

Testimony on Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act by the U.S. Securities and Exchange Commission

by Chairman Mary L. Schapiro
U.S. Securities and Exchange Commission

Before the United States Senate Committee on Banking, Housing, and Urban Affairs

Thursday, February 17, 2011

Chairman Johnson, Ranking Member Shelby, and members of the Committee:

Thank you for inviting me to testify today on behalf of the Securities and Exchange Commission regarding our implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or “Act”). The Act includes over 100 rulemaking provisions applicable to the SEC, and also requires the SEC to conduct more than twenty studies and create five new offices.

Last September, I testified about our progress and plans for implementing the Act. Among other things, I described our new internal processes and cross-disciplinary working groups, the expanded opportunities for public comment we are providing, our emphasis on increased transparency in dealings with the public, the frequent and collaborative consultations we were undertaking with other financial regulators, and the priorities we created to assist us in complying in a timely manner with the Act’s mandates. My prior testimony also provided an overview of the principal areas of Commission responsibility under the Act.

Since that time, the Commission has made significant progress. 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. My testimony today will provide an overview of these activities.

OTC Derivatives

Among the key provisions of the Act are those that will establish a new oversight regime for the over-the-counter (“OTC”) derivatives marketplace. Title VII of the Act requires the SEC to work with other regulators – the Commodity Futures Trading Commission (“CFTC”) in particular – to write rules that address, among other things, capital and margin requirements, mandatory clearing, the operation of trade execution facilities and data repositories, business conduct standards for security-based swap dealers, and public transparency for transactional information. These rulemakings are intended to improve transparency and facilitate the centralized clearing of swaps, helping, among other things, to reduce counterparty risk. In addition, they should enhance investor protection by increasing disclosure regarding security-based swap transactions and helping to mitigate conflicts of interest involving security-based

swaps. Finally, these rulemakings should serve our broader objective of providing a framework that allows the OTC derivatives market to continue to develop in a more transparent, efficient, accessible, and competitive manner.

Title VIII of the Act provides for increased regulation of financial market utilities and financial institutions that engage in payment, clearing and settlement activities that are designated as systemically important. The purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability.

To date, the SEC has proposed nine rulemakings required by Title VII:

- Anti-fraud and anti-manipulation rules for security-based swaps that would subject market conduct in connection with the offer, purchase, or sale of any security-based swap to the same general anti-fraud provisions that apply to all securities and would explicitly reach misconduct in connection with ongoing payments and deliveries under a security-based swap;¹
- Rules regarding trade reporting, data elements, and real-time public dissemination of trade information for security-based swaps that would lay out who must report security-based swaps, what information must be reported, and where and when it must be reported;²
- Rules regarding the obligations of security-based swap data repositories that would require them to register with the SEC and specify other requirements with which they must comply;³
- Rules relating to mandatory clearing of security-based swaps that would set out the way in which clearing agencies provide information to the SEC about security-based swaps that the clearing agencies plan to accept for clearing;⁴

¹ See Release No. 34-63236, *Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps* (November 3, 2010), <http://www.sec.gov/rules/proposed/2010/34-63236.pdf>.

² See Release No. 34-63346, *Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information* (November 19, 2010), <http://www.sec.gov/rules/proposed/2010/34-63346.pdf>.

³ See Release No. 34-63347, *Security-Based Swap Data Repository Registration, Duties, and Core Principles* (November 19, 2010), <http://www.sec.gov/rules/proposed/2010/34-63347.pdf>.

⁴ See Release No. 34-63557, *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* (December 15, 2010), <http://www.sec.gov/rules/proposed/2010/34-63557.pdf>.

