Testimony on "Oversight of Financial Stability and Data Security"
by
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Chairman Johnson, Ranking Member Crapo, and members of the Committee,

Thank you for inviting me to testify about the Securities and Exchange Commission's ("SEC" or "Commission") ongoing implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act") and our efforts regarding data security.[1]

The SEC's overarching mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The Dodd-Frank Act gave the SEC significant new responsibilities over, among other things, municipal advisors, hedge fund and other private fund advisers, and over-the-counter derivatives. The Act also established a new whistleblower program designed to strengthen the SEC's enforcement functions, enhanced the SEC's authority over credit rating agencies and clearing agencies, and strengthened the regulation of asset-backed securities. Implementing these new responsibilities has required the SEC to undertake one of the largest and most complex rulemaking agendas in the history of the agency, with more than 90 provisions that require SEC rulemaking and more than 20 other provisions that require studies or reports. In addition, the Act and the financial crisis focused the SEC's efforts more directly on enhancing financial stability and the reduction of systemic risk.

The SEC has made substantial progress implementing this agenda. Since I arrived at the Commission in April 2013, we have advanced rules and other initiatives across the wide range of regulatory objectives set by the Dodd-Frank Act, as well as the Jumpstart Our Business Startups ("JOBS") Act. Among other areas, our efforts under the Dodd-Frank Act have covered:

- The registration and regulation of over a thousand municipal advisors;
- The assessment and analytical deployment of the first complete set of data from Form PF filings by registered advisers to private funds, including hedge funds and private equity funds, so that the SEC and the Financial Stability Oversight Council ("FSOC") can better assess the impact of these funds on financial stability;
- The cross-border application of our security-based swap rules in the global swaps market;

[1] The views expressed in this testimony are those of the Chair of the Securities and Exchange Commission and do not necessarily represent the views of the full Commission.

- Proprietary trading and investments in private funds by banks and their affiliates, under what is commonly called the "Volcker Rule";

- Further safeguarding the custody of customer funds and securities by broker-dealers and the framework under which such custody is independently audited;

- The removal of references to nationally recognized statistical rating organization ("NRSRO") ratings in our broker-dealer and investment company regulations;

- The disclosure of the ratio of the compensation a company pays to its CEO relative to the compensation it pays its median employee;

- The disqualification of felons and other "bad actors" from important private securities offering exemptions;

- The retention of a certain amount of credit risk by securitizers of asset-backed securities; and

- Programs established by broker-dealers, investment companies, and other regulated entities to address risks of identity theft.

These efforts are in addition to the rules we have proposed or adopted to implement the JOBS Act, including rules intended to increase access to capital for smaller companies by permitting the use of general solicitation in certain private offerings, crowdfunding, and updating and expanding the Regulation A exemption. Despite our significant progress, work remains to be done with respect to both statutes. To that end, completing the rulemakings and studies mandated by Congress in these two statutes remains among the top priorities for the Commission.

As requested by the Committee, my testimony today will provide an overview of the Commission's Dodd-Frank Act implementation and discuss those rules which are yet to be completed.[2]

Municipal Securities

The Dodd-Frank Act included several provisions related to the municipal securities market, which encompasses over $3.7 trillion in outstanding municipal securities, over 44,000 municipal issuers, and an average of over 12,000 bond issues annually. The Act created a new class of regulated persons, "municipal advisors," and requires these advisors to register with the SEC. This registration requirement applies to persons who provide advice to municipal entities or obligated persons on municipal financial products or the issuance of municipal securities, or

[2] A list of the rulemaking provisions in the Dodd-Frank Act applicable to the SEC is attached as Appendix A.

who solicit municipal entities or obligated persons.[3] In September 2013, the Commission adopted final rules for municipal advisor registration.[4]

The final rules provide guidance on the statutory definition of the term "municipal advisor," the statutory exclusions from that definition, and certain additional regulatory exemptions. The new registration requirements and regulatory standards are intended to mitigate some of the problems observed with the conduct of some municipal advisors, including "pay to play" practices, undisclosed conflicts of interest, advice rendered by financial advisors without adequate training or qualifications, and failure to place the duty of loyalty to their clients ahead of their own interests. Compliance with the final rules will be required on July 1, 2014,[5] with a phased-in compliance period for registration using the final forms beginning on that day and ending on October 31, 2014.

The Dodd-Frank Act also required the Commission to establish an Office of Municipal Securities ("OMS"), reporting directly to the Chair, to administer the rules pertaining to broker-dealers, municipal advisors, investors and issuers of municipal securities, and to coordinate with the Municipal Securities Rulemaking Board ("MSRB") on rulemaking and enforcement actions.[6] During its first year of operations, OMS devoted its attention primarily to finalizing the municipal advisor registration final rules and presenting these final rules for the Commission's consideration. Over the next year, OMS expects to devote significant attention to implementing these final rules, including providing interpretive guidance to market participants, participating in the review of municipal advisor registrations, and reviewing a significant number of rule filings by the MSRB related to municipal advisor regulation. In addition, OMS also continues to monitor current issues in the municipal securities market (such as pension disclosure, accounting, and municipal bankruptcy issues) and to assist in considering further recommendations to the Commision with respect to disclosure, market structure, and price transparency in the municipal securities markets.[7]

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[3] In September 2010, the Commission adopted, and subsequently extended, an interim final rule establishing a temporary means for municipal advisors to satisfy the registration requirement. *See* Release No. 34-62824, *Temporary Registration of Municipal Advisors*, (September 1, 2010), http://www.sec.gov/rules/interim/2010/34-62824.pdf. The Commission has received over 1,100 confirmed registrations of municipal advisors pursuant to this temporary rule.

[4] *See* Registration of Municipal Advisors, Release No. 34-70462 (September 20, 2013), http://www.sec.gov/rules/final/2013/34-70462.pdf. *See also* Registration of Municipal Advisors Frequently Asked Questions (issued on January 10, 2014 and last updated on January 16, 2014), http://www.sec.gov/info/municipal/mun-advisors-faqs.pdf. The staff in the Office of Municipal Securities provided this interpretive guidance to address certain questions that arose from municipal market participants relating to the implementation of the final rules.

[5] *See* Release No. 34-71288, *Registration of Municipal Advisors; Temporary Stay of Final Rule*, (January 13, 2014), http://www.sec.gov/rules/final/2014/34-71288.pdf.

[6] *See* § 979 of the Dodd-Frank Act.

[7] *See* recommendations in the Commission's Report on the Municipal Securities Market (July 31, 2012), http://www.sec.gov/news/studies/2012/munireport073112.pdf.

Private Fund Adviser Registration and Reporting

Title IV of the Dodd-Frank Act directed the Commission to implement a number of provisions designed to enhance the oversight of private fund advisers, including registration of advisers to hedge funds and other private funds that were previously exempt from SEC registration. These provisions enable regulators to have a more comprehensive view of private funds and the investment advisers managing those assets.

