coherent, coordinated response to the huge volume of TCRs we receive every year, thereby enhancing our ability to open the right investigations, bring solid cases, and effectively protect investors.² In addition, Enforcement will use this TCR information to identify emerging threats to investors and markets, which will in turn inform how we employ our limited enforcement resources in order to maximize investor protection and deterrence.

Moreover, over the past two years, we have completely revamped the way the entire agency handles TCRs, including new policies, procedures and systems, as well as a centralized database so that staff across the agency has this information available to them. In fact, next week we plan to begin rolling out our new TCR system that improves our ability to obtain information from the public while providing the staff with workflow tools to better correlate, prioritize, assign and track progress of TCRs through to resolution.³

² Each year, the SEC receives an enormous number of TCRs from a countless array of sources. The challenge is to identify from this unstructured mass of information, which includes anonymous submissions that may contain little specificity, those items that involve actual fraud and wrongdoing.

³ In April 2010, the SEC implemented an interim repository to serve as a central system for collecting all TCRs while the new system was being developed.

Elimination of Unnecessary Process. We improved our law enforcement capabilities and sent a clear signal to our staff that we value toughness and speed by removing procedural roadblocks impeding investigations. For example, we delegated to senior staff the authority to issue subpoenas, so investigations can be launched without the time-consuming process of obtaining the approval of the Commission. Enforcement also has eliminated duplicative and unnecessary approvals for certain routine settlement discussions, Wells notices, and the opening of initial matters under investigation. In addition, we have abolished the requirement that staff obtain Commission approval before entering into settlement talks involving civil monetary penalties against public issuers. Proper levels of supervision remain across all of these areas – we simply eliminated unnecessary and inefficient processes and approvals that slowed down investigations.

Whistleblower Office. The Dodd-Frank Act substantially expands the agency’s authority to compensate individuals who provide the SEC with information about violations of the federal securities laws. Last November, the Commission proposed rules mapping out the procedure for would-be whistleblowers to provide critical information to the agency.⁴ The proposed rules convey how eligible whistleblowers can qualify for an award through a transparent process that provides them an opportunity to assert their claim to an award. Recently, we announced the selection of a Whistleblower Coordinator to oversee the whistleblower program. We also have fully funded the SEC Investor Protection Fund, which will be used to pay awards to qualifying whistleblowers. Pending the adoption of final rules, Enforcement staff has been reviewing and tracking whistleblower complaints submitted to the Commission.

Cooperation Program. We have added a host of measures to encourage corporate insiders and others to come forward with evidence of wrongdoing. These new cooperation initiatives establish incentives for individuals and companies to cooperate and assist with SEC investigations and enforcement actions. This program will encourage “insiders” with knowledge of wrongdoing to come forward early, thus allowing us to shut down fraudulent schemes earlier than would otherwise be possible.

These reforms are already generating improvements. Court-ordered disgorgements in FY 2010 were over \$1 billion more than those ordered in FY 2008 (\$1.82 billion compared to \$774 million), and court-ordered penalties in FY 2010 exceeded the penalties imposed in FY 2008 by over \$770 million (\$1.03 billion compared to \$256 million). We also returned to harmed investors in FY 2010 \$2.2 billion, or \$1.2 billion more than we returned in FY 2008, and filed more than twice as many Ponzi scheme cases in FY 2010 as we filed in FY 2008.

Of course, numbers alone do not fully capture the complexity, range, or importance of our enforcement accomplishments. During the past year, the Commission brought significant

⁴ See Release No. 34-63237, *Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934* (November 3, 2010), <http://www.sec.gov/rules/proposed/2010/34-63237.pdf>. In addition, last October, the Commission provided its first annual report to Congress on the Whistleblower Program as provided by the Dodd-Frank Act.

actions involving issues arising from the financial crisis, including actions against the former CEO and other executives of Countrywide Financial, Citigroup and its former CFO and Head of Investor Relations, Morgan Keegan, Goldman Sachs, State Street Bank, former executives of New Century Financial, Brookstreet Securities, former executives of IndyMac Bancorp, and ICP Asset Management and its President. We have obtained multi-million dollar settlements with Tyson Foods, Alcatel-Lucent, Technip, and General Electric for violations of the Foreign Corrupt Practices Act (FCPA). We filed our first case against a state involving municipal securities. We brought accounting fraud cases against Dell, Diebold, and DHB Industries. We brought a significant case involving inappropriate use of confidential customer information by a proprietary trading desk at Merrill Lynch and an action against AXA Rosenberg in the challenging and rapidly evolving area of computer-based quantitative investment management. More recently, we brought charges involving illegal trading on confidential information obtained from technology company employees moonlighting as expert network consultants, and involving a \$1.5 billion mortgage securities fraud scheme concerning an attempt to scam the U.S. Treasury's Troubled Asset Relief Program.

