Testimony on
"Enhanced Oversight After the Financial Crisis: The Wall Street Reform Act at One Year"
by
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Chairman Johnson, Ranking Member Shelby, and members of the Committee:

Thank you for inviting me to testify on the occasion of the one-year anniversary of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act").[1]

This landmark legislation set out to reshape the U.S. regulatory landscape, reduce systemic risk and help restore confidence in the financial system. Among other things, the Act brings hedge fund and other private fund advisers under the regulatory umbrella of the Investment Advisers Act, creates a new whistleblower program, establishes an entirely new regime for the over-the-counter ("OTC") derivatives market, enhances the SEC's authority over nationally recognized statistical rating organizations ("NRSROs") and clearing agencies, and heightens regulation of asset-backed securities ("ABS").

To help fulfill its objective, the Act directs the SEC to write a large number of rules necessary to implement the Act and, over the past year, the SEC has accomplished much. Of the more than 90 mandatory rulemaking provisions, the SEC already has proposed or adopted rules for more than two-thirds of them -- not including rules stemming from the dozens of other provisions that give the SEC discretionary rulemaking authority. Additionally, the SEC has finalized ten of the more than twenty studies and reports that it is required to complete under the Act. While the Commission has voted unanimously on the vast majority of these rules and studies, specific rules, proposals and studies have generated robust debate among Commissioners. Even in the instances where the votes were not unanimous, the diverse views and input from Commissioners has benefited and strengthened the work product as we try to develop the best possible rules.

While we have had much success, we are continuing to work diligently to implement all provisions of the Act for which we have responsibility – even as we continue to perform our longstanding core responsibilities. Indeed, we are well on our way to completing the rulemakings and studies assigned to us under the Act.

In my prior testimony before this Committee on Dodd-Frank Act implementation, I outlined our efforts to modernize our internal processes to enable us to better accomplish both our preexisting responsibilities and those added by the Act. Among others, these efforts include the creation of new cross-disciplinary working groups; our focus on increasing transparency, consultation and

[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 full Commission.

public input; and the forging and strengthening of collaborative relationships with other federal regulators and our international counterparts. To date, we have participated in scores of interagency and working group meetings, conducted five public roundtables, met with hundreds of interested groups and individuals including investors, academics and industry participants, and received, reviewed and considered thousands of public comments.

While some feel we are moving too quickly and others feel we are not moving rapidly enough, I believe we are proceeding at a pace that ensures we get the rules right. And, provided the SEC receives the appropriate funding and uses its resources effectively and efficiently, we will be able to successfully implement those rules and help further protect investors, as the law intended.

The progress we have made so far is the result of the exceptional work of my fellow Commissioners and our staff, whose extraordinary efforts have enabled us to accomplish so much in a relatively short time. While the Dodd-Frank Act added significantly to their workload, they have been implementing the Act in a thoughtful, thorough, and professional manner.

My testimony today will provide an overview of these activities, emphasizing the Commission's efforts since the Committee's Dodd-Frank Act implementation hearing in February.

Hedge Fund and Other Private Fund Adviser Registration and Reporting

The Commission already has completed a suite of rulemaking under the many Dodd-Frank Act amendments to the Investment Advisers Act of 1940 ("Advisers Act"). Those rules require registration and reporting by investment advisers to hedge funds and other private funds.

Several of those rules, adopted by the Commission on June 22, 2011, become effective today, including rules that:

- require the registration of, and reporting by, advisers to hedge funds and other private funds and other advisers previously exempt from SEC registration;
- require reporting by investment advisers relying on certain new exemptions from SEC registration; and
- reallocate regulatory responsibility to the state securities authorities for advisers that have between $25M and $100M in assets under management.[2]

The three new Advisers Act exemptions from registration include: (i) advisers solely to venture capital funds; (ii) advisers solely to private funds with less than $150 million in assets under management in the U.S.; and (iii) certain foreign advisers without a place of business in the U.S. and with only a de minimis amount of U.S. business.[3] The Commission also approved a rule

[2] *See* Release No. IA-3221, *Rules Implementing Amendments to the Investment Advisers Act* (June 22, 2011), http://www.sec.gov/rules/final/2011/IA-3221.pdf.

[3] *See* Release No. IA-3222 *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers* (June 22, 2011), http://www.sec.gov/rules/final/2011/IA-3222.pdf.

defining "family offices" – a group that historically has not been required to register as advisers – that excludes private advisers to a single family from the definition of investment adviser.[4] The Commission also defined "venture capital fund" as required by the Act.

As a result of these rules, both regulators and the public will have access to identifying data and an operational overview of private fund advisers and the hedge funds and other funds they manage.

In addition, on January 26, 2011, in a joint release with the CFTC, the Commission proposed a new rule that would require hedge fund advisers and other private fund advisers to report systemic risk information on a new form – Form PF.[5] This new form requires the non-public reporting of information about private funds managed by advisers for the purpose of the assessment of systemic risk by the Financial Stability Oversight Council ("FSOC"), as provided in Title IV of the Dodd-Frank Act.

Also, this month, the Commission issued an order that raises, to adjust for inflation, the dollar amount thresholds in Rule 205-3 under the Advisers Act, that determine whether an investment adviser can charge its clients performance-based compensation.[6] The Commission also has proposed related amendments to the rule that would specify the method for calculating future inflation adjustments of these dollar amount thresholds, and exclude the value of a client's primary residence from the calculation of net worth.[7]

Staff Studies Regarding Investment Advisers and Broker-Dealers

In January, the Commission submitted to Congress two staff studies in the investment management area as required under the Dodd-Frank Act.

The first study, mandated by Section 914, analyzed the need for enhanced examination and enforcement resources for investment advisers that are registered with the Commission.[8] It found that the Commission likely will not have sufficient capacity in the near or long term to

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[4] *See* Release No. IA-3220, *Family Offices* (June 22, 2011), http://www.sec.gov/rules/final/ia-3220.pdf.

[5] *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.

[6] *See* Release No. IA-3236 (July 12, 2011).

[7] *See* Release. No. IA-3198, *Investment Adviser Performance Compensation*, (May 10, 2011), http://www.sec.gov/rules/proposed/2011/ia-3198.pdf.

