

Testimony before the Before the Subcommittee on Securities, Insurance, and Investment

**Committee on Banking, Housing, and Urban Affairs
United States Senate**

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

March 10, 2011

Chairman Reed, Ranking Member Crapo, Members of the Subcommittee:

Thank you for the opportunity to testify in support of the President's FY 2012 budget request for the U.S. Securities and Exchange Commission (SEC).¹ I welcome this opportunity to answer your questions and provide you with additional information on how the SEC would make effective use of the \$1.407 billion that is requested for the coming fiscal year.²

Over the past two years, we have worked tirelessly to make the SEC more vigilant, agile, and responsive, and are moving on multiple fronts to enhance the agency's effectiveness and provide robust oversight of the financial markets. We have new senior leadership in all key positions and have embarked on a vigorous rulemaking agenda, addressing areas such as equity market structure, investment adviser custody controls, money market fund resiliency, asset-backed securities, large trader reporting, pay-to-play, and municipal securities disclosure.

In addition to carrying out our longstanding core responsibilities, last year's enactment of the Dodd-Frank Act has added significantly to the SEC's workload. In the short term, it requires the agency to promulgate more than 100 new rules, create five new offices, and produce more than 20 studies and reports. The law assigns the SEC considerable new responsibilities that will have a significant long-term impact on the agency's workload, including oversight of the over-the-counter (OTC) derivatives market and hedge fund advisers; registration of municipal advisors and security-based swap market participants; enhanced supervision of nationally recognized statistical rating organizations (NRSROs) and clearing agencies; heightened regulation of asset-backed securities (ABS); and creation of a new whistleblower program.

My testimony will provide an overview of the agency's actions and initiatives over the past year. I will then discuss the FY 2012 budget request and the activities that these resources would make possible.

New Leadership, Organizational Reform, and Expertise

Without a doubt, the most critical element to our success in improving the Commission's operations is the agency's talented staff. Over the past two years, we have installed new

¹ A copy of the SEC's FY2012 Budget Congressional Justification can be found on our website at <http://www.sec.gov/about/secfy12congbudgetjust.pdf>.

² 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 President or the full Commission.

management across the major divisions and offices of the Commission. These new senior managers are playing a vital role in our efforts to transform the agency.

During my first year, we brought in new leadership to run the four largest operating units—the Division of Enforcement, the Office of Compliance Inspections and Examinations (OCIE), the Division of Corporation Finance, and the Division of Trading and Markets. We also created a new Division of Risk, Strategy, and Financial Innovation to re-focus the agency’s attention on—and response to—new products, trading practices, and risks.

This past year, we brought on board a new director to oversee the Division of Investment Management, and hired deputy directors in the Divisions of Trading and Markets and Corporation Finance. We also brought on board key leaders to help improve internal operations. This includes the creation of a new Chief Operating Officer position; the hiring of a new Chief Financial Officer to oversee the agency’s budget, accounting, and financial reporting; the hiring of a new Chief Information Officer to oversee the agency’s information technology program; and the hiring of the agency’s first Chief Compliance Officer. At all levels we have focused on hiring individuals with key skill sets that reflect the rapidly changing markets under our supervision.

We’re continuing to make significant progress in reforming how the SEC operates. Since 2009, the agency has carried out a comprehensive review and restructuring of its two largest programs—enforcement and examinations—to ensure effective performance. The Enforcement Division has streamlined its procedures to bring cases more swiftly, removed a layer of management, created national specialized units, and added new staff with new skills to pursue complex fraud and market abuses. More recently, the SEC’s examinations unit restructured its exam program after a top-to-bottom review, becoming more risk-based in its approach, enhancing staff training, and installing better systems to support examiners.

In addition, the Division of Corporation Finance recently made targeted changes to its operations to help us: address complexities and changes in the asset-backed securities market; determine if our rules, regulations, and review approach are adequately addressing trends in securities offerings and in our capital markets; and enhance our focus on the largest financial institutions.

Also during the past year, to the extent permitted by available resources, we worked to improve training and education of agency staff, to establish a deeper reservoir of experts throughout the agency, and to modernize information technology, including a centralized system for tips and complaints, enforcement and examination management systems, risk analysis tools, and financial management systems.

Enforcing the Law

Enforcement of the securities laws is the foundation of the SEC’s mission. Swift and vigorous proceedings directed at those who have broken the law are at the heart of the agency’s efforts to protect investors.