The SEC's implementation of required rulemaking under Title IV is complete. In June 2011, the Commission adopted rules requiring advisers to hedge funds and other private funds to register by March 2012, addressing what had once been a sizable "blind spot" in regulators' ability to monitor for systemic risk and potential misconduct.[8] As a result of the Dodd-Frank Act and the SEC's new rules, the number of SEC-registered private fund advisers has increased by more than 50% to 4,136 advisers. Even after accounting for the shift of mid-sized advisers to state registration pursuant to the Dodd-Frank Act,[9] the total amount of assets managed by SEC-registered advisers has increased significantly from $43.8 trillion in April 2011 to $55.4 trillion in December 2013, while the total number of SEC-registered advisers dropped only slightly from 11,505 to 10,920. It is also worth noting that the newly-registered private fund advisers typically have investment strategies, potential conflicts, and other regulatory issues that are much more complex than the advisers that switched to state registration.

Concurrently with the rules requiring the registration of private fund advisers, the Commission adopted rules to implement new adviser registration exemptions created by the Dodd-Frank Act.[10] The new rules implemented exemptions for advisers to venture capital funds and for advisers to private funds with less than $150 million in assets under management in the United States. Consistent with the Dodd Frank Act, these exempt reporting advisers are now required to file basic reporting information each year with the Commission, but are not subject to routine examination. Today, there are approximately 2,500 exempt reporting advisers that have filed reports with respect to almost 8,000 private funds with total assets of over $2.4 trillion.

For private fund advisers required to be registered with the Commission, pursuant to the Dodd-Frank Act, the Commission adopted confidential systemic risk reporting requirements on Form PF in October 2011 to assist the FSOC in systemic risk oversight.[11] As required by the

[8] *See* Release No. IA-3221, *Rules Implementing Amendments to the Investment Advisers Act of 1940* (June 22, 2011), http://www.sec.gov/rules/final/2011/ia-3221.pdf.

[9] *See* Release No. IA-3221, *Rules Implementing Amendments to the Investment Advisers Act of 1940* (June 22, 2011), http://www.sec.gov/rules/final/2011/ia-3221.pdf.

[10] *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.

[11] *See* Release No. IA-3308, *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF; Joint Final Rule* (October 21, 2011), http://www.sec.gov/rules/final/2011/ia-3308.pdf.

Act, Form PF was designed in consultation with FSOC, and the data filed on Form PF has been made available to the Office of Financial Research within the Department of the Treasury.

As a result of staggered filing dates, the Commission first received a full complement of Form PF filings last year. To date, approximately 2,400 investment advisers have filed reports on approximately 7,000 hedge funds, 66 liquidity funds and 6,000 private equity funds. Consistent with enhanced confidentiality provisions established under the Dodd-Frank Act for information collected on Form PF, filings are made on a secure filing system that encrypts data, and Commission staff has designed and implemented controls for handling of Form PF data across the agency. Commission staff also uses the data in connection with the Commission's regulatory mission, including in examinations, investigations, and investor protection efforts. As required by the Dodd-Frank Act, Commission staff transmitted a report to Congress this past July on these uses.[12] Use of the new Form PF data has been a helpful supplement to the staff's overall efforts to enhance monitoring of the investment advisory industry to identify trends and emerging risks.

We recognize that the Dodd-Frank Act mandates new registration and compliance responsibilities for many private fund advisers. As a result, Commission staff has sought to better understand and take into account private fund business models and the needs of private fund investors. During 2013, Commission staff reviewed the Advisers Act and its rules and provided guidance regarding their application to private fund advisers, including guidance to clarify: when an adviser to an audited private fund may itself maintain custody of private stock certificates instead of holding them at a third party custodian;[13] when certain private fund investors are qualified clients under the Advisers Act;[14] and the application of the venture capital exemption in certain common scenarios.[15]

In addition, Commission staff has launched an initiative to conduct focused, risk-based exams of newly registered private fund advisers. These "presence" examinations are shorter in duration and more streamlined than typical examinations, and are designed both to engage with the new registrants to inform them of their obligations as registered entities and to permit the Commission to examine a higher percentage of new registrants. The initiative includes examinations, outreach, and, where appropriate, written publications highlighting exam findings. SEC examination staff has identified five critical areas that are the focus of these examinations: (1) marketing; (2) portfolio management; (3) conflicts of interest; (4) safety of client assets; and

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[12] *See Annual Staff Report Regarding the Use of Data Collected from Private Fund Systemic Risk Reports* (July 25, 2013), http://www.sec.gov/news/studies/2013/im-annualreport-072513.pdf.

[13] *See* IM Guidance Update, *Privately Offered Securities under the Investment Adviser Act Custody Rule* (August 2013), http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-04.pdf.

[14] *See* IM Guidance Update, *Status of Certain Private Fund Investors as Qualified Clients* (November 2013), http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-10.pdf.

[15] *See* IM Guidance Update, *Guidance on the Exemption for Advisers to Venture Capital Funds* (December 2013), http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-13.pdf.

(5) valuation. As of early January 2014, staff had completed approximately 250 examinations of newly registered private fund advisers and had over 30 additional examinations underway.

Whistleblower Program

Pursuant to Section 922 of the Dodd-Frank Act, the SEC established a whistleblower program to pay awards to eligible whistleblowers who voluntarily provide the agency with original information about a violation of the federal securities laws that leads to a successful SEC enforcement action in which over $1 million in sanctions is ordered. The SEC's Office of the Whistleblower, which administers the program, filed its third Annual Report to Congress on November 15, 2013.[16] As detailed in the Annual Report, during FY 2013 the Commission received 3,238 tips from whistleblowers in the United States and 55 other countries. The high quality information that we have been receiving from whistleblowers has, in many instances, allowed our investigative staff to work more efficiently and permitted us to better utilize agency resources. In addition, on September 30, 2013, the Commission made its largest whistleblower award to date under the program, awarding over $14 million to a whistleblower whose information led to an SEC enforcement action that recovered substantial investor funds.[17] We expect future payments to further increase the visibility and effectiveness of this important enforcement initiative.

Over-the-Counter Derivatives

The Dodd-Frank Act established a new oversight regime for the over-the-counter derivatives marketplace. Title VII of the Act requires the Commission to regulate "security-based swaps" and to write rules that address, among other things: mandatory clearing; trade reporting and trade execution; the operation of clearing agencies, trade data repositories, and trade execution facilities; capital, margin, and segregation requirements and business conduct standards for dealers and major market participants; and public transparency for transactional information. Such rules are intended to achieve a number of goals, including:

- Facilitating the centralized clearing of security-based swaps, whenever possible and appropriate, with the intent of reducing counterparty and systemic risk;
- Increasing transparency for market participants and regulators in their efforts to monitor the market and, as appropriate, address risks to financial stability;
- Increasing security-based swap transaction disclosure;

[16] *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2013* (November 2013), http://www.sec.gov/about/offices/owb/annual-report-2013.pdf.