[8] *See Study on Enhancing Investor Adviser Examinations* (January 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.

conduct effective examinations of registered investment advisers with adequate frequency. Therefore, the study stated that the Commission's examination program requires a source of funding that is adequate to permit the Commission to meet new examination challenges and sufficiently stable to prevent adviser examination resources from continuously being outstripped by growth in the number of registered investment advisers.

The study highlighted the following three options to strengthen the Commission's investment adviser examination program: (1) imposing user fees on Commission-registered investment advisers to fund their examinations; (2) authorizing one or more self-regulatory organizations that assess fees on their members to examine, subject to Commission oversight, all Commission-registered investment advisers; or (3) authorizing FINRA to examine a subset of advisers – i.e., dually registered investment advisers and broker-dealers – for compliance with the Advisers Act.

The second staff study, as required by Section 913 of the Dodd-Frank Act, addressed the obligations of investment advisers and broker-dealers.[9] This study reviewed the broker-dealer and investment adviser industries, the regulatory landscape surrounding each, issues raised by stakeholders who commented during the preparation of the report, and other considerations.

The study made two primary recommendations: that the Commission (1) exercise its discretionary rulemaking authority 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 broker-dealers and investment advisers provide the same or substantially similar services to retail investors and when such harmonization adds meaningfully to investor protection.

Under Section 913, the uniform fiduciary standard to which broker-dealers and investment advisers would be subject would be "no less stringent" than the standard that applies to investment advisers today.

As the study notes, the distinction between an investment adviser and a broker-dealer is often lost on investors and it remains difficult to justify why there should be different rules and standards of conduct for the two roles – especially when the same or substantially similar services are being provided. Investment professionals' first duty must be to their clients, and we look forward to implementing the study's recommendations.

Whistleblower Program

Section 922 of the Dodd-Frank Act established a whistleblower program that requires the SEC to pay an award to eligible whistleblowers who voluntarily provide the agency with original

[9] *See Study on Investment Advisers and Broker-Dealers* (January 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.

information about a violation of the federal securities laws that leads to the successful enforcement of an SEC action.

In May, the Commission adopted final rules to implement the new program.[10] The rules outline the process by which individuals can apply for awards, describe the Commission's procedures for making decisions on claims, generally explain the scope of the whistleblower program to the public and define certain critical terms.

There were many complex policy considerations associated with the promulgation of these rules. These included, for example, whether the program should reward culpable whistleblowers who participated in the alleged misconduct, and whether the rules should require employees to first report possible violations through their employer's internal compliance procedures before coming to the SEC. The Commission's proposed rules provoked strongly held and diverse views on these and a number of other significant topics. The proposal underwent a robust comment process, which included hundreds of comment letters from various interested constituencies including whistleblower advocacy groups, public companies, corporate compliance personnel, professional associations, and individual investors.

Perhaps the most vigorously-debated issue was the effect of the whistleblower program on internal corporate compliance processes. Many advocated that the Commission require whistleblowers to report violations through their employers' internal compliance systems before or at the same time they report to the SEC in order to qualify for an award. After careful consideration, the Commission concluded that an absolute requirement that whistleblowers report internally to qualify for an award would be detrimental to the SEC's enforcement program.

Requiring whistleblowers to first reveal incriminating information to the very persons they may be suggesting acted unlawfully would significantly decrease the likelihood of whistleblowers coming forward. That is why the rules leave the decision as to whether or not to report internally in the hands of the person best equipped to make that decision – the whistleblower, considering the circumstances of his or her individual situation. But, recognizing the significant value that effective corporate compliance programs deliver in identifying, remediating, and deterring wrongdoers, the rules include a number of provisions designed to incentivize whistleblowers to utilize their companies' internal compliance and reporting systems, when appropriate, by increasing the likelihood and potential recovery for an award in instances where a whistleblower chooses to report internally first.

The whistleblower rules reflect a thoughtful and thorough weighing of the comments that were received and a careful balancing of these and many other important policy considerations. Although it is too early to assess the impact of our new whistleblower program, the agency is already seeing the effects of the whistleblower provisions in the quality of tips we are getting. While the SEC has a history of receiving high volumes of tips and complaints, the quality of the tips has improved since the enactment of Section 922, and this trend is expected to continue.

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[10] *See* Release No. 34-64545, *Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934* (May 25, 2011), http://www.sec.gov/rules/final/2011/34-64545.pdf.

Section 924 of the Dodd-Frank Act also required the SEC to establish an office to administer the whistleblower program. The new Office of the Whistleblower is now staffed and busy reviewing whistleblower complaints. Due to budgetary constraints, the office has been staffed by detailing current Commission staff from their normal responsibilities until we can hire permanent staff.

Additional Investor Protection Provisions

Nationwide Service of Process: The SEC is seeing the benefits of the many other enforcement-related investor protection provisions contained in the Dodd-Frank Act. For example, Section 929E allowed for nationwide service of process so that the SEC can compel a witness to appear at trial anywhere in the United States. Already, this authority has enabled our trial team to subpoena and present witnesses' live testimony, and ultimately prevail, in the recent *SEC v. Delphi* trial.

Live testimony can be invaluable in litigating securities law violations, which often turn on the credibility of those testifying. Our trial teams have also used the new provision to subpoena documents, which enables them to more efficiently present documentary evidence.

Collateral Bars: With respect to new sanctions available to the Commission, the Dodd-Frank Act provides the SEC with the authority to bar or suspend persons -- who have engaged in misconduct in one industry that the Commission regulates -- from other industries that the Commission regulates. Since the enactment of Section 925, the Commission has used this "collateral bar" authority to impose broad prophylactic relief to provide more effective protection to investors.

In one example, the Commission last month imposed cross-industry sanctions against a Swiss trader employed by a registered broker-dealer and investment adviser for engaging in insider trading that netted him illegal profits of almost $1.2 million.[11] Prior to the enactment of Dodd-Frank, the Commission would have been able to bar the respondent from the broker-dealer industry, but it would not have been able to similarly protect investors in any of the other industries we regulate. Using the new authority, the Commission was able to extend the protection to other vulnerable investors by barring the respondent from associating with any broker, dealer, investment adviser, municipal securities dealer, transfer agent, municipal advisor, or nationally recognized statistical ratings organization.

