Statement of
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before the

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Chairman Dodd, Senator Shelby and Members of the Committee:

I am pleased to be here today to discuss the important work the Securities and Exchange Commission is doing to protect investors, foster efficient markets, and promote capital formation.

The initiatives underway at the Commission have a common theme: they are aimed at benefiting investors whose returns are dependent on healthy, well-functioning markets. This is the SEC's traditional responsibility. Back in Joseph Kennedy's day, our first SEC Chairman was amazed that "one person in every ten" owned stocks. But today, more than half of all households own securities.

In fact, when one considers the staggering growth in Americans' participation in the markets, the enormity of the SEC's task becomes apparent. About 3,600 staff at the SEC are responsible for overseeing more than 10,000 publicly traded companies, more than 10,000 investment advisers that manage more than $37 trillion in assets, nearly 1,000 fund complexes, 6,000 broker-dealers with 172,000 branches, and the $44 trillion worth of trading conducted each year on America's stock and options exchanges.

Perhaps the most striking development that is underway in our markets is that they are becoming increasingly interconnected with other global markets, and at an accelerating rate. This is challenging the United States and securities regulators around the world to collaborate more closely than ever before. Investors have much to gain in a truly global marketplace, but there are many risks and pitfalls as well. Not only issuers of securities and providers of capital, but fraud artists as well, have gone international.

Vigorous Enforcement of the Securities Laws

Mr. Chairman, many of the issues we face are sometimes trivialized as disputes between business and investors – as if to be pro-investor is to be anti-business, or to be pro-business is to be anti-investor. The truth is, when people invest in a company's securities, they are risking their money on the success of the business. Only if the business succeeds will their investment prosper. That is why the SEC's first Chairman described the SEC's role, and our relationship to business, as a partnership. We take that to mean, today just as back when Joe Kennedy was Chairman, that if a business is investor friendly, the SEC will be friendly to it. But anyone who seeks to drive a wedge between the interests of the business and the interests of the investors in that business will face a relentless and powerful adversary in the Securities and Exchange Commission.

Today, the SEC's Enforcement Division is significantly larger than it was five years ago. Our staff is engaged in combating abuses ranging from boiler rooms and Ponzi schemes to stock option grants to fictitious employees. We are pursuing individuals and firms who have falsified corporate documents, engaged in self-enrichment to the detriment of their investors, and attempted cover-ups of this sort of conduct. We are investigating and filing actions against perpetrators of Internet scams, pump-and-dump schemes, and prime bank frauds, executives who have lied to their auditors, and accountants, lawyers, and other gatekeepers who have joined in the fraud themselves.

The Commission is also making increasing use of the new authority that Congress provided us in the Sarbanes-Oxley Act to use "Fair Funds" to ensure that the penalties and disgorgements that result from the Commission's enforcement efforts are returned to investors as quickly as possible. Through this program we have returned over $2 billion to injured investors. But the Commission recognizes that we can improve on our efforts in this area. To that end, the Commission is developing a considerable expertise in the distribution of Fair Funds and I recently announced our intention to create a dedicated office that will specialize in this area, which should be up and running by October.

And because investors are best protected when securities firms have robust compliance programs that prevent violations, the Commission has taken new steps to help securities firms meet their compliance obligations. Through our CCOutreach Program, we're helping chief compliance officers of mutual funds and investment advisers to implement strong compliance programs for the protection of investors. And, we're making greater use of our website to provide helpful information to securities firms about common deficiencies that we find in examinations, to help them to proactively improve their own compliance programs.

A Record of Accomplishment

The SEC's compliance and enforcement efforts undergird the integrity of the U.S. capital markets. Beyond the SEC's law enforcement and compliance functions, we have undertaken a variety of initiatives and rulemakings to protect investors and increase the efficiency of our rules.

Perhaps the most important step we have taken this year is to improve the implementation of the Sarbanes-Oxley Act ("SOX"), which was enacted five years ago this week. The SEC recently approved new guidance for management in implementing section 404 of the Act. And last week, the Commission voted to approve the PCAOB's new auditing standard, Auditing Standard No. 5, to streamline and improve the audit of a company's internal controls. The new auditing standard and the new management guidance should encourage executives, auditors, directors, and audit committee members to focus on the material risks that investors care about. These actions also represent more than two years of hard work aimed at improving the implementation of 404 for companies of all sizes.