- Rules regarding the exception to the mandatory clearing requirement for hedging by end users that would specify the steps that end users must follow, as required under the Act, to notify the SEC of how they generally meet their financial obligations when engaging in security-based swap transactions exempt from the mandatory clearing requirement;⁵
- Rules regarding registration and regulation of security-based swap execution facilities that would define them, specify their registration requirements, and establish their duties and implement the core principles for security-based swap execution facilities laid out in the Act;⁶
- Joint rules with the CFTC regarding the definitions of swap and security-based swap dealers, and major swap and security-based swap participants;⁷
- Rules regarding the confirmation of security-based swap transactions that would govern the way in which certain of these transactions are acknowledged and verified by the parties who enter into them;⁸ and
- Rules intended to address conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.⁹

We also adopted interim final rules regarding the reporting of outstanding security-based swaps entered into prior to the date of enactment of the Dodd-Frank Act.¹⁰ These interim final rules require certain security-based swap dealers and other parties to preserve and report to the SEC or a registered security-based swap data repository certain information pertaining to any security-based swap entered into prior to the July 21, 2010 passage of the Dodd-Frank Act and whose terms had not expired as of that date.

⁵ See Release No. 34-63556, *End-User Exception of Mandatory Clearing of Security-Based Swaps* (December 15, 2010), <http://www.sec.gov/rules/proposed/2010/34-63556.pdf>.

⁶ See Release No. 34-63825, *Registration and Regulation of Security-Based Swap Execution Facilities* (February 2, 2011), <http://www.sec.gov/rules/proposed/2011/34-63825.pdf>.

⁷ See Release No. 34-63452, *Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”* (December 7, 2010), <http://www.sec.gov/rules/proposed/2010/34-63452.pdf>.

⁸ See Release No. 34-63727, *Trade Acknowledgment and Verification on Security-Based Swap Transactions* (January 14, 2011), <http://www.sec.gov/rules/proposed/2011/34-63727.pdf>.

⁹ See Release No. 34-63107, *Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC* (October 14, 2010), <http://www.sec.gov/rules/proposed/2010/34-63107.pdf>.

¹⁰ See Release No. 34-63094, *Reporting of Security-Based Swap Transaction Data* (October 13, 2010), <http://www.sec.gov/rules/interim-final-temp.shtml>.

As required by Title VIII of the Act, our staff also is working closely with the Federal Reserve Board and CFTC to develop a common framework to supervise financial market utilities, such as clearing agencies registered with the SEC, that the Financial Stability Oversight Council (“FSOC”) designates as systemically important. For example, last December we coordinated with the other agencies to propose rules under Title VIII regarding the filing of notices of material changes to rules, procedures, or operations by systemically important financial market utilities. In addition, in December the FSOC issued an advance notice of proposed rulemaking regarding the criteria and analytical framework that should be applied in designating financial market utilities under the Dodd-Frank Act.¹¹

Our staff also has been actively coordinating with the other agencies on the new authority granted to the SEC and CFTC to develop standards for these financial market utilities. Moreover, the SEC and CFTC staffs have begun working with staff from the Federal Reserve Board to develop a framework for consulting and working together on supervision and examination of systemically important financial market utilities consistent with Title VIII.

Private Fund Adviser Registration and Reporting

Under Title IV of the Dodd-Frank Act, large hedge fund advisers and private equity fund advisers will be required to register with the Commission beginning in July of this year. Under the Act, venture capital fund advisers and private fund advisers with less than \$150 million in assets under management in the United States will be exempt from the new registration requirements. In addition, family offices will not be subject to registration. To implement these provisions, the Commission has proposed:

- Amendments to Form ADV, the investment adviser registration form, to facilitate the registration of advisers to hedge funds and other private funds and to gather information about these private funds, including identification of the private funds’ auditors, custodians and other “gatekeepers;”¹²
- To implement the Act’s mandate to exempt from registration advisers to private funds with less than \$150 million in assets under management in the United States;¹³
- A definition of “venture capital fund” that distinguishes these funds from other types of private funds;¹⁴ and

¹¹ The FSOC’s advance notice of proposed rulemaking can be found at <http://www.treasury.gov/initiatives/Documents/VIII%20-%20ANPR%20on%20FMU%20Designations%20111910.pdf>.

¹² See Release No. IA-3110, *Rules Implementing Amendments to the Investment Advisers Act of 1940* (November 19, 2010), <http://www.sec.gov/rules/proposed/2010/ia-3110.pdf>.