In another example, just last week, the Commission sanctioned an unregistered broker for his role in an offering fraud and Ponzi scheme that raised at least $2.5 million from approximately 75 investors.[12] Under Section 925, the Commission was able to bar this person from associating with any transfer agent, broker, dealer, investment adviser, municipal securities dealer, municipal advisor, or nationally recognized statistical rating organization.

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[11] *See In the Matter of Giuseppe Tullio Abatemarco, Release No. 34-64600 (June 3, 2011)* (*http://www.sec.gov/litigation/admin/2011/34-64600.pdf*).

[12] *See In the Matter of Gregory D. Wood, Release No. 34-64873 (July 13, 2011)* (*http://www.sec.gov/litigation/admin/2011/34-64873.pdf*).

Penalties in Cease and Desist Proceedings: The Commission also has used the authority granted in Dodd-Frank Section 929P(a) to impose penalties in administrative cease and desist actions against non-regulated individuals and entities. Although the Commission could impose penalties against regulated persons administratively prior to Dodd-Frank, it could obtain penalties against non-regulated persons only in enforcement actions filed in district court. The Act now permits the Commission to obtain penalties against non-regulated violators of the federal securities laws in either forum.

In one recent example of our exercise of this authority, the Commission imposed a $200,000 administrative penalty against Hudson Highland Group, Inc. for its failures to maintain appropriate internal controls and books and records relating to its sales tax liabilities that resulted in a $3.9 million tax liability for the corporation.[13] Prior to the Dodd-Frank Act, the Commission would not have been able to impose a penalty against Hudson in a cease-and-desist proceeding; that sanction would only have been available in a district court action. Accordingly, to obtain full relief, the Commission would have had to either file the entire action in district court or, alternatively, file two separate actions – one administrative and one civil. With the new authority granted in Section 929P(a), the Commission no longer has to file multiple actions or abandon what may be the more appropriate forum in order to obtain an appropriate penalty.

Greater Access to Foreign Papers: The Dodd-Frank Act's amendments to Sarbanes-Oxley Section 106 require foreign accounting firms that perform work for a domestic registered public accounting firm to designate an agent for service of process to allow both the SEC and the PCAOB to serve requests for documents and enforcement pleadings that may arise out of a violation of Section 106. This provision, which has aided our enforcement efforts, resolves a significant impediment to ensuring that the SEC will have the ability to serve requests for documents expeditiously.

OTC Derivatives

Among the key provisions of the Dodd-Frank Act are those that will establish a new oversight regime for the 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, mandatory clearing, the operation of trade execution facilities and data repositories, business conduct standards for certain market intermediaries, capital and margin requirements, and public transparency for transactional information;
- Improve transparency and facilitate the centralized clearing of swaps, helping, among other things, to reduce counterparty risk and systemic risk that results from exposures by market participants to uncleared swaps;
- Enhance investor protection by increasing security-based swap transaction disclosure and helping to mitigate security-based swap conflicts of interest; and

[13] *See In the Matter of Hudson Highland Group, Inc., Release No. 34-63688 (Jan. 10, 2011) (http://www.sec.gov/litigation/admin/2011/34-63688.pdf).*

- Allow the OTC derivatives market to continue to develop in a more transparent, efficient, and competitive manner.

Title VII Implementation to Date

To date, the SEC has proposed rules in twelve areas required by Title VII:

- Rules prohibiting fraud and manipulation in connection with security-based swaps;[14]
- 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;[15]
- Rules regarding the obligations of security-based swap data repositories that would require them to register with the SEC and specify the extensive confidentiality and other requirements with which they must comply;[16]
- Rules relating to mandatory clearing of security-based swaps that would establish a process for clearing agencies to provide information to the SEC about security-based swaps that the clearing agencies plan to accept for clearing;[17]
- 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;[18]
- Rules defining and regulating security-based swap execution facilities, which specify their registration requirements, and establish the duties and implement the core principles for security-based swap execution facilities specified in the Act;[19]
- Joint rules with the CFTC regarding the definitions of swap and security-based swap dealers, and major swap and security-based swap participants;[20]

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[14] *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.

[15] *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.

[16] *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.

[17] *See* Release No. 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.

[18] *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.

[19] *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.

- 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;[21]
- Rules regarding certain standards that clearing agencies would be required to maintain with respect to, among other things, their risk management and operations;[22]
- Joint rules with the CFTC regarding further definitions of the terms "swap", "security-based swap," and "security-based swap agreement"; the regulation of mixed swaps; and security-based swap agreement recordkeeping;[23]
- Rules regarding business conduct that would establish certain minimum standards of conduct for security-based swap dealers and major security-based swap participants, including in connection with their dealings with "special entities", which include municipalities, pension plans, endowments and similar entities;[24] 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.[25]

The Commission also adopted an interim final rule regarding the reporting of outstanding security-based swaps entered into prior to the date of enactment of the Dodd-Frank Act.[26] This interim final rule notifies certain security-based swap dealers and other parties of the need 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.

In addition, in order to facilitate clearing of security-based swaps, the Commission proposed rules providing exemptions under the Securities Act, the Exchange Act, and the Trust Indenture

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[20] *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.

[21] *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.

[22] *See* Release No. 34-64017, *Clearing Agency Standards for Operation and Governance* (March 2, 2011), http://www.sec.gov/rules/proposed/2011/34-64017.pdf.

[23] *See* Release No. 33-9204, *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping* (April 27, 2011), http://www.sec.gov/rules/proposed/2011/33-9204.pdf.

[24] *See* Release No. 34-64766, *Business Conduct Standards for Security-Based Swaps Dealer and Major Security-Based Swap Participants* (June 29, 2011), http://www.sec.gov/rules/proposed/2011/34-64766.pdf.

[25] *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.

[26] *See* Release No. 34-63094, *Reporting of Security-Based Swap Transaction Data* (October 13, 2010), http://www.sec.gov/rules/interim/2011/34-63094.pdf.

Act of 1939 for security-based swaps transactions involving certain clearing agencies satisfying certain conditions.[27] We also readopted certain of our beneficial ownership rules to preserve their application to persons who purchase or sell security-based swaps.[28]

Next Steps for Implementation of Title VII

While the Commission has made significant progress to date, much remains to be done to fully implement Title VII. First, there is a need to complete the core elements of our proposal phase, focusing in particular on rules related to the registration and financial responsibility of security-based swap dealers and major security-based swap participants.