[17] *See In the Matter of Claim for Award*, SEC Release No. 34-70554 (September 30, 2013), http://www.sec.gov/rules/other/2013/34-70554.pdf, and *SEC Awards more than $14 Million to Whistleblower*, SEC Release No. 2013-209 (October 1, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539854258.

- Reducing counterparty and systemic risk through capital, margin and segregation requirements for non-bank dealers and major market participants; and

- Addressing potential conflict of interest issues relating to security-based swaps.

The Commission issued a sequencing policy statement in June 2012 describing, and requesting public comment on, the order in which it expects to require compliance by market participants with its final Title VII rules.[18] The policy statement is part of our overall commitment to making sure that market participants know what the "rules of the road" are before requiring compliance with those rules. The statement emphasizes that those subject to the new regulatory requirements from these rules will be given adequate, but not excessive, time to come into compliance with them. As part of this commitment, the Commission also has taken a number of steps to provide legal certainty and avoid unnecessary market disruption pending implementation of Title VII.[19]

Consistent with this policy statement, the Commission has proposed substantially all of the core rules required by Title VII, proposed rules and interpretive guidance addressing the application of Title VII in the cross-border context, and adopted several key final rules and interpretations. In anticipation of additional final rulemakings, the Commission also last year

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[18] *See* Release No. 34-37177*, Statement of General Policy on the Sequencing of the Compliance Dates for Rules Applicable to Security-Based Swaps* (June 11, 2012), http://www.sec.gov/rules/policy/2012/34-67177.pdf.

[19] These steps include guidance regarding which provisions in Title VII governing security-based swaps became operable as of the effective date of Title VII, as well as temporary relief from several other provisions. *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.

In addition, the Commission has provided guidance regarding – and, where appropriate, interim exemptions from – the various pre-Dodd-Frank provisions that otherwise would have applied to security-based swaps on the effective date. *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; Release No. 34-68864, *Order Extending 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* (February 7, 2013), http://www.sec.gov/rules/exorders/2013/34-68864.pdf; Release No. 33-9231, *Exemptions for Security-Based Swaps* (July 1, 2011), http://www.sec.gov/rules/interim/2011/33-9231.pdf; and Release No. 33-9383, *Extension of Exemptions for Security-Based Swaps* (January 29, 2013), http://www.sec.gov/rules/interim/2013/33-9383.pdf.

The Commission has also provided temporary relief for entities providing certain clearing services for security-based swaps. *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.

reopened the comment periods for all of its proposals under Title VII. Continuing to complete Title VII rules is a priority for 2014.[20]

In implementing Title VII, Commission staff has consulted regularly with staff of the Commodity Futures Trading Commission ("CFTC"), as well as the staffs of the Board of Governors of the Federal Reserve System ("Board") and other federal financial regulators. We will continue to consult and coordinate with the CFTC to assure consistency and comparability to the extent possible. The Commission staff also has been actively engaged in ongoing discussions with domestic and foreign regulators regarding the direction of international derivatives regulation and the Commission's efforts to implement Title VII, including participation in the Financial Stability Board and the International Organization of Securities Commissions, and engaging in regulatory dialogues with other countries about our respective regulatory reform efforts.

The Commission's more recent efforts to implement Title VII are discussed below in more detail.

Proposal of Rules Regarding the Application of Title VII in the Cross-Border Context

Given the highly global nature of the derivatives market, the application of Title VII in the cross-border context is a key implementation issue. In May 2013, the Commission issued a comprehensive proposal regarding the application of Title VII to cross-border security-based swap transactions (the "Cross-Border Proposal").[21] The Cross-Border Proposal includes proposed rules and interpretive guidance that, among other things, would inform parties to a security-based swap transaction about which regulatory requirements apply when their transaction occurs in part within and in part outside the United States. In addition, the Cross-Border Proposal provides proposed interpretive guidance regarding when a trading platform or clearing agency is required to register with the Commission.

Under the Cross-Border Proposal, a party may have the ability to comply with Commission requirements in one or more areas covered by the Title VII rules by complying instead with some or all of the requirements of a foreign regulatory regime, provided that those requirements have been determined by the Commission to achieve comparable regulatory outcomes. The Cross-Border Proposal refers to this approach as "substituted compliance." Under substituted compliance, a foreign market participant would be permitted to comply with the requirements imposed by its own home country, so long as those requirements achieve regulatory outcomes comparable with the regulatory outcomes of the relevant provisions of Title VII, as determined by the Commission. If the home country does not have requirements that

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[20] *See* Release No. 34-69491, *Reopening of Comment Periods for Certain Rulemaking Releases and Policy Statement Applicable to Security-Based Swaps Proposed Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act* (May 1, 2013), http://www.sec.gov/rules/proposed/2013/34-69491.pdf.

[21] *See* Release No. 34-69490, *Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants* (May 1, 2013), http://sec.gov/rules/proposed/2012/34-68071.pdf.

achieve comparable regulatory outcomes, substituted compliance would not be permitted and the foreign entity would be required to comply with the applicable U.S. requirements.

The Commission is actively reviewing public input on the Cross-Border Proposal, as well as public comment we have received on other Title VII proposals, including in response to the reopening of the comment periods on those proposals. In addition, we are considering the final cross-border guidance approved by the CFTC on July 12, 2013, public comment on that guidance, and subsequent developments, including a pending legal challenge, related to that guidance.

Adoption of Key Definitional Rules

In July 2012, the Commission adopted final rules and interpretations jointly with the CFTC regarding key product definitions under Title VII.[22] This effort follows the Commission's work on the entity definition rules, which the Commission adopted jointly with the CFTC in April 2012.[23] The completion of these joint rulemakings was a foundational step toward the complete implementation of Title VII.

Although foundational, these final rules did not trigger compliance with the other rules the Commission is adopting under Title VII. Instead, the compliance dates applicable to each final rule will be set forth in the adopting release for the applicable rule in order to better provide for an orderly implementation of the various Title VII rules.

Next Steps for Implementation of Title VII

The Commission staff continues to work to develop recommendations for final rules required by Title VII that have been proposed but not yet adopted. These final rules will address:

- Application of Title VII in the cross-border context;
- Regulatory reporting and post-trade public transparency;[24]

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[22] *See* Release No. 33-9338, *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping* (July 18, 2012) http://www.sec.gov/rules/final/2012/33-9338.pdf.

[23] *See* Release No. 34-66868, *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant"* (April 27, 2012) http://www.sec.gov/rules/final/2012/34-66868.pdf. *See also* Memorandum from the Division of Risk, Strategy, and Financial Innovation, *Information regarding activities and positions of participants in the single-name credit default swap market* (March 15, 2012) http://www.sec.gov/comments/s7-39-10/s73910-154.pdf (analyzing the level of trading activity and positions in the credit default swap market to assist the Commission in evaluating the impact of alternative approaches to implementing *de minimis* exceptions to certain definitions).