Examination Program Reforms

Similarly, our Office of Compliance, Inspections and Examinations (OCIE) recently instituted significant reforms to sharpen its focus on a risk-based examination process in the wake of an intensive nation-wide self assessment program it launched last March. These reforms and improvements to the office's risk-based approach were driven in part by the fact that our current examination resources can cover only a small portion of the registrants that we are responsible for examining. For example, there are approximately 460 exam staff responsible for more than 11,000 advisers that manage,⁵ among others, 7,500 mutual funds and thousands of additional private funds. These advisers manage nearly \$40 trillion in assets under management, including more than \$11 trillion in mutual fund portfolios.

Improved Risk Assessment Procedures. OCIE is improving its risk assessment procedures and techniques to better identify areas of risk to investors and more effectively allocate limited resources to their highest and best use. Last fall, OCIE formed a central Risk and Surveillance Unit to analyze emerging risks among the SEC's registrant population. OCIE also is enhancing the information that financial firms submit and is improving techniques to better identify those particular firms that represent the highest risk profiles and therefore warrant a closer look. Once we select firms for examination using a risk-focused methodology, OCIE examination staff are more rigorously reviewing information about these individual firms before sending examiners out to the field, so that we can use our limited resources more effectively and target key risk areas at those firms with the greatest overall risk profiles.

Improved Fraud Detection. We also have instituted measures to improve the ability of examiners to detect fraud involving theft of assets and other types of violations. Examination

⁵ While the number of registered advisers is anticipated to shrink by 28 percent, the total assets managed by advisers registered with the Commission are expected to rise.

staff across the country now routinely reach out to third parties such as custodians, counterparties and customers during examinations to verify the existence and integrity of all or part of the client assets managed by the firm. The measures also include expanded use of exams of an entire entity when firms have joint or dual registrants such as affiliated broker-dealers and investment advisers.

Greater Collaboration with Enforcement. As a result of various Enforcement/OCIE initiatives, there now exists a significantly increased level of collaboration between Enforcement and OCIE staff. OCIE and Enforcement staff and leadership have been directed to evaluate potential enforcement referrals from the OCIE exam staff regularly and determine the disposition of referrals. If there is disagreement on a case at the regional level, exam staff has been instructed to escalate the matter to the attention of senior leadership in Washington. These processes ensure that concerns can be escalated in a timely manner to senior leadership of both the exam and enforcement programs for appropriate review and resolution.

Enforcement and OCIE also hold regular meetings to discuss issues raised in ongoing examinations. Moreover, OCIE policy now requires that exam staff hold quarterly Exam Reviews in which the progress and status of every exam in a Regional Office is discussed and evaluated for several factors, including significant issues with the firm being examined, determining whether more staff resources are needed, and deciding if a potential referral to Enforcement is appropriate. These reviews are an opportunity to preview findings that appear likely to trigger possible Enforcement referrals, as well as to flag any potential differences in the assessment of urgency, potential harm to investors, or other issues that can then be raised at the joint regional meetings or to OCIE senior management.

Recruiting and Hiring Experts. In FY 2010, OCIE hired new staff with diverse skill sets to expand its knowledge base and improve its ability to assess risk, conduct examinations, detect and investigate wrongdoing, and focus our priorities. We have hired new Senior Specialized Examiners – and hope to bring on board more – who have specialized experience in areas such as risk management, trading, operations, portfolio management, options, compliance, valuation, new instruments and portfolio strategies, and forensic accounting. Many of these Senior Specialized Examiners now co-chair OCIE’s five new Specialization Working Groups where managers and examiners across the country can hone their expertise in critical areas. We also hired additional staff with expertise in financial products and techniques – such as derivatives, structured products and hedge fund activities. This will permit other staffers to tap into that expertise to help them identify emerging issues and understand the ways the industry is changing. Such expertise can also be helpful in efforts to improve the techniques used in examinations and the collection and analysis of data.