In addition, because the OTC derivatives market has grown to become a truly global market in the last three decades, we must continue to evaluate carefully the international implications of Title VII. Rather than deal with these implications piecemeal, we intend to address the relevant international issues holistically in a single proposal. The publication of such a proposal would give investors, market participants, foreign regulators, and other interested parties an opportunity to consider as an integrated whole our proposed approach to the registration and regulation of foreign entities engaged in cross-border transactions involving U.S. parties.

More broadly, the SEC has been working with our fellow regulators and with market participants to consider implementation timeframes that are reasonable for the various rulemakings, and we are reviewing what steps market participants will need to take in order to comply with our proposed rules. These discussions are vital to establishing a coordinated implementation timeline that is workable.

After proposing all of the key rules under Title VII, we intend to seek public comment on a detailed implementation plan that will permit a roll-out of the new securities-based swap requirements in logical, progressive, and efficient manner, while minimizing unnecessary disruption and costs to the markets. Implementing the new rules through a coherent and sequenced plan should help avoid undue delay in the creation of a more sound foundation for the regulatory oversight of the OTC derivatives market.

Steps to Address the Effective Date of Title VII

As the Commission continues to move forward with the implementation of Title VII, it has taken a number of steps to provide legal certainty and avoid unnecessary market disruption that might otherwise have arisen as a result of final rules not having been enacted by the July 16 effective date of Title VII. Specifically, we:

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[27] *See* Release No. 33-9222, *Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies* (June 9, 2011), http://www.sec.gov/rules/proposed/2011/33-9222.pdf.

[28] *See* Release No. 34-64628, *Beneficial Ownership Reporting Requirements and Security-Based Swaps* (June 8, 2011), http://www.sec.gov/rules/final/2011/34-64628.pdf.

- Provided guidance regarding which provisions in Title VII governing security-based swaps became operable as of the effective date and provided temporary relief from several of these provisions;[29]
- Provided guidance regarding – and where appropriate, interim exemptions from – the various pre-Dodd-Frank provisions that would otherwise have applied to security-based swaps on July 16;[30] and
- Took other actions to address the effective date, including extending certain existing temporary rules and relief to continue to facilitate the clearing of certain credit default swaps by clearing agencies functioning as central counterparties. [31]

Clearing Agencies

Title VIII of the Dodd-Frank 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. Clearing agencies play a critical role in the financial markets by ensuring that transactions settle on time and on agreed-upon terms. The purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability.

To help ensure the integrity of clearing agency operations and governance, the Commission proposed certain enhanced requirements for clearing agencies.[32] Specifically, the proposed rules would require clearing agencies to maintain certain standards with respect to risk management and operations, have adequate safeguards and procedures to protect the confidentiality of trading information, have procedures that identify and address conflicts of interest, require minimum governance standards for boards of directors, designate a chief compliance officer, and disseminate pricing and valuation information if the clearing agency performs central counterparty services for security-based swaps. Many of the proposed requirements would apply to all clearing agencies, while others would focus more specifically on clearing agencies that clear security-based swaps.

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[29] *See* Release No. 34-64678, *Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps* (June 15, 2011), http://www.sec.gov/rules/exorders/2011/34-64678.pdf.

[30] *See* Release No. 34-64795, Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment (July 1, 2011), http://sec.gov/rules/exorders/2011/34-64795.pdf; and Release No. 33-9231, Exemptions for Security-Based Swaps (July 1, 2011), http://www.sec.gov/rules/interim/2011/33-9231.pdf.

[31] *See* Release No. 34-64796, Order Pursuant to Section 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions from Clearing Agency Registration Requirements under Section 17A(b) of the Exchange Act for Entities Providing Certain Clearing Services for Security-Based Swaps (July 1, 2011), http://sec.gov/rules/exorders/2011/34-64796.pdf; and Release No. 33-9232 Extension of Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps (July 1, 2011) http://www.sec.gov/rules/interim/2011/33-9232.pdf.

[32] *See* Release No. 34-64017, *Clearing Agency Standards for Operation and Governance* (March 3, 2011), http://www.sec.gov/rules/proposed/2011/34-64017.pdf.

The proposal was the result of close work between the Commission staff and staffs of the CFTC and the Federal Reserve Board ("Board"). The proposed requirements are consistent with – and build on – current international standards, and they are designed to further strengthen the Commission's oversight of securities clearing agencies, promote consistency in the regulation of clearing organizations generally, and thereby help to ensure that clearing agency regulation reduces systemic risk in the financial markets.

In addition, as directed by Title VIII, the SEC staff worked jointly with the staffs of the CFTC and the Board over the past year to develop a report to Congress reflecting recommendations regarding risk management supervision of clearing entities designated as systemically important by the FSOC – each called a "designated clearing entity" or "DCE". The staffs of the agencies met regularly and engaged in constructive dialogue to develop a framework for improving consistency in the DCE oversight programs of the SEC and CFTC, promoting robust risk management by DCEs, promoting robust risk management oversight by DCE regulators, and improving regulators' ability to monitor the potential effects of DCE risk management on the stability of the financial system of the United States. The joint report recommended finalizing rulemakings to establish enhanced risk management for DCEs, formalizing the process for consultations and information sharing regarding DCEs, enhancing DCE examinations, and developing ongoing consultative mechanisms to promote understanding of systemic risk. The report should establish a strong framework for ongoing consultation and cooperation in clearing agency oversight among the Commission, the CFTC, and the Board, which in turn should help to mitigate systemic risk and promote financial stability.

Credit Rating Agencies

Under the Dodd-Frank Act, the Commission is required to undertake approximately a dozen rulemakings related to NRSROs. The Commission adopted the first of these required rulemakings in January, and in May, the Commission published for public comment a series of proposed rules that would largely implement this requirement.[33] The proposed rules are intended to strengthen the integrity of credit ratings, including by improving their transparency. Under the Commission's proposals, NRSROs would, among other things, be required to:

- Report on their internal controls;
- Better protect against any conflicts of interest;
- Establish professional standards for their credit analysts;
- Publicly provide – along with the publication of any credit rating – disclosure about the credit rating and the methodology used to determine it; and
- Provide enhanced public disclosures about the performance of their credit ratings.