In the past year, the SEC has continued our structural reforms of the enforcement program. We have created five national specialized investigative groups dedicated to high-priority areas of enforcement; adopted a flatter organizational structure to permit more staff to be allocated to front-line investigations; and created a new Office of Market Intelligence to serve as the hub for the effective handling of tips, complaints, and referrals.

The Dodd-Frank Act substantially expands the agency's authority to compensate whistleblowers who provide the SEC with high-quality information about violations of the federal securities laws. Last November, the Commission proposed rules mapping out the procedure for would-be whistleblowers to provide information to the agency. The proposed rules describe 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.

We also have added a series of additional 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 fully and truthfully 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, which were intended to maximize our use of resources and permit the agency to move more swiftly and strategically, are already showing improvements. Over the past calendar year, court-ordered disgorgements are up 20 percent, while the amount of monetary penalties has almost tripled. Of course, numbers alone don't fully capture the complexity, range, or importance of our enforcement accomplishments. During the past year, the Commission:

- brought significant actions involving issues arising from the financial crisis, including actions against the former Chief Executive Officer (CEO) and other executives of Countrywide Financial, Citigroup and its former Chief Financial Officer (CFO) and Head of Investor Relations, Morgan Keegan, Goldman Sachs, State Street Bank, former executives of New Century Financial and IndyMac Bancorp, Brookstreet Securities, and ICP Asset Management and its President;
- obtained multi-million dollar settlements with Tyson Foods, Alcatel-Lucent, Technip, and General Electric for violations of the Foreign Corrupt Practices Act (FCPA).
- filed our first case against a state involving municipal securities;
- brought accounting fraud cases against Dell, Diebold, and DHB Industries;
- brought a significant case alleging 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;
- filed a variety of cases to halt Ponzi scheme operators and perpetrators of offering frauds, including those brought in conjunction with the Financial Fraud Enforcement Task

Force's Operation Broken Trust sweep – indeed, in each of the past two fiscal years we've filed more than twice as many Ponzi cases as we filed in fiscal 2008;

- brought actions alleging illegal trading on confidential information obtained from technology company employees moonlighting as expert network consultants and illegal trading by major hedge funds based on illegal tips; and
- brought an action alleging a \$1.5 billion mortgage securities fraud scheme to defraud the U.S. Treasury's Troubled Asset Relief Program (TARP).

Strengthening Oversight

Strong regulation is essential to the fair, orderly, and efficient operation of markets. A vigorous examination program not only reduces the opportunities for wrongdoing and fraud, but also provides early warning about emerging trends and potential weaknesses in compliance programs.

This past year, the SEC reorganized the agency's national examination program in response to rapidly-changing Wall Street practices and lessons learned from the Madoff and Stanford frauds. The agency strengthened the national exam program to provide greater consistency and efficiencies across our eleven regions and to focus more sharply on identifying the higher risk firms that it targets for examination. We also implemented new policies requiring examiners to routinely verify the existence of client assets with third party custodians, counterparties, and customers. Additionally, the exam unit now assembles individual specialists with the appropriate skill-sets for the firm they are examining or the issues on which they are focusing. Finally, the SEC has also worked to enhance the training of examiners and bring on board specialists in risk management, trading, and complex structured products.

These reforms are helping to deliver results in the exam program's work to evaluate risks, inform policy, and identify potential wrongdoing. In fact, in January 2011 alone, the Enforcement Division brought three significant cases stemming directly from exams. And going forward, the national exam program will continue to conduct sweeps in critical areas from trading practices to market manipulation to structured products.

Improving Market Structure

No discussion of the SEC's actions over the past year would be complete without a discussion of May 6, 2010—the day our markets dropped more than 500 points in a matter of minutes, only to bounce back minutes later. That event reinforced the importance of our ongoing review of market structure, which we had launched months earlier with a concept release inviting comment on regulation of the changing financial markets.

The U.S. equity market structure has changed dramatically in recent years. A decade ago, most of the volume in stocks was executed manually, whether on the floor of an exchange or over the telephone between traders. Now nearly all orders are executed by fully automated systems at great speed. The fastest exchanges and trading venues are now able to accept, execute, and send a response to orders in less than one thousandth of a second.

Speed is not the only thing that has changed. As little as five years ago, the great majority of U.S. equities capitalization was traded on a listing market – the New York Stock Exchange (NYSE) – that executed nearly 80 percent or more of volume in those stocks. Today, the NYSE executes approximately 22 percent of the volume in its listed stocks. The remaining volume is split among 15 public exchanges, more than 30 dark pools, 3 electronic communication networks (ECNs), and more than 200 internalizing broker-dealers. Currently, more than 30 percent of the volume in U.S.-listed equities is executed in venues that do not display their liquidity or make it generally available to the public, reflecting an increase over the last year.