¹³ See *id.*

¹⁴ See Release No. IA-3111, *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less*

- A definition of “family office” that focuses on firms that provide investment advice only to family members (as defined by the rule), certain key employees, charities and trusts established by family members and entities wholly owned and controlled by family members.¹⁵

In addition, following consultation with staff of the FSOC member agencies, the Commission and CFTC jointly proposed rules to implement the Act’s mandate to require advisers to hedge funds and other private funds to report information for use by the FSOC in monitoring for systemic risk to the U.S. financial system.¹⁶ The proposal, which builds on coordinated work on hedge fund reporting conducted with international regulators, would institute a “tiered” approach to gathering the systemic risk data which would remain confidential. Thus, the largest private fund advisers – those with \$1 billion or more in hedge fund, private equity fund, or “liquidity fund” assets – would provide more comprehensive and more frequent systemic risk information than other private fund advisers.

Asset-Backed Securities

Section 943 of the Dodd-Frank Act requires the Commission to adopt rules on the use of representations and warranties in the market for asset-backed securities (“ABS”). In January, the Commission adopted final rules¹⁷ that require ABS issuers to disclose the history of repurchase requests received and repurchases made relating to their outstanding ABS. Issuers will be required to make their initial filing on February 14, 2012, disclosing the repurchase history for the three years ending December 31, 2011. The disclosure requirements will apply to issuers of registered and unregistered ABS, including municipal ABS, though the rules provide municipal ABS an additional three-year phase-in period.

Section 945 requires the Commission to issue rules requiring an asset-backed issuer in a Securities Act registered transaction to perform a review of the assets underlying the ABS and disclose the nature of such review. In January, the Commission adopted final rules to implement

Than \$150 Million in Assets Under Management and Foreign Private Advisers (November 19, 2010), <http://www.sec.gov/rules/proposed/2010/ia-3111.pdf>.

¹⁵ See Release No. IA-3098, *Family Offices* (October 12, 2010); <http://www.sec.gov/rules/proposed/2010/ia-3098.pdf>.

¹⁶ See Release No. IA-3145, *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF* (January 26, 2011), <http://www.sec.gov/rules/proposed/2011/ia-3145.pdf>.

¹⁷ See Release No. 33-9175, *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (January 20, 2011), <http://www.sec.gov/rules/final/2011/33-9175.pdf>.

Section 945.¹⁸ Under the final rules, the type of review conducted may vary, but at a minimum must be designed and effected to provide reasonable assurance that the prospectus disclosure about the assets is accurate in all material respects. The final rule provides a phase-in period to allow market participants to adjust their practices to comply with the new requirements.

Section 942(a) of the Dodd-Frank Act eliminated the automatic suspension of the duty to file reports under Section 15(d) of the Exchange Act for ABS issuers and granted the Commission authority to issue rules providing for the suspension or termination of this duty to file reports. The Commission has proposed rules in connection with this provision of the Act which would permit suspension of the reporting obligations for ABS issuers when there are no longer asset-backed securities of the class sold in a registered transaction held by non-affiliates of the depositor.¹⁹

We are working closely with other regulators to jointly create the risk retention rules required by Section 941 of the Act, which will address the appropriate amount, form and duration of required risk retention for ABS securitizers, and will define qualified residential mortgages. We expect that the Commission will consider proposed risk retention rules in the near future.

Credit Rating Agencies

Under the Dodd-Frank Act, the Commission is required to undertake approximately a dozen rulemakings related to nationally recognized statistical rating organizations (“NRSROs”). The Act requires the SEC to address, among other things, internal controls and procedures, conflicts of interest, credit rating methodologies, transparency, ratings performance, analyst training, credit rating symbology, and disclosures accompanying the publication of credit ratings. The staff plans to recommend rule proposals to the Commission on these matters in the near future.²⁰

In addition, the Act requires 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.²¹ On February 9, 2011, the Commission proposed rule

¹⁸ See 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>.

¹⁹ See Release No. 34-63652, *Suspension of the Duty to File Reports for Classes of Asset-Backed Securities Under Section 15(d) of the Securities Exchange Act of 1934* (January 6, 2011), <http://www.sec.gov/rules/proposed/2011/34-63652.pdf>.