The proposals also would require disclosure concerning third-party due diligence reports for asset-backed securities.

[33] *See* Release No. 34-64514, *Proposed Rules for Nationally Recognized Statistical Rating Organizations* (May 18, 2011), http://www.sec.gov/rules/proposed/2011/34-64514.pdf.

The Act also requires the SEC to conduct three studies relating to credit rating agencies. In December, the Commission requested public comment on the feasibility and desirability of standardizing credit rating terminology.[34] The Act also requires (1) a two-year study on alternative compensation models for rating structured finance products and (2) a three-year study on NRSRO independence.

With respect to alternative compensation models, the Act directs the Commission to study the credit rating process for structured finance products and the conflicts associated with the "issuer-pay" and the "subscriber-pay" models. The Act further requires the Commission to study the feasibility of establishing a system in which a public or private utility or a self-regulatory organization would assign NRSROs to determine the credit ratings for structured finance products. Accordingly, in May the Commission published a request for public comment on the feasibility of such a system, asking interested parties to provide comments, proposals, data and analysis by September.[35]

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.

- In February 2011, the Commission proposed rule amendments that would remove credit ratings as conditions for companies seeking to use short-form registration when registering securities for public sale. 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.[36] In addition, prior to adoption of the Act, in April 2010 the Commission proposed new requirements to replace the current credit rating references in shelf eligibility criteria for asset-backed security issuers with new shelf eligibility criteria.[37]

- In March 2011, the Commission proposed to remove credit ratings from rules relating to what securities a money market fund can purchase.[38] This proposal includes amendments to Rule 2a-7, which governs the operation of money market funds and

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

[35] *See* Release No. 34-64456, *Solicitation of Comment to Assist in Study on Assigned Credit Ratings* (May 10, 2011), http://www.sec.gov/rules/other/2011/34-64456.pdf.

[36] *See* Release No. 33-9186, *Security Ratings* (February 9, 2011), http://www.sec.gov/rules/proposed/2011/33-9186.pdf.

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

[38] See Release Nos. 33-9193; IC-29592, *References to Credit Ratings in Certain Investment Company Act Rules and Forms* (March 3, 2011), http://www.sec.gov/rules/proposed/2011/33-9193.pdf.

requires these funds to invest only in highly liquid, short-term investments of the highest quality. These proposed amendments would replace the current requirement that rated portfolio securities have received a first or second tier rating. They are designed to offer protections comparable to those provided by NRSRO ratings and to retain a degree of risk limitation similar to the current rule.

- In April 2011, the Commission proposed to remove references to credit ratings in rules concerning broker-dealer financial responsibility, distributions of securities, and confirmations of transactions.[39]

In September 2010, as required by Section 939B of the Act, the Commission adopted a rule amendment to remove communications with credit rating agencies from the list of excepted communications in Regulation FD.[40]

In addition, the Dodd-Frank Act requires the SEC to conduct staff examinations of each NRSRO at least annually and issue an annual report summarizing the exam findings. Our staff is in the process of completing the first cycle of these exams, but at our current funding level achieving that statutory mandate has required drawing away critical resources from other parts of our examination and NRSRO programs.

Volcker Rule

In January, 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.[41] Informed by these recommendations, the Commission staff is working closely with staffs from the federal banking agencies and the CFTC in drafting proposed rules to implement Section 619. The agency staffs are consulting and coordinating efforts in order to assure that the proposed regulations are comparable and provide for consistent application and implementation across regulated entities subject to the Volcker Rule, to the extent possible. We anticipate that the proposal will solicit comments on a variety of issues, including the costs and benefits of the proposed rule and its potential impact on competitiveness.

Municipal Advisors

Section 975 of the Dodd-Frank Act requires the registration of municipal advisors with the Commission. This new registration requirement became effective on October 1, 2010, making it

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[39] *See* Release No. 34-64352, *Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934* (April 27, 2011), http://www.sec.gov/rules/proposed/2011/34-64352.pdf.

[40] *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.

[41] 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. *See also,* http://sec.gov/spotlight/dodd-frank/volckerrule.htm.

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.[42] In December, the Commission proposed a permanent rule creating a new process by which municipal advisors must register with the SEC.[43] We have received approximately 1,000 comment letters on the proposal, including many expressing concerns regarding the treatment of appointed officials and traditional banking products and services. We will give all of these comments careful consideration before adopting a final rule.

Broker-Dealer Audits and Custody Arrangements

In June, the Commission proposed amendments to its broker-dealer financial reporting rule in order to strengthen the audits of broker-dealers as well as its oversight of the way broker-dealers handle their customers' securities and cash.[44] The proposed amendments also would facilitate the ability of the Public Company Accounting Oversight Board to implement its new oversight authority over independent public accountants of broker-dealers that was provided in Section 982 of the Dodd-Frank Act.

Asset-Backed Securities

During the past year, the Commission has been active in implementing Subtitle D of Title IX of the Dodd-Frank Act, entitled "Improvements to the Asset-Backed Securitization Process." Most recently, on March 30, 2011, the Commission joined its fellow regulators in issuing for public comment proposed risk retention rules to implement Section 941 of the Act.[45] Section 941, which is codified as new Section 15G of the Securities Exchange Act of 1934, generally requires the Commission, the Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and, in the case of the securitization of any "residential mortgage asset," the Federal Housing Finance Agency and Department of Housing and Urban Development, to jointly prescribe regulations that require a securitizer to retain not less than five percent of the credit risk of any asset that the securitizer – through the issuance of an asset-backed security – transfers, sells, or conveys to a third party. Section 15G also provides that the jointly prescribed regulations must prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain.[46]

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[42] *See* Release No. 34-62824, *Temporary Registration of Municipal Advisors* (September 1, 2010), http://www.sec.gov/rules/interim/2010/34-62824.pdf.

[43] *See* Release No. 34-63576, *Registration of Municipal Advisors* (December 20, 2010), http://sec.gov/rules/proposed/2010/34-63576.pdf.

[44] *See* Release No. 34-64676, *Broker-Dealer Reports* (June 15, 2011), http://www.sec.gov/proposed/2011/34-64676.pdf.