The evolution of trading technologies has dramatically increased the speed, capacity, and sophistication of the trading functions that are available to market participants. The new electronic market structure has opened the door for entirely new types of professional market participants. Today, proprietary trading firms play a dominant role by providing liquidity through the use of highly sophisticated trading systems capable of submitting many thousands of orders in a single second. These high-frequency trading firms can generate more than a million trades in a single day and now account for more than 50 percent of equity market volume.

Public feedback from a wide variety of market participants has been that today's market structure clearly offers many advantages, including reduced trading costs, when compared to the markets of ten, and even just five years ago. Nevertheless, as highlighted by the events of May 6, the current structure has many potential issues that should be studied and addressed where appropriate. High-speed, algorithm-driven electronic trading has increased the risk of sudden liquidity imbalances that can lead to disorderly market conditions and unexpected volatility. The continuing growth of trading in dark pools and other types of dark venues can challenge the quality of the market's price-discovery function. And the complexity of the market structure sometimes makes it difficult for even sophisticated investors to pursue their own best interests.

Over the past year, the SEC has engaged in a dedicated effort to study and learn from the experiences of May 6, with the aim of taking action to preserve the benefits of the current structure while minimizing its downsides. The agency worked with FINRA and the exchanges to develop rules that trigger circuit breakers for certain individual stocks, clarify up front how and when erroneous trades would be broken, and effectively prohibit "stub quotes" in the U.S. equity markets. We adopted a rule that prohibits broker-dealers from providing their clients with unfiltered access to exchanges, and proposed the creation of a large trader reporting system that would enhance our ability to identify large market participants, collect information on their trades, and analyze their trading activity.

We also proposed a new rule that would require the creation of a consolidated audit trail that would enable regulators to track information about trading orders received and executed across the securities markets. Today, there is no standardized, automated system to collect data across the various trading venues, products, and market participants. Each market has its own individual and often incomplete data collection system, and as a result, regulators tracking suspicious activity or reconstructing an unusual event must obtain and merge an immense volume of disparate data from a number of different markets. And even then, the data does not always reveal who traded which security, and when. To obtain individual trader information, the SEC must make a series of manual requests that can take days or even weeks to fulfill. In brief,

the Commission's tools for collecting data and surveilling our markets are wholly inadequate to the task of overseeing the largest equity markets in the world.

The proposed consolidated audit trail rule would require the exchanges and FINRA to jointly develop a national market system (NMS) plan to create, implement, and maintain a consolidated audit trail in the form of a newly-created central repository. The information would capture each step in the life of the order, from receipt or origination of an order, through the modification, cancellation, routing and execution of an order. Notably, this would include information identifying the "ultimate customer" who generated the order. And, it would require members to "tag" each order with a unique order identifier that would stay with that order throughout its life.

If implemented effectively, the consolidated audit trail would, for the first time, allow self-regulatory organizations (SROs) and the Commission to track trade data across multiple markets, products and participants simultaneously. It would allow us to rapidly reconstruct trading activity and to more quickly analyze both suspicious trading behavior and unusual market events. It is important to recognize, however, that the consolidated audit trail is a major change in the technology infrastructure for our equity markets, and thus will require some time to fully implement. In addition, in order to fully use this new infrastructure, the Commission's own technology and human resources will need to be expanded well beyond their current levels.

Key Rulemaking

Over the past year, the Commission has pursued an active rulemaking agenda aimed at making our financial markets more secure, providing investors with more and better information, finding ways to make securities markets less volatile and more transparent, and promoting effective corporate governance. Even before passage of the Dodd-Frank Act, the SEC was in the midst of a productive period of rulemaking on diverse topics. Among the key ongoing and recently completed rulemakings are the following:

- ***Municipal securities:*** The Commission adopted rules that provide market participants with more meaningful and timely information regarding the health of municipal securities. In addition, as discussed below, we adopted rules to curtail pay to play practices by investment advisers seeking to manage public pensions.
- ***Proxy enhancements:*** The Commission adopted rules to facilitate exercise of shareholders' traditional state law right to nominate directors to corporate boards. We also improved disclosure relating to risk and compensation and revised the e-proxy rules so that additional materials could be provided to shareholders with the company's notice. And, we issued a concept release requesting public input on the mechanics of proxy voting and shareholder communications.
- ***Investment adviser disclosure:*** In order to ensure that investors receive clear and accurate information from their advisers, the Commission adopted rules requiring advisers to provide clients with brochures that plainly disclose their business practices, fees, conflicts of interests, and disciplinary information.