²⁰ In addition, last September the Commission issued an amendment to Regulation FD that implements Section 939B of the Act, which requires that the SEC amend Regulation FD to remove the specific exemption from the rule for disclosures made to NRSROs and credit rating agencies for the purpose of determining or monitoring credit ratings. See Release No. 33-9146, *Removal from Regulation FD of the Exemption for Credit Rating Agencies* (September 29, 2010), <http://www.sec.gov/rules/final/2010/33-9146.pdf>.

²¹ See Section 939A of the Dodd-Frank Act.

amendments that would remove credit ratings as conditions for companies seeking to use short-form registration when registering securities for public sale.²² Under the proposed rules, the new test for eligibility to use Form S-3 or Form F-3 short-form registration would be tied to the amount of debt and other non-convertible securities a particular company has sold in registered primary offerings within the previous three years. Additional rule proposals in response to Section 939A will be forthcoming.

The Act also requires the SEC to conduct three studies relating to credit rating agencies. In December, the Commission requested comment on the feasibility and desirability of standardizing credit rating terminology.²³ The additional NRSRO-related studies concern (1) alternative compensation models for rating structured finance products and (2) NRSRO independence. Given the complexity of the issues it raises, we likely will seek comment on the compensation study in the near future so as to provide commentators an extended period in which to communicate their views.

Corporate Governance and Executive Compensation

Section 951 of the Act requires public companies subject to the federal proxy rules to provide a shareholder advisory “say-on-pay” vote on executive compensation at least once every three years and a separate advisory vote at least once every six years on whether the say-on-pay resolution will be presented for shareholder approval every one, two, or three years. In addition, Section 951 requires disclosure about – and a shareholder advisory vote to approve – compensation related to merger or similar transactions, known as “golden parachute” arrangements. In January, the Commission adopted rules to implement these provisions of Section 951.²⁴ The rules provide smaller reporting companies a two-year delayed compliance period for the say-on-pay and “frequency” votes. Section 951 also requires that institutional investment managers report their votes on these matters at least annually. The Commission proposed rules to implement this requirement last October, and we expect that these rules will be finalized shortly.²⁵

Section 957 of the Act requires the rules of each national securities exchange to be amended to prohibit brokers from voting uninstructed shares on the election of directors (other than uncontested elections of directors of registered investment companies), executive compensation

²² See Release No. 33-9186, *Removing Security Ratings as Condition for Short-Form Registration* (February 9, 2011), <http://www.sec.gov/rules/proposed/2011/33-9186.pdf>.

²³ See Release No. 34-63573, *Credit Rating Standardization Study* (December 17, 2010), <http://www.sec.gov/rules/other/2010/34-63573.pdf>.

²⁴ See 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>.

²⁵ See Release No. 34-63123, *Reporting of Proxy Votes on Executive Compensation and Other Matters* (October 18, 2010), <http://www.sec.gov/rules/proposed/2010/34-63123.pdf>.

matters, or any other significant matter, as determined by the Commission by rule. To date, the Commission has approved changes to the rules of the New York Stock Exchange, the Nasdaq Stock Market and the International Securities Exchange.²⁶ We anticipate that corresponding changes to the rules of other national securities exchanges will be considered by the Commission in the near future.

The Commission also is required by the Act to adopt several additional rules related to corporate governance and executive compensation. We anticipate that the staff will recommend proposed rules for the Commission's consideration in the near future, which will mandate new listing standards relating to the independence of compensation committees and establish new disclosure requirements and conflict of interest standards that boards must observe when retaining compensation consultants.²⁷ In addition, Section 956 requires the Commission, jointly with other financial regulators, to adopt incentive-based compensation regulations or guidelines that apply to covered financial institutions, including broker-dealers and investment advisers, with assets of \$1 billion or more. The Commission staff has been working closely with the other regulators to prepare a proposal implementing this provision.

The Act also requires the Commission to adopt rules mandating new listing standards relating to specified "clawback" policies²⁸ and rules requiring new disclosures about executive compensation and company performance,²⁹ executive pay ratios,³⁰ and employee and director hedging.³¹ These provisions of the Act do not contain rulemaking deadlines, but are being considered and assessed by the staff.