[24] *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; and 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. In 2013, the Commission re-proposed Regulation SBSR. *See* Release No. 34-69490, *Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and*

- Security-based swap dealers and major security-based swap participant requirements;[25]

- Mandatory clearing and trade execution, and the regulation of clearing agencies and security-based swap execution facilities;[26] and

- Enforcement and market integrity.[27]

As indicated in the Cross-Border Proposal, the Commission is likely to consider certain of the issues presented in that proposal in an initial cross-border adopting release. Under such an approach, this initial cross-border adopting release would likely focus on adopting key definitions relevant to the application of Title VII in the cross-border context; other matters raised by the Cross-Border Proposal would be addressed in subsequent releases. Such an approach would allow the Commission to consider the cross-border application of the substantive requirements imposed by Title VII in conjunction with the final rules that will implement those substantive requirements.

In addition, I expect that the Commission in the short term will consider rules relating to recordkeeping and reporting requirements for security-based swap dealers and major security-based swap participants. I also expect that the Commission will consider the application of

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Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants (May 1, 2013), http://www.sec.gov/rules/proposed/2013/34-69490.pdf; and Release No. 34-69491.

[25] *See* Release No. 34-65543, *Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants* (October 12, 2011), http://www.sec.gov/rules/proposed/2011/34-65543.pdf; Release No. 34-68071, *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers* (October 18, 2012), http://www.sec.gov/rules/proposed/2012/34-68071.pdf; 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; and 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.

[26] *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; 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; and *Registration and Regulation of Security-Based Swap Execution Facilities* (February 2, 2011), http://www.sec.gov/rules/proposed/2011/34-63825.pdf.

In March 2012, the Commission adopted rules providing exemptions under the Securities Act of 1933 ("Securities Act"), the Securities Exchange Act of 1934 ("Exchange Act"), and the Trust Indenture Act of 1939 for security-based swaps transactions involving certain clearing agencies satisfying certain conditions. *See* Release No. 33-9308, *Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies* (March 30, 2012), http://www.sec.gov/rules/final/2012/33-9308.pdf.

[27] *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.

mandatory clearing requirements to single-name credit default swaps, starting with those that were first cleared prior to the enactment of the Dodd-Frank Act.

Clearing Agencies

Title VIII of the Dodd-Frank Act provides for increased regulation of financial market utilities[28] ("FMUs") and financial institutions that engage in payment, clearing, and settlement activities designated as systemically important. The purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability. In addition, Title VII of the Dodd-Frank Act requires, among other things, that an entity acting as a clearing agency with respect to security-based swaps register with the Commission and that the Commission adopt rules with respect to clearing agencies that clear security-based swaps.

Adoption of Clearing Agency Standards

To further these objectives and promote the integrity of clearing agency operations and governance, the Commission adopted rules in October 2012 requiring all registered clearing agencies to maintain certain standards with respect to risk management and certain operational matters.[29] The rules also contain specific requirements for clearing agencies that perform central counterparty services, such as provisions governing credit exposures and the financial resources of the clearing agency. The rules also establish recordkeeping and financial disclosure requirements for all registered clearing agencies.

These rules benefited from consultations between the Commission staff and staffs of the CFTC and the Board, and take into consideration international standards. The requirements 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.

Systemically Important Clearing Agencies

Under Title VIII, FSOC is authorized to designate an FMU as systemically important if the failure or a disruption to the functioning of the FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. SEC staff participates in the interagency committee established by FSOC to develop a framework for the designation of

[28] 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."

[29] *See* Release No. 34-68080, *Clearing Agency Standards* (October 22, 2012), http://www.sec.gov/rules/final/2012/34-68080.pdf.

systemically important FMUs. In July 2012, FSOC designated six clearing agencies registered with the Commission as systemically important FMUs under Title VIII.[30]

Title VIII also provides a framework for an enhanced supervisory regime for designated FMUs, including oversight in consultation with the Board and FSOC. The Commission is expected to consider regulations containing risk management standards for the designated FMUs it supervises, taking into consideration relevant international standards and existing prudential requirements for such FMUs.[31] The Commission also is required to examine such FMUs annually, and to consider certain advance notices identifying changes to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the FMU in consultation with the Board.[32]

In June 2012, the Commission adopted rules that establish procedures for how it will address advance notices from the FMUs,[33] and it has since considered a significant number of such notices.[34] Commission staff also has completed the first series of annual examinations of the designated FMUs for which it acts as supervisory agency and recently initiated the second series of annual examinations.

Credit Rating Agencies

The Dodd-Frank Act requires the Commission to undertake a number of rulemakings related to NRSROs. The Commission began the process of implementing these mandates with the adoption of a new rule in January 2011[35] requiring NRSROs to provide a description of the

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[30] Clearing agencies that have been designated systemically important are Chicago Mercantile Exchange, Inc., The Depository Trust Company, Fixed Income Clearing Corporation, ICE Clear Credit LLC, National Securities Clearing Corporation, and The Options Clearing Corporation.

[31] *See* § 805(a)(2) of the Dodd-Frank Act. Commission staff also worked jointly with the staffs of the CFTC and the Board to submit a report required under the Dodd-Frank Act to Congress in July 2011 discussing recommendations regarding risk management supervision of clearing entities that are DFMUs. Risk Management Supervision of Designated Clearing Entities, Report by the Commission, Board and CFTC to the Senate Committees on Banking, Housing, and Urban Affairs and Agriculture in fulfillment of Section 813 of Title VIII of the Dodd-Frank Act (July 2011), http://www.sec.gov/news/studies/2011/813study.pdf.

[32] *See* § 806(e)(4) of the Dodd-Frank Act.

[33] *See* Release No. 34-67286, *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* (June 28, 2012), http://www.sec.gov/rules/final/2012/34-67286.pdf.

[34] Advance notices are published on the Commission website at http://www.sec.gov/rules/sro.shtml.

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

representations, warranties, and enforcement mechanisms available to investors in an offering of asset-backed securities, including how they differ from those of similar offerings. In May 2011, the Commission proposed a series of rules to further implement the NRSRO provisions of the Dodd-Frank Act,[36] which would require NRSROs to: (1) report on internal controls; (2) protect against potential conflicts of interest; (3) establish professional standards for credit analysts; (4) publicly provide – along with the publication of the credit rating – disclosure about the credit rating and the methodology used to determine it; and (5) enhance their public disclosures about the performance of their credit ratings. I expect that the Commission will consider final rules in the near future.