Our SEC guidance to management represents the first time since SOX became law that corporate managers will have guidance intended for its own use in implementing section 404. No longer will the auditing standard be the de facto rulebook for management's compliance with our rules. This guidance should enable cost-effective compliance with 404 for companies of all sizes. Those already complying with our rules can use the guidance to eliminate unnecessary make-work that does little to further the goal of providing reliable financial statements to investors. Those not yet complying (that is, most small companies) can benefit from the lessons learned. For them, the guidance should be a way to avoid wasteful and unnecessary compliance efforts that others have had to endure. Because we have again deferred (for the fourth time) the external audit requirement for smaller companies, management will have a full extra year to develop its own cost-effective compliance approach. It is our intention that this will make it far easier to coordinate a cost-effective external audit when it is first required of smaller public companies in 2009.

When, eventually, smaller companies do come into full compliance, the new auditing standard will allow them to tailor their compliance efforts to their own individual facts and circumstances. The new standard encourages the scaling of all audits. Small companies will be able to apply the guidance to their unique control systems – rather than create costly or complex control systems for the sole purpose of complying with the guidance. By allowing them to tailor the documentation and evaluation approaches to their particular business, we hope to avoid the one-size-fits-all, check-list approach that many larger companies have bristled under as they have tried to comply with 404.

With new guidance that allows management to scale and tailor evaluations to focus on what matters most – and with a new auditing standard that enables auditors to deliver more cost-effective audit services, one final step remains. The SEC and the PCAOB expect a change in the behavior of the individuals who are responsible for following these new procedures. To that end, the PCAOB's inspection program will monitor whether audit firms are implementing the new auditing standard in a cost-effective way that is designed to achieve the intended results. And the SEC, in our oversight capacity, will monitor the effectiveness of the PCAOB's inspections. So both the SEC's and the PCAOB's inspectors will be focused on whether audit firms are achieving the desired audit and cost efficiencies in the implementation of 404. The SEC staff will also conduct an economic analysis – using real-world information – to evaluate whether the costs and benefits of implementing section 404 are in line with our expectations.

These improvements to the implementation of Sarbanes-Oxley are important in the international realm because, while many countries have adopted requirements similar to our internal control assessment in section 404(a) of SOX, ours is the only country that requires an attestation along with the independent auditor's report. This fact has been a source of friction with other markets and with other national regulators and international bodies. The Congress has charged the SEC with making section 404 work both effectively and efficiently and we recognize that doing so will greatly benefit U.S. investors as well as the competitiveness of U.S. companies and financial services providers in the global capital markets.

Just as we are reforming the implementation of section 404 to focus on those areas of highest risk, we have also focused our enforcement, education, and rulemaking efforts on the most vulnerable populations. One manifestation of these efforts is our focus on helping seniors. We organized the first-ever Seniors Summit with our fellow regulators and law enforcement officials and in September will host this year's Seniors Summit, which will integrate even more of our national resources. We are attacking the problem from all angles – from aggressive enforcement efforts, to targeted examinations, rules, and investor education. We have brought 26 enforcement actions during the past year aimed specifically at protecting elderly investors. Many of these were coordinated with state authorities. Another tool in fighting securities fraud against seniors is education. These efforts are aimed not only at seniors, but also their caregivers – as well as pre-retirement workers, who are encouraged to plan for contingencies in later life. The SEC is expanding our efforts to reach out to community organizations, and to enlist their help in educating Americans about investment fraud and abuse that is aimed at seniors. We have also devoted a portion of the SEC website specifically to senior citizens (http://www.sec.gov/investor/seniors.shtml). The site provides links to critical information on investments that are commonly marketed to seniors, and detailed warnings about common scam tactics.

The SEC has also identified the men and women of our military as an at-risk group vulnerable to unscrupulous sales practices for financial and investment products. We have directed our enforcement, examinations, and investor education resources to protecting against these abuses, and we have initiated a coordinated approach with other regulators. We worked with you in the Congress to enact the Military Personnel Financial Services Protection Act just last year, to prevent the sale of potentially abusive insurance and investment products to military personnel.

This week, I am announcing an expansion of the agency's Office of Investor Education and Advocacy. This Office each year has contact with tens of thousands of individual American investors through its investor assistance and education programs. As a result of the knowledge and experience gained through these programs, the Office of Investor Education and Advocacy is able to provide invaluable advice to the Commission on how to advance the interests of America's investors. The Office also plays an important role in the Commission's key initiatives aimed at retail investors – including using "interactive data" to make disclosures more useful to investors, helping senior citizens to guard against securities fraud, and standing up for investors who want disclosures in plain English and easily available on the Internet. Expanding the responsibilities of the Office of Investor Education and Advocacy will help the Commission stay firmly focused on its work to put individual investors first.