Integration of Our Exam Programs. In addition, OCIE has instituted several measures to integrate the activities of the broker-dealer and investment adviser examination programs. The New York Regional Office, for example, has adopted a protocol that integrates examination teams to make sure people with the right skill sets are assigned to examinations. Under the protocol, a single team of examiners, drawn from the broker-dealer and investment management

units, jointly examines selected dually-registered firms to ensure that the examination team includes those personnel relevant to the subject of the exam. In addition, the examination program has expanded opportunities for examiners to cross-train and increase coordination between broker-dealer and investment management staff on their examination plans. Finally, the examination program has begun to include experts from other SEC divisions and offices in exams to ensure we are leveraging SEC expertise and knowledge across the exam process.

New Governance Structure. OCIE a recently implemented a new governance structure, which is transforming our lines of communication and accountability. Specifically, the OCIE National Leadership Team now includes Directors of the Regional Offices, who manage both the Enforcement and Examinations programs in each Regional Office. This strengthens the OCIE/Enforcement partnership and speeds alerts, information hand offs, and transitions from OCIE Exam staff to the Enforcement Division when warranted.

Improved Exam Staffing. In addition, OCIE has outlined a new “open architecture” structure for staffing exams that will enable management to reach across disciplines and specialties to better match the skills of examination teams to the business models and risk areas of registrants. OCIE is also redesigning our exam team structure to redeploy the expertise and experience of managers from office administration to on-site exams in the field. These changes will help ensure that managers spend additional time and attention on supervision and oversight in the field on exams of registrants.

Improvements to our FOIA Program

The Commission’s Freedom of Information Act (FOIA) workload has escalated rapidly in the last 10 years. In 2001, we received approximately 2,500 requests. In the most recent fiscal year, we received over 10,000 requests, the most in Commission history and an almost 33 percent increase over FY 2009. By way of contrast, the total number of FOIA requests received by the FDIC, CFTC, and the Federal Reserve Board in FY10 totaled less than 2,900. Almost 75 percent of the FOIA requests we received were from commercial entities performing due diligence research on companies, investment advisers, and broker-dealers.

I share the commitment to accountability and transparency that FOIA encourages, and as Chairman I am committed to improving our FOIA program so that we respond to requests in a timely manner, treat all requesters equally, and provide as much information as possible without adversely affecting our mission.

Since hiring a new Chief FOIA Officer in October 2009, we have, among other things:

- issued new procedures that provide clear and concise processing guidance to all FOIA liaisons and Commission staff involved in FOIA responses;
- restructured the FOIA Office to improve management oversight of the quality and consistency of responses as well as adherence to policies and procedures;

- upgraded existing technology resources;
- made additional equipment available to deal with the escalating number of FOIA requests; and
- made more training available to all staff responsible for processing FOIA requests by using recognized experts in the field, such as a former Co-Director of the Justice Department's Office of Information Policy, which is responsible for providing guidance to all Government agencies on FOIA matters.

Last fiscal year, the Commission realized an 11 percent increase in the number of FOIA requests where records were released in full, and a 6 percent increase where records were released in part. Discretionary withholding also has decreased. Despite the tremendous increase in workload, the Commission ended the year with only 399 pending requests, the lowest number in eight years.

Significantly, action has been taken on all recommendations made by the SEC's Inspector General in his September 25, 2009 report on SEC FOIA operations, and the Inspector General has since closed out the report.

Prompt Responses to Recommendations

I have made it a top management priority to strengthen the SEC's program for ensuring appropriate and timely follow-up on audit recommendations, including by the agency's Office of Inspector General (OIG) and the Government Accountability Office (GAO).

In 2009, with the assistance of the SEC's Inspector General, we drafted and approved a new internal rule (SEC-R 30-2) to strengthen controls and accountability over audit follow-up activities. Among other things, it requires that offices prepare and share with the OIG a formal corrective action plan for all unresolved audit recommendations, as a way of ensuring consultation with the OIG through the audit follow-up process. I also appointed an Audit Follow-up Official and empowered her to ensure that agency managers are held accountable for timely and appropriate follow-up on audit recommendations.

With these efforts, the agency has made significant progress to address recommendations made in OIG reports. In the two years since I became Chairman, the SEC has successfully addressed and closed approximately 360 OIG recommendations, nearly double the number closed in the comparable preceding period.