Additionally, the Dodd-Frank Act requires each federal agency, to the extent applicable, to review its regulations that require use of credit ratings as an assessment of the credit-worthiness of a security, remove these references, and replace them with appropriate standards of credit-worthiness. The Commission has adopted final amendments that remove references to credit ratings from most of its rules and forms that contained such references, including rules adopted in December 2013 removing references to credit ratings in certain provisions applicable to investment companies and broker-dealers.[37] In the short term, I expect that the Commission will vote on new requirements to replace the credit rating references in shelf eligibility criteria for asset-backed security issuers with new shelf eligibility criteria.

The Dodd-Frank Act also mandated three studies relating to credit rating agencies: (1) a study on the feasibility and desirability of standardizing credit rating terminology, which was published in September 2012;[38] (2) a study on alternative compensation models for rating structured finance products, which was published in December 2012;[39] and (3) a study on NRSRO independence, which was published in November 2013.[40] In response to the study on

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[36] *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.

[37] *See* Release No. 34-60789, *References to Ratings of Nationally Recognized Statistical Rating Organizations*, (October 5, 2009) (pre Dodd-Frank Act adopting amendments to remove references to credit ratings in certain Commission rules) http://www.sec.gov/rules/final/2009/34-60789.pdf; Release No. 33-9245, *Security Ratings*, (July 27, 2011) (post Dodd-Frank Act adopting amendments to remove references to credit ratings in certain Commission rules) http://www.sec.gov/rules/final/2011/33-9245.pdf; Release No. 33-9506, *Removal of Certain References to Credit Ratings Under the Investment Company Act*, (December 27, 2013) (post Dodd-Frank Act adopting amendments to remove references to credit ratings in certain Commission rules), http://www.sec.gov/rules/final/2013/33-9506.pdf; Release No. 34-71194, *Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934*, (December 27, 2013) (post Dodd-Frank Act adopting amendments to remove references to credit ratings in certain Commission Rules), http://www.sec.gov/rules/final/2013/34-71194.pdf.

[38] *Credit Rating Standardization Study* (September 2012), http://www.sec.gov/news/studies/2012/939h_credit_rating_standardization.pdf.

[39] *Report to Congress on Assigned Credit Ratings* (December 2012), http://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf.

[40] *Report to Congress on Credit Rating Agency Independence Study* (November 2013), http://www.sec.gov/news/studies/2013/credit-rating-agency-independence-study-2013.pdf.

alternative compensation models for rating structured finance products, the Commission held a public roundtable in May 2013 to invite discussion regarding, among other things, the courses of action discussed in the report. The staff has considered the various viewpoints presented during discussion at the roundtable, as well as in the related public comment letters, and I expect that they will be presenting to the Commission a recommendation for its consideration.

As required by the Dodd-Frank Act, the Commission established an Office of Credit Ratings ("OCR") charged with administering the rules of the Commission with respect to NRSROs, promoting accuracy in credit ratings issued by NRSROs, and helping to ensure that credit ratings are not unduly influenced by conflicts of interest and NRSROs provide greater disclosure to investors.[41] The Dodd-Frank Act requires OCR to conduct examinations of each NRSRO at least annually and the Commission to make available to the public an annual report summarizing the essential exam findings. The third annual report of the staff's examinations was published in December 2013.[42] The staff will continue to focus on completing the annual examinations of each NRSRO, including follow-up from prior examinations, to promote compliance with statutory and Commission requirements. OCR also has established "colleges" of regulators to provide a framework for information exchange and collaboration with foreign counterparts regarding large, globally-active credit rating agencies.[43] The first meetings of the colleges were held in November 2013.

Asset-Backed Securities

The Commission has made significant progress in implementing the provisions of the Dodd-Frank Act related to asset-backed securities ("ABS"). The Commission is working with other regulators to jointly develop the risk retention rules required by Section 941 of the Act, which will address the appropriate amount, form, and duration of required risk retention for ABS securitizers. In March 2011, the Commission joined its fellow regulators in issuing for public comment proposed risk retention rules to implement Section 941.[44] We carefully considered the

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[41] OCR's scope for NRSRO examinations includes all eight areas required by the Dodd-Frank Act. OCR conducts annual, risk-based examinations of all registered NRSROs to assess and promote compliance with statutory and Commission requirements, monitors the activities of NRSROs, and provides guidance with respect to the Commission's policy and regulatory initiatives related to NRSROs. OCR also conducts special risk-targeted examinations based on credit market issues and concerns and to follow up on tips, complaints, and NRSRO self-reported incidents.

[42] *2013 Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization* (December 2013), http://www.sec.gov/news/studies/2013/nrsro-summary-report-2013.pdf.

[43] *See Supervisory Colleges for Credit Rating Agencies – Final Report* (July 2013), http://www.iosco.org/library/pubdocs/pdf/IOSCOPD416.pdf.

[44] *See* Release No. 34-64148, *Credit Risk Retention* (March 30, 2011), http://www.sec.gov/rules/proposed/2011/34-64148.pdf. Section 941 of the Act generally requires the Commission, the Board, the Federal Deposit Insurance Corporation, the 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 ABS, transfers, sells, or conveys to a third party. It also provides that

many comments received on the original proposal and engaged in further analysis of the securitization and lending markets,[45] ultimately re-proposing the credit risk retention rules with several important modifications in August 2013.[46]

As under the original proposal, a sponsor generally would be permitted under the re-proposal to satisfy its risk retention requirement by choosing from a menu of options designed to provide flexibility while also ensuring that sponsors actually retain credit risk. The re-proposed rules would significantly increase the degree of flexibility that sponsors would have to meet the risk retention requirements. The re-proposed rules also include exemptions from risk retention for certain resecuritizations, seasoned loans, and certain types of securitization transactions with low credit risk. Also, as required by Section 941, the re-proposal provides an exemption from the risk retention requirements for ABS collateralized solely by qualified residential mortgages ("QRMs"). The re-proposal would equate the QRM definition to the definition of qualified mortgage ("QM") adopted by the Consumer Financial Protection Bureau,[47] but also requests comment on an alternative approach to QRM that would add a 70% loan-to-value requirement and certain credit history-related factors.[48] The staff currently is considering the numerous comments received on the re-proposal and working with the other agencies' staff to move forward with appropriate recommendations for a final rule.

In addition, in August 2011, the Commission adopted rules in connection with Section 942(a) of the 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 new rules 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.[49] I expect that in the short term the Commission will consider new requirements for enhanced disclosures for ABS, including requiring standardized asset-level data for certain asset

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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. *See* 15 U.S.C. §78o-11(c)(1)(A).

[45] *See, e.g.*, Division of Economic and Risk Analysis White Paper, *Qualified Residential Mortgage: Background Data Analysis on Credit Risk Retention* (August 2013) (analyzing serious delinquencies among non-GSE securitized mortgages in order to address public comment and to aid in the understanding of potential economic effects related to the definition of QRM), http://www.sec.gov/divisions/riskfin/whitepapers/qrm-analysis-08-2013.pdf.

[46] *See* Release No. 33-34-70277, *Credit Risk Retention* (August 28, 2013), http://www.sec.gov/rules/proposed/2013/34-70277.pdf.