The Commission has also updated our rules to facilitate better communications with shareholders and reduce the costs of complying with our regulations. Our recently adopted "electronic proxy" rules will allow shareholders to choose whether to access their proxy materials in paper or electronically. Of course, shareholders who prefer to receive their proxy materials on paper will always be able to do so – and even then they will still have the opportunity to use the proxy materials on the Internet as well. When it comes to interactive data, the shareholders are in the driver's seat.

Building on Our Successes

Just as we are modernizing the SEC's proxy rules, a topic I will touch on further in a moment, we also need to modernize our processes and rules to make maximum use of the benefits of new technology for making the capital markets more easily accessible and understood by investors. Nothing holds more promise for giving ordinary investors the information they need in a timely, useful way than interactive data. New technology that can sort through mountains of SEC-mandated disclosure and turn it into something meaningful holds enormous potential for investors. What we are calling "interactive data" would provide investors in mutual funds, 401(k)s, common stocks and other securities far more useful information than anything they have ever gotten from the SEC before.

The SEC's current online system, known as EDGAR, is really just a vast electronic filing cabinet that does little to exploit the power of today's computers. Sure, it can bring up electronic copies of pieces of paper on your computer screen, but it does not allow you to manage that information in ways that investors commonly need. Interactive data would change that. It would allow any investor to quickly find, for example, the mutual funds with the lowest expense ratios, the companies within an industry that have the highest net income, or the overall trend in their favorite companies' earnings. This is possible through an internationally used computer language called XBRL. The Commission is investing more than $54 million over several years to begin building the infrastructure to support widespread adoption of interactive data. Companies have told us that the substantial benefits of implementing XBRL will exceed the minimal costs. In addition to providing far more useful information to investors, I believe the use of interactive data can make companies' internal processes more efficient, saving investors' dollars for the costs of registration and compliance reporting to the SEC. It would also make the SEC's own disclosure reviews more productive.

We are also hard at work addressing the question of shareholder access to the company's proxy materials – the second time this decade that the Commission has faced this question. The Commission has recently released two very different proposals for comment and thus my comments on these proposals and the issue of shareholder access to the company's proxy materials are my own and do not necessarily represent the views of my fellow Commissioners. Last September, the Second Circuit invalidated the interpretation of Rule 14a-8(i)(8) that a company may exclude from its proxy materials a shareholder proposal that relates to an election for membership on the company's board of directors. Since the effect of the decision is to create uncertainty about the application of Rule 14a-8, the Commission acted. Moreover, the effect of applying the court's decision as a rule of general application would be to permit director election contests without the disclosures required by the election contest rules.

The Commission considered and approved two different proposals in response to this question so that we will have the benefit of the full breadth of commentary about different ways of addressing this important issue. By considering alternatives, we will have the benefit of thorough analysis of a variety of ways to accomplish our stated objectives. This approach will also give us a richer context in which to evaluate public comment concerning the potential costs and benefits of any new rule.

The first proposal would expressly permit the inclusion of shareholder-proposed bylaws regarding shareholder director nominees in the company's proxy materials. This approach would also ensure that shareholders receive the disclosures currently required under the other proxy rules. And it would require important new disclosures about the shareholder or shareholders who are proposing the bylaw – comparable to those required for a proxy contest. The disclosures would be made under the Schedule 13D/G regime, which requires that shareholders who alone or as part of a group own more than five percent of the company's shares provide certain information about themselves. The shareholder proponent or group of proponents would have complete freedom to structure the bylaw, so long as the procedure for director nominations that it sets out complies with applicable state law and the company's charter and bylaws. This would avoid imposing a federal, one-size-fits-all approach, but rather to promote shareholder choice and private ordering.

In addition, the first proposal includes important new features to facilitate greater online interaction among shareholders and between shareholders and management. It would amend the proxy rules to remove obstacles to electronic shareholder communications. It would clarify that a company or shareholder who maintains an electronic shareholder forum is not liable for statements by any other participant in the forum. It would also eliminate any ambiguity concerning whether participation in an electronic shareholder forum could constitute a proxy solicitation, if such participation occurred more than 60 days prior to a shareholders' meeting.

The second proposal would amend Rule 14a-8(i)(8) to clarify the interpretation of the current rule. That approach would ensure that in all proxy contests, shareholders would receive the disclosures currently required under the other proxy rules. And it would permit the exclusion from the company's proxy materials of all shareholder-proposed bylaws concerning director nominations.

Ultimately, empowering shareholders and issuers is the key to keeping U.S. markets competitive, because capital will flow to where it is treated well – with a firm and fair regulatory regime that serves the common interests of investors and business. We are confronting the challenges and opportunities of more foreign listings here in the United States in a number of ways, not least of which is the growing prevalence of IFRS, or International Financial Reporting Standards. The SEC now reviews IFRS financial statements from foreign issuers, as well as U.S. GAAP statements from domestic issuers.