- **Mutual funds fees and marketing:** The Commission proposed rules to create a more equitable framework for mutual fund marketing fees, known as 12b-1 fees. We proposed rules to help clarify the meaning of a date in a target date fund's name, as well as enhance information in fund advertising and marketing materials.
- **Target date funds:** The Commission proposed rules that are intended to provide enhanced information to investors concerning target date retirement funds and reduce the potential for investors to be confused or misled regarding these funds.
- **Money market funds:** The Commission took action to permit investors, for the first time, to access detailed information that money market funds now file with the agency, including their "shadow NAV" (net asset value). While the SEC uses this information in its real-time oversight of money market funds, public disclosure can provide investors and market analysts with useful insight for their evaluation of funds. We also tightened the quality standards that apply to the funds' investments and are working with our regulatory colleagues to assess the various options for making sure these funds are as safe and resilient in the face of market stresses as investors are led to believe.
- **Asset-backed securities:** The Commission proposed rules that would revise the disclosure, reporting and offering process for ABS to better protect investors in the securitization market.
- **Market access:** The Commission took an important step to promote market stability by adopting a new market access rule. Broker-dealers that access the markets themselves or offer market access to customers will be required to put in place appropriate pre-trade risk management controls and supervisory procedures. The rule effectively prohibits broker-dealers from providing customers with "unfiltered" access to an exchange or alternative trading system. By helping ensure that broker-dealers appropriately control the risks of market access, the rule should prevent broker-dealers from engaging in practices that threaten the financial condition of other market participants and clearing organizations, as well as the integrity of trading on the securities markets.
- **Pay to Play:** The Commission adopted in June of last year a new rule to address so-called "pay to play" practices in which investment advisers make campaign contributions to elected officials in order to influence the award of contracts to manage public pension plan assets and other government investment accounts. The rule, adopted in response to a growing number of reports of such activities across the country, is intended to combat pay to play arrangements at the state and local government level in which advisers are chosen based on their campaign contributions to political officials rather than on merit.

In addition to these items, enactment of the Dodd-Frank Act added significant new work to the Commission's agenda, including more than 100 rulemaking provisions applicable to the SEC. To date, the Commission has issued twenty-eight proposed rule releases, seven final rule releases, and two interim final rule releases in connection with the Dodd-Frank Act. We have

received thousands of public comments, held hundreds of meetings with market participants, completed five studies, and hosted five roundtables. Among the areas of current focus:

- **OTC derivatives:** We are working with the Commodity Futures Trading Commission (CFTC) to implement the new regulatory regime for OTC derivatives—defining terms, developing requirements for new trading and clearing platforms, crafting registration and reporting regulations, carving out end-user exemptions, and undertaking dozens of other tasks.
- **Private fund advisers:** We are working to finalize rules to implement the requirement that advisers to large hedge funds and private equity funds register with the Commission. Additionally, we’re working with members of the Financial Stability Oversight Council and the CFTC to implement the Act’s mandate that advisers to hedge funds and other private funds report information for use in monitoring for systemic risk to the U.S. financial system.
- **Asset-backed securities:** Along with the banking regulators, we are working to propose risk-retention (or “skin in the game”) requirements for asset-backed securities transactions. And under recently adopted rules, ABS issuers, for the first time, will be performing reviews of the bundled assets and disclosing the nature, findings, and conclusions of these reviews. The Commission also adopted rules regarding representations and warranties in ABS. In addition, we are working to sync up our earlier ABS proposed rules with those adopted under the Dodd-Frank Act.
- **Credit rating agencies:** The Commission is working on about a dozen rulemakings related to NRSROs, including with respect to internal controls, conflicts of interest, credit rating methodologies, transparency, ratings performance, analyst training, credit rating symbology, and disclosures accompanying the publication of credit ratings.
- **Corporate governance:** The Commission is working on rules to implement the Act’s various provisions relating to public company governance, including recently-adopted rules on shareholder advisory votes on executive compensation, as well as rules with respect to the independence of compensation committees, retention of compensation consultants, incentive-based compensation regulations or guidelines for certain large financial institutions, clawbacks of executive compensation, pay for performance, pay ratios, and broker voting of uninstructed shares.
- **Studies related to investment advisers and broker-dealers:** To date, the Commission has published three staff studies on enhancing investment adviser examinations, the obligations of investment advisers and broker-dealers, and investor access to information about investment professionals. We will begin to consider rules stemming from these recent studies, including consideration of the recommendation that financial professionals who provide personalized investment advice to retail customers about securities adhere to a fiduciary standard of conduct “no less stringent” than that currently imposed on investment advisers.