[45] *See* Release No. 34-64148, *Credit Risk Retention* (March 30, 2011), http://www.sec.gov/rules/proposed/2011/34-64148.pdf.

[46] *See* § 78o-11(c)(1)(A).

Under the proposed rules, a sponsor generally would be permitted to choose from a menu of four risk retention options to satisfy its minimum five percent risk retention requirement. These options were designed to provide sponsors with flexibility while also ensuring that they actually retain credit risk to align incentives. The proposed rules also include three transaction-specific options related to securitizations involving revolving asset master trusts, asset-backed commercial paper conduits, and commercial mortgage-backed securities. Also, as required by Section 941, the proposal provides a complete exemption from the risk retention requirements for ABS collateralized solely by "qualified residential mortgages" (or QRMs) and establishes the terms and conditions under which a residential mortgage would qualify as a QRM. We have received a number of comments regarding the QRM exemption, which we will carefully consider as we move forward with the interagency rulemaking process. Although the original comment period was scheduled to close on June 10, 2011, in light of requests from various sources for an extension to allow sufficient time for data gathering and impact analyses related to the provisions of the proposed rule, we extended the comment period to August 1, 2011.

In January 2011, the Commission proposed rules in connection with Section 942(a) of the Dodd-Frank Act, which 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 proposed rules 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.[47]

The Commission also adopted rules in January 2011 implementing Section 943, on the use of representations and warranties in the market for ABS,[48] and Section 945, which requires 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.[49]

We also are working on rules prohibiting material conflicts of interest in certain securitizations[50] and rules requiring the disclosure of asset-level information regarding the assets backing each tranche or class of security.[51]

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[47] *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.

[48] *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.

[49] *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.

[50] *See* Section 27B of the Securities Act, as added by Section 621 of the Dodd-Frank Act.

[51] *See* Section 942(b) of the Dodd-Frank Act. In April 2010, the Commission proposed, among other things, to require that, with some exceptions, prospectuses for public offerings of ABS and ongoing Exchange Act reports contain specified asset-level information about each of the assets in the pool. *See* Release No. 33-9117, *Asset-*

Corporate Governance and Executive Compensation

The Dodd-Frank Act includes an array of corporate governance and executive compensation provisions that require Commission rulemaking. Among others, such rulemakings include:

- **Say on Pay.** The Commission adopted rules in January that require, in accordance with Section 951 of the Act, public companies subject to the federal proxy rules to provide a shareholder advisory "say-on-pay" vote on executive compensation, a separate shareholder advisory vote on the frequency of the say-on-pay vote, and disclosure about, and a shareholder advisory vote to approve, compensation related to merger or similar transactions, known as "golden parachute" arrangements.[52] The Commission also proposed rules to implement the Section 951 requirement that institutional investment managers report their votes on these matters at least annually.[53]

- **Compensation Committee and Adviser Requirements.** Section 952 requires the Commission to, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer that does not comply with new compensation committee and compensation adviser requirements. In March 2011, the Commission issued a proposal to implement Section 952 that would require the exchanges to establish listing standards that require each member of a listed issuer's compensation committee to be a member of the board of directors and to be "independent."[54]

  The proposed rules also would direct the exchanges to prohibit the listing of any equity security of any issuer that is not in compliance with certain requirements relating to compensation committees and compensation advisers. The proposal also would amend the Commission's existing compensation consultant disclosure rules to require disclosure about whether the issuer's compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflicts of interest; and, if so, the nature of any such conflict and how it is being addressed. The comment period for the proposal ended on May 19, 2011, and the staff is currently developing recommendations for final rules.

- **Incentive-Based Compensation Arrangements**. Section 956 of the Dodd-Frank Act requires the Commission along with six other financial regulators to jointly adopt

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Backed Securities (April 7, 2010), http://www.sec.gov/rules/proposed/2010/33-9117.pdf. The April 2010 proposals, if adopted, would implement the requirements for registered offerings of Section 942(b).

[52] *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.

[53] *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.

[54] *See* Release No. 33-9199, *Listing Standards for Compensation Committees* (March 30, 2011), http://www.sec.gov/rules/proposed/2011/33-9199.pdf.

regulations or guidelines governing the incentive-based compensation arrangements of certain financial institutions, including broker-dealers and investment advisers with $1 billion or more of assets. Working with the other regulators, in March the Commission published for public comment a proposed rule that would address such arrangements. The Commission has received voluminous comment letters on the proposed rule, and the Commission staff, together with staff from the other regulators, is carefully considering the issues and concerns raised in those comments before adopting any final rules.

- **Prohibition on Broker Voting of Uninstructed Shares**. 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 matters, or any other significant matter, as determined by the Commission by rule. To date, the Commission has approved changes to the rules with regard to director elections and executive compensation matters for most of the national securities exchanges,[55] and we anticipate that corresponding changes to the rules of the remaining 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, including rules mandating new listing standards relating to specified "clawback" policies,[56] and new disclosure requirements about executive compensation and company performance,[57] executive pay ratios,[58] and employee and director hedging.[59] These provisions of the Act do not contain rulemaking deadlines, but the staff is working on developing recommendations for the Commission concerning the implementation of these provisions of the Act.

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[55] *See* Release No. 34-62874 (September 9, 2010), http://www.sec.gov/rules/sro/nyse/2010/34-62874.pdf (New York Stock Exchange); Release No. 34-62992 (September 24, 2010), http://www.sec.gov/rules/sro/nasdaq/2010/34-62992.pdf (NASDAQ Stock Market LLC); Release No. 34-63139 (October 20, 2010), http://www.sec.gov/rules/sro/ise/2010/34-63139.pdf (International Securities Exchange); Release No. 34-63917 (February 16, 2011), http://www.sec.gov/rules/sro/cboe/2011/34-63917.pdf (Chicago Board Options Exchange); Release No. 34-63918 (February 16, 2011), http://www.sec.gov/rules/sro/c2/2011/34-63918.pdf (C2 Options Exchange, Incorporated); Release No. 34-64023 (March 3, 2011), http://www.sec.gov/rules/sro/bx/2011/34-64023.pdf (NASDAQ OMX BX, Inc.); Release No. 34-64121 (March 24, 2011), http://www.sec.gov/rules/sro/chx/2011/34-64121.pdf (Chicago Stock Exchange); Release No. 34-64122 (March 24, 2011), http://www.sec.gov/rules/sro/phlx/2011/34-64122.pdf (NASDAQ OMX PHLX LLC); Release No. 34-64186 (April 5, 2011), http://www.sec.gov/rules/sro/edgx/2011/34-64186.pdf (EDGX Exchange); Release No. 34-64187 (April 5, 2011), http://www.sec.gov/rules/sro/edga/2011/34-64187.pdf (EDGA Exchange).