Last week, the Commission voted unanimously to publish a Concept Release for public comment on allowing U.S. issuers, including investment companies, to prepare their financial statements using International Financial Reporting Standards as published by the International Accounting Standards Board. In June, the Commission proposed to eliminate the U.S. GAAP reconciliation requirement for foreign private issuers that file using IFRS as published by the International Accounting Standards Board. We also have been supportive of the international effort to develop a set of standards that is high-quality, comprehensive, and rigorously applied, because of the significant potential benefit of converging these two standards. A truly global set of standards would allow investors to draw better comparisons among investment options. It would also lower costs for investors and issuers, who would no longer have to incur the cost of maintaining and interpreting financial statements using different sets of accounting standards.

The Commission is also exploring the merits of a "mutual recognition" approach to facilitate global market access. Just last month, the Commission hosted a Roundtable on Mutual Recognition, where distinguished representatives of U.S. and foreign exchanges, global and regional broker-dealers, retail and institutional investors, and others shared their views on the possibility of mutual recognition. Although the details of a viable mutual recognition approach are still in the early stages of development, in essence, it would permit foreign exchanges and broker-dealers to provide services and access to U.S. investors, subject to certain conditions, under an abbreviated registration system. This approach would depend on these entities being supervised in a foreign jurisdiction that provides substantially comparable oversight to that in the U.S.

A mutual recognition regime would consider – for example, under what circumstances foreign exchanges could be permitted to place trading screens with U.S. brokers in the U.S. without full registration. Mutual recognition would also consider under what circumstances foreign broker-dealers that are subject to an applicable foreign jurisdiction's regulatory standards could be permitted to have increased access to U.S. investors without need for intermediation by a U.S.-registered broker-dealer. While this approach could reduce frictions associated with cross-border access, it would not address the significantly greater custodial and settlement costs that are incurred today when trading in foreign markets.

Drawing upon the valuable input received at the Roundtable on Mutual Recognition, Commission staff is developing a proposal regarding mutual recognition for Commission consideration. I expect the staff to have completed its initial work by the fall. In essence, the goal is to develop a regulatory approach that strikes a balance between securing the benefits of greater cross-border access to investment opportunities, while vigorously upholding the Commission's mandate to protect investors, foster capital formation, and maintain fair, orderly, and efficient markets.

Meeting the Emerging Challenges of the Modern Securities Markets

In the rapidly globalizing securities market place, the SEC has a responsibility to be ready to respond to new challenges. When events warrant, we have created special working groups within our Enforcement Division to deal with emerging risks such as stock options backdating and microcap fraud. We are paying particular attention to ensuring the fairness of our trading markets in order to maintain investor confidence in those markets. In the past few years, the Commission has brought numerous enforcement actions alleging that hedge fund portfolio managers engaged in insider trading. We have created a hedge fund working group within our Enforcement Division to, among other things, coordinate and enhance our efforts to combat hedge fund insider trading, including by working with other federal law enforcement agencies and self-regulatory organizations.

In March of this year, the Commission filed cases against 14 defendants alleging one of the most pervasive Wall Street insider trading rings since the days of Ivan Boesky and Dennis Levine. We alleged that participants in the scheme included several hedge funds and their portfolio managers. In another recent case, we charged a pharmaceutical company executive and his three sons in a multimillion dollar insider trading scheme. We alleged that the father regularly tipped his sons with confidential information misappropriated from his employer, and that the family created a purported hedge fund to conduct the trading and further obscure their identities. In these and other cases, we have worked side-by-side with criminal authorities that have brought their own cases in connection with the illegal conduct.

We have also brought a number of enforcement actions against hedge funds and their portfolio managers who, we alleged, made millions of dollars by trading illegally on inside information regarding upcoming public announcements of private investment in public equity (PIPE) stock offerings. In addition, the Commission has brought cases against hedge fund managers that we charged with trading on the basis of inside information ahead of mergers and acquisitions.

We have also moved to keep our rules up to date, to ensure that we have the necessary tools to prosecute fraud wherever it may arise. Earlier this month, the Commission voted to adopt a new antifraud rule prohibiting investment advisers to pooled investment vehicles, including hedge funds, from defrauding investors and prospective investors in the funds. The rule responds to a 2006 court decision, Goldstein v. SEC, which created uncertainty about whether the Investment Advisers Act's antifraud provisions protect investors in the hedge fund and not just the fund itself. The rule helps the Commission police this market – to deter misconduct and to call to task those who engage in misconduct.