- **Rewards for whistleblowers:** The Commission will be finalizing rules that will allow us to benefit more effectively from input by whistleblowers, the individuals who are often closest to fraud and can be an invaluable source of information for our enforcement and inspection efforts.
- **Specialized Disclosures.** Title XV of the Dodd-Frank 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 Commission published the rule proposals relating to these three provisions in December 2010. The comment periods were scheduled to close on January 31, 2011, but the Commission extended the comment periods for all three rule proposals for 30 days, to March 2, 2011 after receiving several requests for an extension of the time for public comment.

SEC Resources

This year finds the SEC at an especially critical juncture in its history. Not only does the Dodd-Frank Act create significant additional work for the SEC, both in the short and long term, but the agency must also continue to carry out its longstanding core responsibilities. These 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—remain essential to investor confidence and trust in financial institutions and markets.

Over the past decade, 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 information technology (IT) systems declined about 50 percent from FY 2005 to 2009.

As a result of increased funding levels in FY 2009 and FY 2010, current SEC staffing levels are just now returning to the level of FY 2005, despite the enormous growth in the size and complexity of the securities markets since then. During the past decade, for example, trading volume has more than doubled, the number of investment advisers has grown by 50 percent, and the assets they manage have increased to \$38 trillion. Six years ago, the SEC's funding was sufficient to provide nineteen examiners for each trillion dollars in investment adviser assets under management. Today, that figure stands at twelve examiners per trillion dollars. 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.

Today, the SEC has responsibility for approximately 35,000 entities, including direct oversight of 11,800 investment advisers, 7,500 mutual funds, and more than 5,000 broker-dealers with more than 160,000 branch offices. We also review the disclosures and financial statements of approximately 10,000 reporting companies. The SEC also oversees approximately 500 transfer agents, 15 national securities exchanges, 9 clearing agencies, 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 the Securities Investor Protection Corporation (SIPC).

In addition to our traditional market oversight and investor protection responsibilities, the enactment of the Dodd-Frank Act has added significant new responsibilities to the SEC's workload. These new responsibilities 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, under the Dodd-Frank Act the SEC has been given responsibilities for hedge fund advisers that are similar to those that the agency has long overseen with respect to traditional asset managers. These hedge fund advisers include 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 the creation of a new whistleblower program.

FY 2011 Continuing Resolution

The SEC has not yet received any additional funds in FY 2011 for its new responsibilities under the Dodd-Frank Act. For FY 2011, the President's budget request for the SEC was \$1.258 billion, which would have constituted an increase over the SEC's FY 2010 appropriation of \$1.111 billion. However, the SEC did not receive this request, and since the start of FY 2011 has been operating under continuing resolutions that provide funding at last year's levels, despite the fact that the agency must sustain a larger workforce than it did last year. This restricted funding has required the SEC to severely restrain any new hiring this year, even to replace staff who leave the agency; to postpone most technology initiatives; and to limit its base mission operations until the final funding level for FY2011 is resolved.

As discussed above, the enactment of the Dodd-Frank Act has added significantly to the SEC's workload. So far, the SEC has proceeded with the first stages of implementation of the Dodd-Frank Act without additional funding. This has largely involved performing studies, conducting analyses, and writing rules. These tasks have taken staff time from other responsibilities, and have been done almost entirely with existing staff. Over the long-term, fulfilling the Act's new oversight responsibilities—for instance, with respect to the OTC derivatives market, hedge fund advisers, municipal advisers, security-based swap participants, NRSROs, clearinghouses, asset-backed securities, and whistleblowers—will require significant additional resources or a substantial reduction in the performance of our core duties. In acknowledgement of this new workload, the Act authorized an increase in the agency's budget to \$1.5 billion in FY 2012, and \$2.25 billion by FY 2015.

FY 2012 Request

The SEC is requesting \$1.407 billion for FY 2012, an increase of \$264 million over the continuing resolution level under which we are currently operating. If enacted, this request would permit us to hire an additional 780 positions (612 FTE) over projected FY 2011 levels.

It is important to note that the SEC's FY 2012 funding request would 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 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.