Investment Adviser Rulemaking and Investment Adviser Related Studies

In consultation with the state securities regulators, the Commission proposed rules and amendments to Form ADV (the adviser registration form) to implement the new threshold for registering advisers with the SEC rather than state regulators. Under the Act, the threshold increased from \$25 million to \$100 million in assets under management.³² As a result of this

²⁶ See Release No. 34-62874 (September 9, 2010), <http://www.sec.gov/rules/sro/nyse/2010/34-62874.pdf>; Release No. 34-62992 (September 24, 2010), <http://www.sec.gov/rules/sro/nasdaq/2010/34-62992.pdf>; Release No. 34-63139 (October 20, 2010), <http://www.sec.gov/rules/sro/ise/2010/34-63139.pdf>.

²⁷ See Section 952 of the Dodd-Frank Act. Under the Act, these rules are to be adopted by the Commission within 360 days from the date of enactment of the Act.

²⁸ See Section 954 of the Dodd-Frank Act.

²⁹ See Section 953(a) of the Dodd-Frank Act.

³⁰ See Section 953(b) of the Dodd-Frank Act.

³¹ See Section 955 of the Dodd-Frank Act.

³² See Release No. IA-3110, *Rules Implementing Amendments to the Investment Advisers Act of 1940* (November 19, 2010), <http://www.sec.gov/rules/proposed/2010/ia-3110.pdf>.

change, we expect that approximately 4,100 investment advisers will switch from SEC to state registration. In addition, approximately 750 large private fund advisers will newly register with the Commission as a result of the Act's private fund adviser provisions.

In addition, the SEC recently released three Dodd-Frank-mandated staff studies related to improving the investment adviser and broker-dealer regulatory frameworks.

First, the Commission published a staff study on enhancing investment adviser examinations.³³ The study concludes that the Commission's investment adviser examination program requires a source of funding sufficiently stable to prevent examination resources from being outstripped by future growth in the number of registered advisers (i.e., that the resources are scalable to any future increase – or decrease – in the number of registered investment advisers). The study identified three options for Congress to consider:

- Impose “user fees” on SEC-registered investment advisers that could be retained by the Commission to fund the investment adviser examination program;
- Authorize one or more SROs to examine, subject to SEC supervision, all SEC-registered investment advisers; or
- Authorize FINRA to examine dual registrants for compliance with the Advisers Act.

Second, we published a staff study on the obligations of investment advisers and broker-dealers.³⁴ That study made two primary recommendations: that the Commission (1) exercise its discretionary rulemaking authority under the Act to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when they are providing personalized investment advice about securities to retail investors; and (2) consider harmonization of broker-dealer and investment adviser regulation when retail investors obtain the same or substantially similar services and when such harmonization adds meaningfully to investor protection. Under the Act, the uniform fiduciary standard to which broker-dealers and investment advisers would

³³ *Staff Study on Enhancing Investment Adviser Examinations* (January 19, 2011), <http://www.sec.gov/news/studies/2011/914studyfinal.pdf>; see also Commissioner Elisse B. Walter, Statement on Study Enhancing Investment Adviser Examinations (Required by Section 914 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act) (Jan. 2010), <http://www.sec.gov/news/speech/2011/spch011911ebw.pdf>.

I did not participate in the study or the vote authorizing its publication.

³⁴ *See Study on Investment Advisers and Broker-Dealers* (January 21, 2011), <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>; see also Statement by SEC Commissioners Kathleen L. Casey and Troy A. Paredes Regarding Study on Investment Advisers and Broker-Dealers (January 21, 2011), <http://www.sec.gov/news/speech/2011/spch012211klctap.htm>.

be subject would be “no less stringent” than the standard that applies to investment advisers today.

Third, we published a staff study on investor access to information about investment professionals. Today, investors must search two separate databases for information about broker-dealers and investment advisers. The primary recommendation was to centralize access to these two databases to enable investors to simultaneously search both databases and receive unified search results.³⁵

Specialized Disclosure Provisions

Title XV of the Act contains specialized disclosure provisions related to conflict minerals, coal or other mine safety, and payments by resource extraction issuers to foreign or U.S. government entities.

The conflict minerals provision of the Act, Section 1502, requires issuers to disclose annually whether any conflict minerals that are necessary to the functionality or production of a product originated in the Democratic Republic of the Congo or an adjoining country. If so, issuers are further required to provide a report describing, among other matters, the measures taken to exercise due diligence on the source and chain of custody of those minerals. The report must include an independent private sector audit that is certified by the person filing the report.