[56] *See* Section 954 of the Dodd-Frank Act.

[57] *See* Section 953(a) of the Dodd-Frank Act.

[58] *See* Section 953(b) of the Dodd-Frank Act.

[59] *See* Section 955 of the Dodd-Frank Act.

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 Commission published rule proposals for the three specialized disclosure requirements in December 2010, and the comment period ended on March 2, 2011.[60] The staff is developing recommendations for the Commission's consideration. The Commission expects to consider adoption of final rules implementing these specialized disclosure provisions in the late summer or early fall of this year.

Exempt Offerings

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. The Commission proposed rules to implement the requirements of Section 926 on May 25, 2011.[61] Under the proposal, the disqualifying events include certain criminal convictions, court injunctions and restraining orders; certain final orders of state securities, insurance, banking, savings association or credit union regulators, federal banking agencies or the National Credit Union Administration; certain types of Commission disciplinary orders; suspension or expulsion from membership in, or from association with a member of, a securities self-regulatory organization; and certain other securities-law related sanctions. The comment period for this rule proposal ended on July 14, 2011.

In addition, the Commission proposed rule amendments in January that would implement Section 413(a) of the Act, which 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.[62] The comment period on this proposal ended on March 11, 2011 and the staff is preparing final rule recommendations for the Commission. This section was effective on the date of enactment of the Dodd-Frank Act; the implementing rules are designed to clarify the requirements and codify them in the Commission's rules.

Financial Stability Oversight Council

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[60] *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.

[61] *See* Release No. 33-9211, *Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings* (May 25, 2011), http://www.sec.gov/rules/proposed/2011/33-9211.pdf.

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

In addition to the rulemaking activity described above, Title I of the Dodd-Frank Act created the FSOC, and with it, a formal structure for coordination among the various financial regulators to monitor systemic risk and to promote financial stability across our nation's financial system. FSOC has the following primary responsibilities:

- Identifying risks to the financial stability of the United States that could arise from the material financial distress or failure – or ongoing activities – of large, interconnected bank holding companies or nonbank financial holding companies, or that could arise outside the financial services marketplace;
- Promoting market discipline by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the government will shield them from losses in the event of failure (*i.e.*, addressing the moral hazard problem of "too big to fail"); and
- Identifying and responding to emerging threats to the stability of the United States financial system.[63]

As Chairman of the SEC, I am a voting member of FSOC. Senior SEC staff and I have actively participated in the FSOC and found its focus on identifying and addressing risks to the financial system to be important and helpful to the SEC as a capital markets regulator. The FSOC also has fostered a healthy and positive sense of collaboration among the financial regulators, facilitating cooperation and coordination for the benefit of investors and our overall financial system. Since passage of the Dodd-Frank Act, the FSOC has taken steps to create an organizational structure, coordinate interagency efforts, and build the foundation for meeting its statutory responsibilities.

To begin defining and implementing the process to identify and designate systemically important financial institutions ("SIFIs") for heightened supervision by the Board, FSOC issued an advanced notice of proposed rulemaking soliciting public comment on the specific criteria and analytical framework for the SIFI designation process, with a focus on how to apply the statutory considerations for such designations, as well as a notice of proposed rulemaking. FSOC is preparing additional guidance regarding the Council's approach to designations and will seek public comment on it.

Financial Market Utilities ("FMUs") are essential to the proper functioning of the nation's financial markets.[64] These utilities form critical links among marketplaces and intermediaries that can strengthen the financial system by reducing counterparty credit risk among market participants, creating significant efficiencies in trading activities, and promoting transparency in financial markets. However, FMUs by their nature create and concentrate new risks that could affect the stability of the broader financial system. To address these risks, Title VIII of the Dodd-Frank Act provides important new enhancements to the regulation and supervision of FMUs designated as systemically important by FSOC ("DFMUs") and of payment, clearance

[63] *See* Dodd-Frank Act § 112(a)(1).

[64] Section 803(6) of the Dodd-Frank Act defines a financial market utility as "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person."

and settlement activities. This enhanced authority in Title VIII should provide consistency, promote robust risk management and safety and soundness, reduce systemic risks, and support the stability of the broader financial system.[65] Importantly, the enhanced authority in Title VIII is designed to be in addition to the authority and requirements of the Securities Exchange Act and Commodity Exchange Act that may apply to FMUs and financial institutions that conduct designated activities.[66]

FSOC established an interagency DFMU committee to develop a framework for the designation of systemically important FMUs, in which staff from the SEC has actively participated, and also published an advanced notice of proposed rulemaking seeking public comment on the designation process for FMUs.

On March 28, 2011, FSOC published a notice of proposed rulemaking to provide further information on the process it proposed to follow when reviewing the systemic importance of FMUs. The FSOC finalized this rule earlier this week.[67]

New Commission Offices

In addition to the Whistleblower Office mentioned earlier, the Dodd-Frank Act requires the Commission to create four new offices within the Commission, specifically, the Office of Credit Ratings, Office of the Investor Advocate, Office of Minority and Women Inclusion, and Office of Municipal Securities. 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.[68]

While reprogramming approval is a necessary step in moving forward to create these new offices, the provision of additional funding to staff them at adequate levels also would be necessary for the SEC to fully execute the new responsibilities. In the meantime, the initial functions of the offices are being performed on a limited basis by other divisions and offices.

Cost-Benefit Analyses

We are keenly aware that our rules have both costs and benefits, and that the steps we take to protect the investing public impact both financial markets and industry participants who must comply with our rules. This is truer than ever given the scope, significance and complexity of the Dodd-Frank Act. Our Division of Risk, Strategy, and Financial Innovation, which has been expanded in both stature and size, directly assists our rule writers in analyzing the economic impact of those rules.