[47] *See* 78 FR 6407 (January 30, 2013), as amended by 78 FR 35429 (June 12, 2013) and 78 FR 44686 (July 24, 2013).

[48] This credit overlay is designed to approximate a 690 FICO score without building into the rule reliance on a private credit rating.

[49] *See* Release No. 34-65148, *Suspension of the Duty to File Reports for Classes of Asset-Backed Securities under Section 15(d) of the Securities Exchange Act of 1934* (August 17, 2011), http://www.sec.gov/rules/final/2011/34-65148.pdf.

classes. If adopted, the new requirements would implement Section 942(b) of the Act, which requires the Commission to adopt regulations to require asset-level information.

In January 2011, the Commission also adopted rules on the use of representations and warranties in the market for ABS as required by the Act's Section 943.[50] The rules require ABS issuers to disclose the history of repurchase requests received and repurchases made relating to their outstanding ABS, and these disclosure filings commenced in February 2012. The disclosure requirements apply to issuers of registered and unregistered ABS, including municipal ABS. The Commission also adopted rules in January 2011 to implement Section 945 of the Dodd-Frank Act, which required an asset-backed issuer transaction registered under the Securities Act to perform a review of the assets underlying the ABS and disclose the nature of such review.[51] Under the final rules, the type of review conducted may vary, but at a minimum must be designed and effected to provide reasonable assurance that the prospectus disclosure about the assets is accurate in all material respects.

In September 2011, the Commission proposed a rule to implement Section 621 of the Act, which prohibited entities that create and distribute ABS from engaging in transactions that involve or result in material conflicts of interest with respect to the investors in such ABS.[52] The proposed rule would prohibit underwriters and other "securitization participants" from engaging in such transactions with respect to both non-synthetic and synthetic asset-backed securities, whether in a registered or unregistered offering. The proposal is not intended to prohibit legitimate securitization activities, and the Commission asked questions in the release to help strike the appropriate balance. The Commission received a number of comments on the proposal, and the staff is carefully considering those comments in preparing its recommendation to the Commission.

Investment Advisers and Broker-Dealers' Standards of Conduct

In January 2011, the Commission submitted to Congress a staff study required by Section 913 of the Dodd-Frank Act (the "IA/BD Study"), which addressed the obligations of investment advisers and broker-dealers when providing personalized investment advice about securities to retail customers.[53] The IA/BD Study made two primary recommendations: that the Commission

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[50] *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.

[51] *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.

[52] *See* Release No. 34-65355, *Prohibition against Conflicts of Interest in Certain Securitizations* (September 19, 2011), http://www.sec.gov/rules/proposed/2011/34-65355.pdf.

[53] *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.

(1) exercise the discretionary rulemaking authority provided by Section 913 of the Dodd-Frank Act to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when they are providing personalized investment advice about securities to retail investors; and (2) consider harmonization of broker-dealer and investment adviser regulation when broker-dealers and investment advisers provide the same or substantially similar services to retail investors and when such harmonization adds meaningfully to investor protection.

Shortly before I joined the Commission, the Commission issued a public Request for Data and Other Information (the "Request") specific to the provision of retail investment advice and regulatory alternatives.[54] The Commission sought, among other things, information relating to the potential impacts a uniform fiduciary standard of conduct, or other regulatory approaches, may have on retail customer costs and access to personalized investment advice and product and service offerings, and how such negative impacts could be mitigated.

Serious consideration is being given to the IA/BD Study's recommendations, the views of investors and other interested market participants, potential economic and market impacts, and the information we received in response to the Request in deciding whether, and if so, how, to exercise our rulemaking authority. The Commission staff is also coordinating with, and providing our expertise to, Department of Labor staff as they consider potential changes to the definition of "fiduciary" under the Employee Retirement Income Security Act. I have prioritized the staff's consideration of these inputs and the substantial issues to be decided.

Volcker Rule

On December 10, 2013, the Commission joined the Board, the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC") (collectively, the "Federal banking agencies"), and the CFTC in adopting the same rule under the Bank Holding Company Act to implement Section 619 of the Dodd-Frank Act, generally referred to as the "Volcker Rule."[55]

To create the final rule, staffs from each of the five agencies engaged in a wide-ranging and extensive process to address issues and develop approaches related to effective

[54] *See Request for Data and Other Information: Duties of Brokers, Dealers and Investment Advisers* (March 1, 2013), http://www.sec.gov/rules/other/2013/34-69013.pdf.

[55] *See* Release No. BHCA-1, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds* (December 10, 2013), http://www.sec.gov/rules/final/2013/bhca-1.pdf. The Commodity Futures Trading Commission ("CFTC") adopted the same common rule on the same date. *See* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister121013.pdf. On January 14, 2014, the Commission, together with the federal banking agencies and the CFTC, approved a companion interim final rule that permits banking entities to retain interests in certain collateralized debt obligations backed primarily by trust preferred securities. *See* Release No. BHCA-2, *Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities with Regard to Prohibitions and Restrictions on Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds* (Jan. 17, 2014), http://www.sec.gov/rules/interim/2014/bhca-2.pdf.

implementation of the statute. The Commission, like the other agencies, received and reviewed thousands of comment letters on the statutory mandate and the proposed rules that the Federal banking agencies and SEC jointly published to implement the Volcker Rule.[56] The comments covered a wide spectrum of issues, with many expressing concern about potential negative impacts on market liquidity as well as evasion concerns. The Commission, together with the other agencies, responded to these comments by crafting a rule that both reduces the potential impacts on market liquidity while also addressing concerns about proprietary trading through a robust compliance program.

Consistent with Section 619 and the interagency proposal, the final rule generally prohibits "banking entities" – including bank-affiliated, SEC-registered broker-dealers, security-based swap dealers, and investment advisers – from engaging as principal for their own trading accounts by taking positions in various securities and instruments for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short term price movements.[57] At the same time, the statute and final rule preserve certain essential financial services such as market making and underwriting, which are necessary for raising capital and the healthy functioning of the U.S. financial system, including our securities markets. Consistent with the statute, the final rule does not, however, allow for these specified permitted activities if they involve material conflicts of interest or the employment of high-risk assets or trading strategies, or if they threaten the safety and soundness of banking institutions or U.S. financial stability.

The final rule takes a measured but robust approach to implementing the statutory exemptions from the prohibition on proprietary trading for market making and underwriting. This approach benefited from a consideration of commenter views on potential economic impacts, particularly with respect to liquidity in off-exchange markets, while preserving an appropriate separation between prohibited proprietary trading and activities permitted by the statute, and taking meaningful steps to prevent evasion.