Another area that has been the focus of significant attention is the municipal securities market. This market is vitally important because of its size and the effect it has on the lives of every individual, and on the business of every company in the United States. There now are more than $2.4 trillion of municipal securities outstanding and last year alone, more than $430 billion of new municipal bonds and notes were issued.

When the federal securities laws were enacted more than 70 years ago, the municipal bond market was relatively small and it was dominated by institutional investors. But today fully 36% of all municipal securities are owned directly by households. And another 33% of the total municipals market is held indirectly through money market funds, mutual funds, and closed-end funds. And despite its reputation as a "buy and hold" market, municipals trading volume at over $6 trillion in 2006 is similar to what we see in the corporate bond market.

While the SEC has antifraud authority – which means that we can come in and clean up municipal messes after the fact – we do not have the authority in the municipal market that we have in the corporate securities market to insist on disclosure of material information to investors at the time the securities are being sold.

Last week, I sent a letter to this Committee offering my view that the best way to address the problems and needs of municipal securities investors in a coherent manner is through legislation designed with the modern realities of today's trading market in mind. Any legislation must keep the need of municipal issuers to have access to capital at the lowest possible cost firmly in mind. And while the regulation of today's highly efficient capital markets for non-municipal issuers offers a blueprint for balancing efficiency and investor protection, the model of full registration and regulation applicable to private companies is not necessary for states and local governments. Instead, legislation could focus on making disclosure information available on a more timely basis – before the sale of municipal securities; mandating municipal issuer use of "generally accepted" governmental accounting standards; requiring or permitting SEC oversight of the independent accounting standards setter, the Governmental Accounting Standards Board; and clarifying the legal responsibilities of issuer officials, underwriters, bond counsel, and other participants in offerings.

As we work to promote a more transparent municipals securities market, we are also interested in promoting transparency in the mutual fund market. Because nearly half of the $3 trillion that Americans have invested through defined contribution plans is in mutual funds, the Commission is hard at work on a simplified, plain English disclosure for mutual funds that would give investors what they need to know, in a form they can use. This new, streamlined disclosure document would provide better information about investment objectives, strategies, risks, and costs. Ideally, that information could be made available online, or in writing – as the investor prefers. We are working with the Department of Labor to make this simplified disclosure available to all 401(k) plan participants invested in mutual funds, because every investor deserves to understand the expenses he or she is being charged and the returns he or she is actually getting. We are also considering making information about funds and the brokers that sell them available at the point of sale.

This is not just a matter of clearer writing, but also of clarifying our regulations concerning mutual fund fees and expenses. So the Commission is conducting a thorough review of mutual fund fees and expenses, and the disclosure of these costs to investors. That review includes an examination of the $12 billion that investors now pay each year in Rule 12b-1 fees. I have also called on Congress to consider the future of the so-called "soft dollars" that brokers receive from mutual funds to pay for things other than executing brokerage transactions.

Finally, the SEC is grappling with how to handle the rising prominence of sovereign wealth funds in the global capital markets. Sovereign wealth funds are government investment vehicles which are funded by foreign exchange assets, and which manage those assets separately from the official reserves of the country's monetary authorities. Sovereign wealth funds are not a new phenomenon, but their recent substantial growth and footprint in the global financial marketplace has been dramatic. Published research has indicated that the total sovereign-wealth funds in the world could reach $12 trillion from the current $2.5 trillion by 2015, and could exceed the total size of the world's official reserves within five years. Today sovereign wealth funds are larger than all the world's hedge funds combined and they are significantly less transparent. These funds are being created with the stated objective of obtaining greater returns on national reserves than those obtained by holding sovereign debt or other traditional investments, albeit with greater exposure to risk. However, the combination of the growing governmental (and potentially political) influence over capital market flows that sovereign wealth fund portend, together with the funds' lack of transparency, presents challenges to a regulatory system premised on free markets, the free flow of information, and investor incentives based on profit and loss. We are working on many of the issues raised by the growth of these funds with others in the U.S. Government through the President's Working Group, and internationally through such groupings such as the Financial Stability Forum, to help ensure that the issues raised by sovereign wealth funds are fully addressed.

Mr. Chairman, this is a necessarily summary description of just some of the most important work underway at the Securities and Exchange Commission. But it is a fair survey of the regulatory and enforcement landscape, and the domestic and international challenges we face in the days ahead.

Thank you for this opportunity to appear before the Committee. I look forward to working with you to meet the needs of our nation's investors, issuers, and markets, and I would be happy to answer any questions you may have.