The SEC also made it a particular priority to ensure that the agency undertakes all necessary actions in response to lessons learned from the agency's handling of the Madoff fraud, which had recently been discovered when I took office. I am pleased to report that, within one year, we were able to address and close all 69 recommendations arising from the OIG's Madoff reports. In addition, our website details all post-Madoff reforms undertaken by the agency.

I also am pleased that the SEC Inspector General's most recent semiannual report to Congress includes a number of further positive indicators with respect to SEC management's reinvigorated commitment to OIG cooperation and follow-up. He reports that, for the most recent period, there were no significant management decisions with which he disagreed, and no instance where agency management refused to produce requested information.

Implementation of Data Standardization

It is imperative that the SEC be able to make timely and efficient use of the information it gathers from filers. Standardizing data is important because it enables us to ensure that we are comparing "like with like," which in turn promotes sound analysis at the entity, industry, and systemic levels. Standardizing data can make it easier for both the SEC and investors to understand the implications of financial statements and other reports, while enabling comparisons between filers and among industries.

In the last two years, the Commission has incorporated data tagging requirements into several of its most significant rulemaking initiatives to increase the ability of parties to analyze the data that filers are required to provide. Among these are the Commission's rules on interactive data to improve financial reporting⁶ and the rules on interactive data for mutual fund risk/return summary.⁷ The Commission also included data tagging requirements in amendments to its Nationally Recognized Statistical Rating Organizations rules,⁸ its rule on money market fund reform⁹, as well as in its proposed rules on asset-backed securities,¹⁰ disclosure of payments for resource extraction issuers,¹¹ and security-based swap data repository registration.¹²

⁶ See Release No. 33-9002, *Interactive Data to Improve Financial Reporting* (Jan. 30, 2009), <http://www.sec.gov/rules/final/2009/33-9002.pdf>.

⁷ See Release No. 33-9006, *Interactive Data for Mutual Fund Risk/Return Summary* (Feb. 11, 2009), <http://www.sec.gov/rules/final/2009/33-9006.pdf>.

⁸ See Release No. 34-59342, *Amendments to Rules for Nationally Recognized Statistical Rating Organizations* (Feb. 2, 2009) <http://www.sec.gov/rules/final/2009/34-59342.pdf>; Release No. 34-61050, *Amendments to Rules for Nationally Recognized Statistical Rating Organizations* (Nov. 23, 2009), <http://www.sec.gov/rules/final/2009/34-61050.pdf>.

⁹ See Release No. IC-29132, *Money Market Fund Reform* (Feb. 23, 2010), <http://www.sec.gov/rules/final/2010/ic-29132.pdf>.

¹⁰ See Release No. 33-9117, *Asset-Backed Securities* (April 7, 2010), <http://www.sec.gov/rules/proposed/2010/33-9117.pdf>.

¹¹ See Release No. 34-63549, *Disclosure of Payments for Resource Extraction Issuers* (Dec. 15, 2010), <http://www.sec.gov/rules/proposed/2010/34-63549.pdf>.

¹² See Release No. 34-63347, *Security-Based Swap Data Repository Registration, Duties and Core Principles* (Nov. 19, 2010), <http://www.sec.gov/rules/proposed/2010/34-63347.pdf>. The Commission also discussed the importance of standardizing data in its concept release on the U.S. proxy system, inquiring into the feasibility of requiring data-

It is critical that the SEC be able to benefit from our data-tagging initiatives, both in terms of enhanced analytics and increased efficiencies. To enable prompt and effective analysis of such tagged data, I directed staff early in my tenure to identify, acquire, and begin to train our reviewing staff on how to use new analytic tools that may be available. Unfortunately, the SEC's current budget situation has reduced our ability to staff fully the desired interactive data platform.

The Commission will continue to promote transparency through data standardization techniques such as data tagging with the goal of improving the intelligibility and analyzability of filings. However, this effort, like our other IT initiatives, will be dependent in part on future resources. Moreover, I expect that, as the utility of tagged data in promoting our analytic objectives becomes more widely known, the market will offer additional analytic tools and develop new taxonomies, while continuing to refine existing ones.

Addressing Material Weaknesses in Internal Controls

In November 2010, the SEC completed its Performance and Accountability Report, the equivalent of a company's annual report. A GAO audit found that the financial statements and notes included in the report were presented fairly and in conformity with U.S. GAAP, but also identified two material weaknesses in internal controls over financial reporting: one in information systems, and a second in financial reporting and accounting processes.