The final rule also implements the statutory provisions limiting the ability of banking entities to sponsor or invest in hedge funds and private equity funds. The Dodd-Frank Act defined a "hedge fund" and "private equity fund" by reference to the regulatory exemptions

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[56] *See* Release No. 34-65545, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds* (October 12, 2011), http://www.sec.gov/rules/proposed/2011/34-65545.pdf. The CFTC issued a substantially similar proposal in January 2012, which was published in the Federal Register in February 2012. *See* 77 FR 8332 (February 14, 2012), http://www.cftc.gov/LawRegulation/FederalRegister/ProposedRules/2012-935.

[57] Section 619 defines "banking entity" as any insured depository institution (other than certain limited purpose trust institutions), any company that controls an insured depository institution, any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (*i.e.*, a foreign entity with a branch, agency, or subsidiary bank operation in the U.S.), and any affiliate or subsidiary of any of the foregoing entities. *See* 12 U.S.C. 1851(h)(1). As set forth in the Dodd-Frank Act, the Commission's final rule applies to banking entities for which the Commission is the primary financial regulatory agency, including, among others, certain SEC-registered broker-dealers, investment advisers, and security-based swap dealers.

under the securities laws commonly used by such funds.[58] The proposal carried forward this definition of a "covered fund," and included in the definition certain commodity pools and foreign funds.

Responding to extensive comments received, the final rule refines the definition of a "covered fund," making clear that certain entities (e.g., entities used for general corporate – rather than investment – purposes; mutual funds and certain foreign funds publicly offered abroad) that should not present the same risks as the covered funds targeted by the statute are excluded. The final rule also takes a tailored approach with respect to foreign funds and commodity pools, and provides an exclusion for loan securitizations to implement the statutory provision regarding the "sale and securitization of loans" by banking entities.

As with any regulatory initiative of this scope and complexity, the final rule demands close attention to the nature and pace of implementation, particularly with respect to smaller banking entities. The final rule's reporting and compliance program requirements are already focusing both the regulatory agencies and firms on implementation. The staged implementation of the required reporting of quantitative trading data will facilitate reporting that is appropriate for the size of the banking entity's trading activities, and allow the agencies to review the merits of the data collected and revise the data collection as appropriate. The threshold for reporting also has been adjusted to help ensure that it will be focused on the largest trading firms. Similarly, the compliance program requirements in the final rule are tiered based on the consolidated size of a firm or its trading activities, and the schedule for compliance will be phased in over time, in order to reduce unnecessary burdens and costs without compromising the objectives of the rule.

Consistent with our experience in other rulemakings, we expect a continued need for guidance regarding questions that will arise as market participants seek to comply with the final rule. We must be alert to both unintended impacts and regulatory loopholes as we move forward. The collaborative relationships among the agencies that developed during the rulemaking process are carrying forward and already are supporting joint and coordinated guidance, such as the recent interim final rule issued by the agencies with respect to the treatment of certain collateralized debt obligations backed by trust-preferred securities.

The agencies have formed an interagency working group that will meet regularly to discuss implementation of the final rule. This interagency group will be instrumental in coordinating the agencies' interpretations and implementation of the final rule on a going-forward basis. The working group's first meeting occurred on January 23 of this year, and the group plans to convene again later this week. Among other things, the group discussed potential methods of coordinating responses to interpretive questions and approaches to supervising and examining banking entities. Such collaboration should carry forward not just in implementing the rule, but also in coordinating the compliance and enforcement of the rule.

[58] Section 619 of the Dodd-Frank Act defines the terms "hedge fund" and "private equity fund" to mean an issuer that would be an investment company, but for section 3(c)(1) or 3(c)(7) of the Investment Company Act, or "such similar funds" as the agencies determine by rule.

Broker-Dealer Audit Requirements

The Dodd-Frank Act provided the Public Company Accounting Oversight Board ("PCAOB") with explicit authority, among other things, to establish, subject to Commission approval, auditing standards for broker-dealer audits filed with the Commission. In August 2013, the Commission amended the broker-dealer financial reporting rule to require that broker-dealer audits be conducted in accordance with PCAOB standards and to more broadly provide additional safeguards with respect to broker-dealer custody of customer securities and funds.[59]

Corporate Governance and Executive Compensation

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

- **Say on Pay.** In accordance with Section 951 of the Act, in January 2011 the Commission adopted rules that require 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.[60] Companies (other than smaller reporting companies) began providing these say-on-pay and "say-on-frequency" advisory votes at shareholder meetings occurring on or after January 21, 2011. The rules provided smaller reporting companies a two-year delayed compliance period for the say-on-pay and "frequency" votes, and those companies began complying with the rules on January 21, 2013. The Commission also proposed rules to implement the Section 951 requirement that institutional investment managers report their votes on these matters at least annually.[61]

- **Pay Ratio Disclosure**. As required by Section 953(b) of the Act, in September 2013, the Commission proposed rules that would amend existing executive compensation rules to require public companies to disclose the ratio of the compensation of a company's chief executive officer to the median compensation of its employees.[62] The proposed rules

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[59] *See* Release No. 43-0073, *Broker-Dealer Reports* (Aug. 21, 2013), http://www.gpo.gov/fdsys/pkg/FR-2013-08-21/pdf/2013-18738.pdf.

[60] *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.

[61] *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.

[62] *See* Release No. 33-9452, *Pay Ratio Disclosure* (September 18, 2013), http://www.sec.gov/rules/proposed/2013/33-9452.pdf.

would allow companies flexibility in developing the disclosure required by the Act by allowing companies to select a calculation methodology that is appropriate to the size and structure of their own businesses and the way they compensate employees. The proposed rules also permit the use of statistical sampling. The Commission has received numerous comments on the proposal, and the staff is working to prepare recommendations for the Commission on a final rule.

- **Compensation Committee and Adviser Requirements.** In June 2012, the Commission adopted rules to implement Section 952 of the Act, which requires the Commission, by rule, to 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.[63] The new rules direct the exchanges to establish listing standards concerning compensation advisers and listing standards that require each member of a listed issuer's compensation committee to be an "independent" member of the board of directors. The rules also require disclosure about the use of compensation consultants and related conflicts of interest. To conform their rules governing independent compensation committees to the new requirements, national securities exchanges that have rules providing for the listing of equity securities filed proposed rule changes with the Commission.[64] The Commission issued final orders approving the proposed rule changes in January 2013.[65]

- **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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[63] *See* Release No. 33-9330, *Listing Standards for Compensation Committees* (June 20, 2012), http://www.sec.gov/rules/final/2012/33-9330.pdf.