The FY 2012 request is designed to provide the SEC with the resources required to achieve several high-priority goals: to adequately staff the agency to fulfill its core mission; to continue to implement the requirements of the Dodd-Frank Act; and to expand the agency's IT systems and management infrastructure to serve the needs of a more modern and complex organization. For purposes of my testimony today, I would like to summarize the request in each of these priority areas:

- ***Reinvigorating Core SEC Programs:*** 40 percent (312) of the new positions requested for FY 2012 would be used to strengthen and support core SEC operations, including protecting investors, maintaining orderly and efficient markets, and facilitating capital formation. As mentioned before, SEC staffing levels are just now returning to FY 2005 levels, even as the agency's responsibilities have grown along with the size and complexity of the securities markets. To help restore core capabilities, this budget request would permit us to add forty-nine positions to the enforcement program that would grow the five new specialized investigative units, bolster the agency's litigation program, and expand the new Office of Market Intelligence which conducts risk assessment and handles thousands of tips, complaints, and referrals. In our examination program, this request would allow us to add fifty-five personnel to augment risk assessment, monitoring, and surveillance functions and to conduct additional adviser and fund inspections. The request would also permit thirty-seven staff to be added to the Division of Corporation Finance primarily to conduct more frequent disclosure reviews of the largest companies, fifteen additional staff to the Division of Investment Management primarily to enhance oversight of money market funds and specialized products, and eleven new positions to be added to the Division of Risk, Strategy, and Financial Innovation to better equip the agency to identify and address emerging risks and long-term issues of critical importance.
- ***Implementing the Dodd-Frank Act:*** 60 percent (468 positions) of the new positions requested for FY 2012 would be used to implement the Dodd-Frank Act. Many of these new positions would be used to hire experts in derivatives, hedge funds, data analytics, credit ratings, and other new or expanded responsibility areas, so that the agency may acquire the deeper expertise and knowledge needed to perform effective oversight. These new positions would support 157 new positions focused on the derivatives markets; 102 focused on hedge fund advisers; 43 to expand investigations of tips received from whistleblowers; 35 focused on municipal securities and examinations of newly registered municipal advisers; 33 focused on clearing agencies, including annual reviews of those determined to be systemically important; and 26 focused on NSRSOs principally to perform the annual examinations required by the Act. The agency also would invest in

technology to facilitate the registration of additional entities and capture and analyze data on the new markets.

The total FY 2012 costs to implement the Dodd-Frank Act through these new positions and technology investments will be approximately \$123 million. In addition to the new positions requested in FY 2012, we also anticipate that an additional 296 positions and additional technology investments will be required in FY 2013 for full implementation of the Dodd-Frank Act.

- ***Investing in Information Technology:*** 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 level of funding would support vital 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 will permit the agency to develop risk analysis tools to assist with triage and analysis of tips, complaints, and referrals and to complete a digital forensics lab that enforcement staff can use to recreate data from computer hard drives and cell phones to capture evidence of sophisticated frauds. The budget request would also permit the hiring of additional staff in the Office of Information Technology, including experienced business analysts and certified project managers to oversee IT projects and staff to address financial statement and information technology deficiencies identified by the Government Accountability Office (GAO).
- ***Improving the Agency's Management Infrastructure:*** The SEC's FY 2012 request would permit the SEC to make further improvements to the agency's basic internal operations and to bring administrative and support services capabilities into alignment with the requirements of today's SEC, and ensure that the agency manages its resources wisely and efficiently. The budget request would permit the strengthening of the newly-established Office of the Chief Operating Officer, including the development of a more robust operational risk management program and the build-out of a data management program. The budget request also contemplates an appropriate expansion of the agency's administrative support functions, including the Offices of Financial Management, Human Resources, Administrative Services, and FOIA and Records Management. The request also includes the necessary space rent and other non-compensation expenses necessary to support the level of staffing requested for FY 2012. Additionally, the SEC is devoting significant management attention to improving program and management controls, including in response to audits and assessments by the Office of the Inspector General (OIG), GAO, and management's own internal assessments.
- ***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. Generally Accepted Accounting Principles (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 unacceptable. The root causes of these weaknesses are gaps in the security and functionality of the agency's financial system, resulting from years of underinvestment in financial systems technology. 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 (FMLoB) 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 the planning phase, and on February 25 signed an interagency agreement to commence the implementation phase. We will work together over the next thirteen months to migrate the SEC's financial system and data, with a planned cutover in April 2012.

Conclusion

Thank you, again, for your support for the agency's mission, and for allowing me to be here today to present the President's budget request. I am happy to answer any questions that you might have.