I find these material weaknesses to be unacceptable. The root causes of these weaknesses are gaps in the security and functionality of the agency's financial system, resulting from years of under investing in financial system technologies. Rather than incur the development risks of creating new technology and systems, we made the decision to outsource this function by migrating to one of the Office of Management and Budget's designated Federal Shared Service Providers (FSSP), under the Financial Management Line of Business model.

After detailed analysis and careful consideration, the Commission selected as its FSSP the Department of Transportation's (DOT) Enterprise Service Center (ESC). Through the implementation of the new financial system, the Commission will reap the benefits of expanded functional capability; business process reengineering, where appropriate; and better integration of program, financial, and budgetary information to support more efficient and effective operations.

In November 2010, the SEC began the planning phase of the financial management improvement project, which focused on the development of a detailed project plan for the full implementation of the ESC solution and the identification of unique Commission requirements. The SEC and the ESC just completed this planning phase, and on February 25 signed an interagency agreement to

tagging for proxy-related materials. See Release No. 34-62495, *Concept Release on the U.S. Proxy System* (July 14, 2010), <http://www.sec.gov/rules/concept/2010/34-62495.pdf>.

commence the implementation phase. We will work together over the next 13 months to migrate the SEC's financial system and data, with a planned cutover in April 2012.

Employee Discipline

Like most other federal agencies, the Commission is required to follow the termination procedures set forth in Chapters 43 and 75 of Title 5 of the United States Code. These statutes create various procedural requirements, including providing the employee a specification of the charge, providing the employee an opportunity to respond to the charge orally and in writing, and a written decision by the deciding official. If the discipline imposed is greater than a 14 day suspension, the employee has a right to appeal to the Merit Systems Protection Board (MSPB), including the right to an evidentiary hearing before the MSPB. Obviously, before terminating an employee, the Commission must of course meet the requisite burden of evidentiary proof.

In March 2010, I issued a memorandum requiring the Office of Human Resources (OHR) to concur on all disciplinary matters. Prior to this change, OHR did not have the authority necessary to insure consistent and appropriate discipline across the agency. In addition, I have required OHR staff to meet with my office on a monthly basis to discuss the status of all pending disciplinary cases. These changes have built a greater level of accountability into the process.

In April 2010, I sent an email to all SEC employees conveying my anger and frustration at those few individuals who had used SEC time and resources to view sexually explicit materials on the Internet. In that email, I emphasized that any person that violated our clear rules against this inappropriate behavior faced termination of employment, and that we could not – and would not – tolerate such misconduct. I believe our efforts since that time have been effective in addressing that inappropriate use of agency resources.

While these cases have caused the SEC embarrassment, the fact that they have come to light is a sign of our aggressive approach. We employ sophisticated surveillance and internet filters to detect potential abuse, and forward suspected misconduct to the OIG for investigation.

The President's FY 2012 Budget Request

Our longstanding core responsibilities – pursuing securities fraud, reviewing public company disclosures and financial statements, inspecting the activities of investment advisers and broker-dealers, and ensuring fair and efficient markets, to name a few – are essential ingredients to restoring investor confidence and trust in financial institutions and markets following the recent financial crisis.

Until recent years, the SEC has faced significant challenges in maintaining a staffing level and budget sufficient to carry out its core mission. The SEC experienced three years of frozen or reduced budgets from FY 2005 to 2007 that forced a reduction of 10 percent of the agency's staff. Similarly, the agency's investments in new or enhanced IT systems underwent a decline of about 50 percent from FY 2005 to 2009.

SEC staffing levels are just now returning to the level of FY 2005, despite the fact that the size and complexity of the securities markets have undergone tremendous growth since then. During the past decade, trading volume has more than doubled, the number of investment advisers grew by 50 percent, and the funds they manage have increased to \$38 trillion. A number of financial firms spend many times more each year on their technology budgets alone than the SEC spends on all of its operations.