Section 1503 of the Act, which relates to mine safety, requires mining companies to disclose information about health and safety violations in their periodic reports filed with the Commission. It also requires issuers to file Form 8-K reports disclosing receipt of specified orders or notices from the Mine Safety and Health Administration. The disclosure requirement currently is in effect by operation of the Act.

Section 1504 of the Act requires resource extraction issuers that are required to file annual reports with the Commission and that engage in commercial development of oil, natural gas, and minerals to disclose annually information about any payment made by the issuer or its subsidiaries, or an entity under the control of the issuer, to the U.S. or a foreign government for the purpose of the commercial development of oil, natural gas or minerals.

The Commission published rule proposals relating to these three provisions of the Act in December.³⁶ The comment periods were scheduled to close on January 31, 2011, but the

³⁵ See *Study and Recommendations on Improved Investor Access to Registration Information About Investment Advisers and Broker-Dealers* (January 26, 2011), <http://www.sec.gov/news/studies/2011/919bstudy.pdf>.

³⁶ See Release No. 34-63547, *Conflict Minerals* (December 15, 2010), <http://www.sec.gov/rules/proposed/2010/34-63547.pdf>; Release No. 33-9164, *Mine Safety Disclosure* (December 15, 2010), <http://www.sec.gov/rules/proposed/2010/33-9164.pdf>; Release No. 34-63549, *Disclosure of Payments by Resource Extraction Issuers* (December 15, 2010), <http://www.sec.gov/rules/proposed/2010/34-63549.pdf>.

Commission recently extended the comment periods for all three rule proposals for 30 days, to March 2, 2011.³⁷ The nature of the proposed disclosure requirements differs from the disclosure traditionally required by the Exchange Act, and comments were requested on a variety of significant aspects of the proposed rules. After receiving requests for extensions of the public comment period for all three rule proposals, we determined that providing the public additional time to consider thoroughly the matters addressed by the releases and to submit comprehensive responses would benefit the Commission in its consideration of final rules.

Whistleblower

Section 922 of the Act requires the SEC, under regulations prescribed by the Commission, to pay awards to individuals who voluntarily provide the Commission with original information that leads to the successful enforcement of (1) an SEC action that results in monetary sanctions exceeding \$1 million or (2) certain related actions. 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. Prior to the Act, the agency's bounty program was limited to insider trading cases, and the amount of an award was capped at 10 percent of the penalties collected in the action.

Last November, the Commission proposed rules mapping out the procedure for would-be whistleblowers to provide critical information to the agency.³⁸ 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. 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.

The Act requires the Commission to create a separate office within the SEC to administer and enforce whistleblower provisions of the Act. Soon, we plan to announce the selection of a Whistleblower Coordinator to oversee the whistleblower program.

Exempt Offerings

³⁷ See Release No. 34-63793, *Conflict Minerals (extension of comment period)* (January 28, 2011), <http://www.sec.gov/rules/proposed/2011/34-63793.pdf>; Release No. 33-9179, *Mine Safety Disclosure (extension of comment period)* (January 28, 2011), <http://www.sec.gov/rules/proposed/2011/33-9179.pdf>; Release No. 34-63795, *Disclosure of Payments by Resource Extraction Issuers (extension of comment period)* (January 28, 2011), <http://www.sec.gov/rules/proposed/2011/34-63795.pdf>.

³⁸ 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 Act.

Section 413(a) of the Act requires the Commission to exclude the value of an individual's primary residence when determining if that individual's net worth exceeds the \$1 million threshold required for "accredited investor" status. This change was effective upon enactment of the Act, but the Commission is also required to revise its rules to reflect the new standard. The Commission proposed rule amendments in January that would implement this provision, and would clarify the treatment of any indebtedness secured by the residence in the net worth calculation.³⁹

In addition, under Section 926 of the Act, the Commission is required to adopt rules that disqualify securities offerings involving certain "felons and other 'bad actors'" from relying on the safe harbor from Securities Act registration provided by Rule 506 of Regulation D. We expect that the staff will recommend proposed rules for the Commission's consideration soon.