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[65] *See* Dodd-Frank Act § 802.

[66] *See* Dodd-Frank Act § 805.

[67] http://www.treasury.gov/initiatives/Documents/Finalruledisclaimer7-18-2011.pdf.

[68] The Senate Committee on Appropriations' Subcommittee on Financial Services and General Government Appropriations provided reprogramming approval to the Commission on July 14, 2011.

When engaging in rulemaking, we analyze the direct and indirect costs and benefits of the Commission's proposed decisions against alternative approaches, including, the effects on competition, efficiency and capital formation. We invite the public to comment on our analysis and provide any information and data that may better inform our decision making. In adopting releases, the Commission responds to the information provided and revises its analysis as appropriate. This approach helps ensure a regulatory framework that strikes the right balance between the costs and the benefits of regulation.[69]

Funding for Implementation of the Dodd-Frank Act

The provisions of the Dodd-Frank Act expand the SEC's responsibilities and will require significant additional resources to fully implement the law. To date, the SEC has proceeded with the first stages of implementation without the necessary 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 sufficient investments in areas such as information technology.

It is incumbent upon us to use our existing resources efficiently and effectively as we strive to fulfill statutory mandates, protect investors and achieve our mission. That said, the new responsibilities assigned to the agency under the Dodd-Frank Act are so significant that they cannot be achieved solely by wringing efficiencies out of the existing budget without also severely hampering our ability to meet our existing responsibilities.

The budget justification the SEC submitted in February in connection with the President's 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.[70] 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.

The Dodd-Frank Act requires the SEC to collect transaction fees to offset the annual appropriation to the SEC. Accordingly, regardless of the amount appropriated to the SEC, the appropriation will be fully offset by the fees that we collect and will have no impact on the nation's budget deficits.

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[69] After reviewing cost benefit analyses included in six of our Dodd-Frank Act rulemaking releases, the SEC's Inspector General issued a report last month. While the Office of Inspector General ("OIG") is continuing to review the Commission's cost benefit analyses, this report concluded that "a systematic cost-benefit analysis was conducted for each of the six rules reviewed. Overall, [the OIG] found that the SEC formed teams with sufficient expertise to conduct a comprehensive and thoughtful review of the economic analysis of the six proposed released that [the OIG] scrutinized in [its] review." *See* U.S. SEC Office of the Inspector General, *Report of Review of Economic Analyses Performed by the Securities and Exchange Commission in Connection with Dodd-Frank Rulemakings* (June 13, 2011) http://www.sec-oig.gov/Reports/AuditsInspections/2011/Report_6_13_11.pdf at 43. We look forward to continuing to work with the OIG as it conducts a further review.

[70] *See* the SEC's FY2012 Congressional Budget Justification http://www.sec.gov/about/secfy12congbudgjust.pdf.

If the SEC does not receive additional resources, many of the issues highlighted by the financial crisis and which the Dodd-Frank Act seeks to fix will not be adequately addressed, as the SEC will not be able to build out the technology and hire industry expertise and other staff desperately needed to oversee and police these new areas of responsibility. Examples of likely impacts include:

- The implementation of rules for the OTC derivatives markets will be delayed, depriving financial firms and market participants of the legal certainty they need to make routine investment decisions, upgrade systems and technology infrastructure, and improve risk management opportunities for manufacturers, pension funds, municipalities, and others. Even after the rules are eventually finalized, market participants will face further delays and uncertainty due to the lack of adequate Commission staff to process and review on a timely basis requests for registrations or other required approvals. Further, the Commission will be unable to conduct adequate oversight and examinations of registered swap market participants, or to use newly-available data to surveil the security-based swap markets for excessive risks or other threats to our markets and investors.

- Oversight of vital clearing functions and expected new securities-based swap data repositories will be wholly inadequate. The average transaction volume cleared and settled by clearing agencies is approximately $1.8 trillion a day. For the current actively-registered nine clearing agencies, the SEC has approximately ten examiners devoted to them, with limited on-site presence in only three of those. This situation will worsen as more clearing agencies register with the SEC as a result of Dodd-Frank.

- The SEC will continue to have only a skeletal crew to handle analysis of complex legal and regulatory issues that will increase significantly as more than 750 advisers to hedge funds and private equity funds begin to register with the Commission. Even after shifting staff from other important program areas, the SEC's Division of Investment Management will be able to dedicate only a handful of staff to this area.

The Dodd-Frank Act also established a $50 million SEC Reserve Fund to allow the SEC to respond to unexpected market events (such as the May 6th market plunge), invest in multi-year IT projects, and manage authorized programs during continuing resolutions. If this fund is eliminated or the SEC is not permitted to access the fund, it would have significant consequences for important IT projects, such as building out the infrastructure to take in, manage and analyze the significant amounts of critical new data we will soon receive from previously unregulated markets, including a segment of the $600 trillion OTC derivatives market and hedge fund and other private fund advisers. Without the appropriate IT infrastructure, our ability to establish effective monitoring regimes will be significantly hindered.

Section 967 Organizational Assessment

While additional resources are needed to implement the Dodd-Frank Act, it is also critical that we use existing resources effectively and efficiently. In order to implement our new responsibilities and to effectively supervise the changing financial markets, the SEC is carefully examining its operations and processes to maximize efficiency and effectiveness. 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. This organizational assessment was recently performed by the Boston Consulting Group, Inc. ("BCG") [71] and is providing valuable guidance and structure for our efforts. Among other issues, the organizational assessment raises significant issues regarding SEC resources and questions whether the statutory design of the four new offices creates management complexity, duplication and a need for new support capacity when many of their functions already exist at the SEC. SEC staff is currently reviewing the recommendations of the study and will be moving forward with those suggested changes that could improve organizational effectiveness.

Conclusion

Though the SEC's efforts to implement the Dodd-Frank Act have been extensive, we know our work is far from over and we are committed to finishing the job. Thank you for inviting me to share with you our progress to date and our plans going forward. I look forward to answering your questions.

[71] On March 10, 2011, BCG submitted to the SEC and to the Congress its Report, *U.S. Securities and Exchange Commission: Organizational Study and Reform*. The report is available to the public at www.sec.gov/news/studies/2011/967study.pdf.