In July 2010, the President signed into law the Dodd-Frank Act. The Dodd-Frank Act significantly expanded the SEC's responsibilities and will require significant additional resources for full implementation. In addition to our traditional market oversight and investor protection responsibilities, the new responsibilities under Dodd-Frank include a parallel set of responsibilities to oversee the over-the-counter derivatives market, including direct regulation of participants such as security-based swaps dealers, venues such as swap execution facilities, warehouses such as swap data repositories, and clearing agencies set up as long-term central counterparties. In a similar fashion, whereas the agency has long overseen traditional asset managers, under the Dodd-Frank Act the SEC has been mandated with similar responsibilities for hedge fund advisers, including those that trade with highly complex instruments and strategies. Additionally, the Commission has new responsibility for registration of municipal advisers, enhanced supervision of NRSROs, heightened regulation of asset-backed securities, and creation of a new whistleblower program.

In the short term, the Dodd-Frank Act requires the SEC to promulgate more than 100 new rules, create five new offices, and conduct more than 20 studies and reports. To date, the SEC has proceeded with the first stages of implementation of the Dodd-Frank Act without additional funding.¹³ These tasks have taken staff time from other responsibilities, and have been done almost entirely with existing staff.

The SEC's FY 2012 request of \$1.407 billion – an increase of \$264 million over the agency's current FY 2011 spending authority – is designed to provide the SEC with the resources required to achieve multiple, high-priority goals: adequately staff the agency to fulfill its core mission; continue to implement the Dodd-Frank Act; and expand the agency's information technology systems and management infrastructure to serve the needs of a more modern and complex organization. Moreover, the request will permit additional improvements to the agency's internal operations, including to strengthen the Office of the Chief Operating Officer, build a more robust operational risk management program, and improve program and management controls, including in response to OIG and GAO audits.

It is important to note that the SEC's FY 2012 funding request will be fully offset by matching collections of fees on securities transactions. Currently, the transaction fees collected by the SEC are approximately two cents per \$1,000 of transactions. Under the Dodd-Frank Act, beginning with FY 2012, the SEC is required to adjust fee rates so that the amount collected will

¹³ To date, in connection with the Dodd-Frank Act, the Commission has issued 25 proposed rule releases, seven final rule releases, and two interim final rule releases. We have received thousands of public comments, completed five studies, and hosted five roundtables.

match the total amount appropriated for the agency by Congress. Under this mechanism, SEC funding will be deficit-neutral, as any increase or decrease in the SEC's budget would result in a corresponding rise or fall in offsetting fee collections.

Of the new positions requested for FY 2012, 312 positions (40 percent) will be used to strengthen and support core SEC functions and to continue reforming its operations and fostering stronger protections for investors. The other 468 positions (60 percent) of the new positions requested for FY 2012 are necessary initially to implement the Dodd-Frank Act. The agency also will invest in technology to facilitate the registration of additional entities and capture and analyze data on the new markets. The costs of these new positions and technology investments to implement the Dodd-Frank Act will be approximately \$123 million. Many of these new positions will be for experts in derivatives, hedge funds, data analytics, credit ratings, and other new or expanded responsibility areas.

Investing in Improved Information Technology

Data management and analysis is critical in identifying and assessing potential risk to the U.S. financial markets. The recent growth in the size and technological complexity of the U.S. markets requires that the SEC leverage its own technology to identify and address the most significant threats to investors, as well as to continuously improve agency productivity. The SEC's budget request for FY 2012 will support information technology investments of \$78 million, an increase of \$23 million over FY 2011. This will help to address the technology gap that resulted between FY 2005 and 2009, when SEC investments in new IT systems dropped by more than half. This level of funding is needed to support critical new technology initiatives, including data management and integration, document management, EDGAR modernization, market data, internal accounting and financial reporting, infrastructure functions, and improved project management. This funding also will permit the agency to develop risk analysis tools to assist with triage and analysis of the thousands of tips, complaints, and referrals received annually, and to complete a digital forensics lab that enforcement staff can use to recreate data from computer hard drives and cell phones to catch sophisticated fraudsters. This request also includes funding for technology needed to facilitate the registration of additional entities required by the Dodd-Frank Act and to capture and analyze data on these new markets.

Conclusion

While the SEC has made substantial progress in reforming its operations and increasing its efficiency, our efforts are ongoing. Our budget request reflects this need to further improve our internal operations, and also provides the resources needed to accomplish our core mission, implement the responsibilities given to us under the Dodd-Frank Act, and undertake badly needed new technology initiatives. I look forward to continuing to work closely with Congress as this legislative session continues, I thank you for inviting me here today, and I look forward to answering your questions.