Volcker Rule

On January 18, 2011, the FSOC approved and released to the public a study formalizing its findings and recommendations for implementing section 619 of the Dodd-Frank Act, commonly referred to as the Volcker Rule.⁴⁰ Commission staff actively participated in the study. We recently solicited public comments in advance of our rule proposal concerning the SEC's implementation of the Volcker Rule.⁴¹

Procedural Rules for SRO Filings

Section 916 of the Act amended Section 19(b) of the Securities Exchange Act of 1934, which governs the handling of proposed rule changes submitted by SROs. Among other things, Section 916 required the Commission to promulgate rules setting forth the procedural requirements of proceedings to determine whether a proposed rule change should be disapproved. In satisfaction of this requirement, the Commission adopted new Rules of Practice to formalize the process it will use when conducting proceedings to determine whether an SRO's proposed rule change should be disapproved under Section 19(b)(2) of the Exchange Act.⁴² The new rules are intended to add transparency to the Commission's conduct of those proceedings, to address the

³⁹ See Release No. 33-9177, *Net Worth Standard for Accredited Investors* (January 25, 2011), <http://www.sec.gov/rules/proposed/2011/33-9177.pdf>.

⁴⁰ The FSOC Volcker Rule study and recommendations can be found at <http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf>.

⁴¹ See <http://sec.gov/spotlight/dodd-frank/volckerrule.htm>.

⁴² See Release No. 34-63049, *Delegation of Authority to the Director of the Division of Trading and Markets* (Effective Date - October 12, 2010), <http://www.sec.gov/rules/final/2010/34-63049.pdf>; Release No. 34-63699, *Delegation of Authority to the Chief Accountant* (Effective Date - January 18, 2011), <http://www.sec.gov/rules/final/2011/34-63699.pdf>; and Release No. 34-63723, *Rules of Practice* (Effective Date - January 24, 2011), <http://www.sec.gov/rules/final/2011/34-63723.pdf>.

process the Commission will follow to institute proceedings and provide notice of the grounds for disapproval under consideration, and to provide interested parties with an opportunity to submit written materials to the Commission.

Creation of SEC Offices

Beyond the whistleblower office, the Act requires the Commission to create four new offices within the Commission, specifically, the Office of Credit Ratings,⁴³ Office of the Investor Advocate,⁴⁴ Office of Minority and Women Inclusion,⁴⁵ and Office of Municipal Securities.⁴⁶ As each of these offices is statutorily required to report directly to the Chairman, the creation of these offices is subject to approval by the Commission's appropriations subcommittees to reprogram funds for this purpose. Until approval is received, the initial functions of the offices are being performed on a limited basis by other divisions and offices. Below is a summary of our plans for each office, as well as the current status as to each.

- Office of Credit Ratings – The office will be responsible for administering the rules of the Commission with respect to the practices of NRSROs in determining ratings; promoting accuracy in credit ratings issued by NRSROs; ensuring that such ratings are not unduly influenced by conflicts of interest; and conducting examinations of each NRSRO at least annually. Currently, the NRSRO-related rulemaking functions remain with staff within the Commission's Division of Trading and Markets, and the examination functions continue to be performed by the existing Office of Compliance Inspections and Examination.
- Office of the Investor Advocate – The office will assist retail investors in resolving significant problems they may have with the Commission or with SROs; 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 office will include an Ombudsman as required by the Act. Currently, activities regarding investor perspectives in rulemaking continue to be performed by staff in the existing Office of Investor Education and Advocacy.
- Office of Minority and Women Inclusion – The Office of Minority and Women Inclusion will be responsible for all matters of the agency relating to diversity in management, employment, and business activities. The director of this office will advise the Chairman on the impact of the policies and regulations of the SEC on minority-owned and women-

⁴³ See Section 932 of the Dodd-Frank Act.

⁴⁴ See Section 915 of the Dodd-Frank Act.

⁴⁵ See Section 342 of the Dodd-Frank Act.

⁴⁶ See Section 979 of the Dodd-Frank Act.

owned businesses. The director also will develop and implement standards for: equal employment opportunity and the racial, ethnic, and gender diversity of the workforce and senior management of the SEC; increased participation of minority-owned and women-owned businesses in the programs and contracts of the agency, including standards for coordinating technical assistance to such businesses; and assessing the diversity policies and practices of entities regulated by the SEC. Currently, activities regarding diversity in hiring and small business contracting continue to be performed by staff in the existing EEO Office.

- Office of Municipal Securities – The office will administer the rules pertaining to broker-dealers, advisors, investors, and issuers of municipal securities,⁴⁷ as well as coordinate with the Municipal Securities Rulemaking Board on rulemaking and enforcement actions. Currently, those functions continue to be assigned to staff within the Division of Trading and Markets.

Internal Operations

In the past two years the SEC has taken significant and comprehensive steps to reform the way it operates. We have brought in new leadership and senior management, revitalized and restructured our enforcement, examination and corporation finance operations, revamped our handling of tips and complaints, taken 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, and enhanced safeguards for investors' assets, among other things. Despite these changes, much work remains, and we continue to seek ways to improve our operations.

To assist the SEC in assessing its operational efficiency, Section 967 of the Dodd-Frank Act directed the agency to engage the services of an independent consultant to study a number of specific areas of SEC internal operations and of the SEC's relationship with SROs. On October 15, 2010, the Commission engaged Boston Consulting Group (BCG) to perform the organizational study. During the past four months, our staff has been fully engaged with BCG, participating in interviews, providing documentation, and responding to questions. BCG's report is due March 14, and we expect it will include recommendations that will identify additional efficiencies for SEC operations.

Funding for Implementation of the Dodd-Frank Act

⁴⁷ Section 975 of the Act also requires the registration of municipal advisors with the Commission. This new registration requirement became effective on October 1, 2010, making it unlawful for any municipal advisor to provide advice to a municipality unless registered with the Commission. Last September, the Commission adopted an interim final rule establishing a temporary means for municipal advisors to satisfy the registration requirement. In December, the Commission proposed a permanent rule creating a new process by which municipal advisors must register with the SEC.

The provisions of the Dodd-Frank Act represent a major expansion of the SEC's responsibilities and will require significant additional resources for full implementation. To date, the SEC has proceeded with the first stages of implementation of the Dodd-Frank Act without additional funding. As described above, implementation up to this point has largely involved performing studies, analysis, and the writing of rules. These tasks have taken staff time from other responsibilities, and have been done almost entirely with existing staff and without additional expenses in areas such as information technology.

The budget justification I recently submitted⁴⁸ – provided in connection with the President's fiscal year 2012 ("FY 2012") budget request – estimates that, over time, full implementation of the Dodd-Frank Act will require a total of approximately 770 new staff, of which many will need to be expert in derivatives, hedge funds, data analytics, credit ratings, or other new or expanded responsibility areas. The SEC also will need to invest in technology, to facilitate the registration of additional entities and capture and analyze data on these new markets.

Sixty percent, or 468, of the new staff positions requested are necessary initially to implement Dodd-Frank responsibilities. This number includes positions that I anticipate are needed to fully staff the five new offices at adequate levels. The agency also will need to invest in technology to facilitate the registration of additional entities and capture and analyze data on the new markets. It is estimated the costs of these new positions and technology investments will be approximately \$123 million. The remaining positions requested in the budget will be used to strengthen and support core SEC operations and to continue reforming its operations and fostering stronger protections for investors.

In addition to the new positions requested in FY 2012, I also anticipate that an additional 296 positions will be required in FY 2013 for full implementation of the Dodd-Frank Act. It is important to note that the SEC's FY 2012 funding will be fully offset by matching collections of fees on securities transactions. Currently, the transaction fees collected by the SEC are approximately 2 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 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.

Conclusion

Though the SEC's efforts to implement the Dodd-Frank Act have been extensive, our work is far from over. As we proceed with implementation, we look forward to continuing to work closely with Congress, our fellow regulators and members of the financial and investing public. Thank you for inviting me here today to share with you our progress on and plans for implementation. I look forward to answering your questions.

⁴⁸ In accordance with past practice, the budget justification of the agency was submitted by the Chairman of the Commission and was not voted on by the full Commission.