[64] *See* Release No. 34-68022 (October 9, 2012), http://www.sec.gov/rules/sro/bats/2012/34-68022.pdf (BATS Exchange, Inc.); Release No. 34-68020 (October 9, 2012), http://www.sec.gov/rules/sro/cboe/2012/34-68020.pdf (Chicago Board of Options Exchange, Inc.); Release No. 34-68033 (October 10, 2012), http://www.sec.gov/rules/sro/chx/2012/34-68033.pdf (Chicago Stock Exchange, Inc.); Release No. 34-68013 (October 9, 2012), http://www.sec.gov/rules/sro/nasdaq/2012/34-68013.pdf (Nasdaq Stock Market LLC); Release No. 34-68018 (October 9, 2012), http://www.sec.gov/rules/sro/bx/2012/34-68018.pdf (Nasdaq OMX BX, Inc.); Release No. 34-68039 (October 11, 2012), http://www.sec.gov/rules/sro/nsx/2012/34-68039.pdf (National Stock Exchange, Inc.); Release No. 34-68011 (October 9, 2012), http://www.sec.gov/rules/sro/nyse/2012/34-68011.pdf (New York Stock Exchange LLC); Release No. 34-68006 (October 9, 2012), http://www.sec.gov/rules/sro/nysearca/2012/34-68006.pdf (NYSEArca LLC); Release No. 34-68007 (October 9, 2012), http://www.sec.gov/rules/sro/nysemkt/2012/34-68007.pdf (NYSE MKT LLC).

[65] *See* Release No. 34-68643 (January 11, 2013), http://www.sec.gov/rules/sro/bats/2013/34-68643.pdf (BATS Exchange, Inc.); Release No. 34-68642 (January 11, 2013), http://www.sec.gov/rules/sro/cboe/2013/34-68642.pdf (Chicago Board of Options Exchange, Inc.); Release No. 34-68653 (January 14, 2013), http://www.sec.gov/rules/sro/chx/2013/34-68653.pdf (Chicago Stock Exchange, Inc.); Release No. 34-68640 (January 11, 2013), http://www.sec.gov/rules/sro/nasdaq/2013/34-68640.pdf (Nasdaq Stock Market LLC); Release No. 34-68641 (January 11, 2012), http://www.sec.gov/rules/sro/bx/2013/34-68641.pdf (Nasdaq OMX BX, Inc.); Release No. 34-68662 (January 15, 2012), http://www.sec.gov/rules/sro/nsx/2013/34-68662.pdf (National Stock Exchange, Inc.); Release No. 34-68635 (January 11, 2013), http://www.sec.gov/rules/sro/nyse/2013/34-68635.pdf (New York Stock Exchange LLC); Release No. 34-68638 (January 11, 2013), http://www.sec.gov/rules/sro/nysearca/2013/34-68638.pdf (NYSEArca LLC); Release No. 34-68637 (January 11, 2013), http://www.sec.gov/rules/sro/nysemkt/2013/34-68637.pdf (NYSE MKT LLC).

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 2011, the Commission published for public comment a proposed rule that would address such arrangements.[66] The Commission has received many 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 making a recommendation for Commission consideration.

- **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 in director elections (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. The Commission has approved changes to the rules with regard to director elections and executive compensation matters for all of the national securities exchanges, and these rules are all now effective.[67]

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,[68] and new disclosure requirements about executive compensation and company performance,[69] and employee and director hedging.[70] The

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[66] *See* Release No. 34-64140 (March 29, 2011), http://www.sec.gov/rules/proposed/2011/34-64140.pdf.

[67] *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. 34-64024 (March 3, 2011), http://www.sec.gov/rules/sro/bx/2011/34-64024.pdf (Boston Options Exchange Group, LLC); 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); Release No. 34-65449 (September 30, 2011), http://www.sec.gov/rules/sro/bats/2011/34-65449.pdf (BATS Exchange, Inc.); Release No. 34-65448 (September 30, 2011), http://www.sec.gov/rules/sro/byx/2011/34-65448.pdf (BATS Y-Exchange, Inc.); Release No. 34-65804 (November 22, 2011), http://www.sec.gov/rules/sro/nsx/2011/34-65804.pdf (National Stock Exchange, Inc.); Release No. 34-66006 (December 20, 2011) http://www.sec.gov/rules/sro/nyseamex/2011/34-66006.pdf. (NYSE Amex LLC); Release No. 34-66192 (January 19, 2012), http://www.sec.gov/rules/sro/nysearca/2012/34-66192.pdf (NYSE Arca, Inc.); and Release No. 68723 (January 24, 2013) (MIAX-2013-02).

[68] *See* § 954 of the Dodd-Frank Act.

[69] *See* § 953(a) of the Dodd-Frank Act.

[70] *See* § 955 of the Dodd-Frank Act.

staff currently is in the process of developing recommendations for the Commission concerning the implementation of these provisions of the 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 adopted final rules for the mine safety provision in December 2011,[71] and companies are currently complying with those rules. In addition, the Commission adopted final rules for disclosure relating to conflict minerals and payments by resource extraction issuers in August 2012.[72]

A lawsuit was filed challenging the resource extraction issuer rules, and in July 2013, the U.S. District Court for the District of Columbia vacated the rules.[73] The Commission did not appeal the decision and is considering the Court's decision in determining how to proceed with the rulemaking to implement the statutory mandate.

A lawsuit also was filed challenging the conflict minerals rule, and in July 2013, the U.S. District Court for the District of Columbia upheld the rule.[74] This ruling, however, has been appealed to the U.S. Court of Appeals for the D.C. Circuit. The Court expedited consideration of the case and the oral argument was held last month. A stay of the conflict minerals rule has not been requested, and issuers are expected to provide their initial filings by May 31, 2014.

Exempt Offerings

In December 2011, the Commission adopted rule amendments to 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.[75] Section 413(a) was effective on the date of

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[71] *See* Release No. 33-9286, *Mine Safety Disclosure* (December 21, 2011), http://www.sec.gov/rules/final/2011/33-9286.pdf.

[72] *See* Release No. 34-67716, *Conflict Minerals* (August 22, 2012), http://www.sec.gov/rules/final/2012/34-67716.pdf and *Disclosure of Payments by Resource Extraction Issuers* (August 22, 2012), http://www.sec.gov/rules/final/2012/34-67717.pdf.

[73] *American Petroleum Institute, et al. v. Securities and Exchange Commission and Oxfam America Inc.*, No. 12-1668 (D.D.C. July 2, 2013).

[74] *National Association of Manufacturers, et al. v. Securities and Exchange Commission, Amnesty International USA, and Amnesty International Ltd.*, 12-1422 (D.D.C. July 23, 2013).

[75] *See* Release No. 33-9287, *Net Worth Standard for Accredited Investors* (December 21, 2011) and (March23, 2012), http://www.sec.gov/rules/final/2011/33-9287.pdf and http://www.sec.gov/rules/final/2012/33-9287a.pdf (technical amendment).

enactment of the Dodd-Frank Act and the implementing rules clarify the requirements and codify them in the Commission's rules. Section 413(b)(2)(A) of the Act requires the Commission to undertake a review of the accredited investor definition in its entirety as it relates to natural persons four years after the enactment of the Act. The staff is currently conducting this review and I expect that the Commission will consider whether to propose any changes to the definition once the review is completed.

Section 926 of the Act requires the Commission 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 adopted final rules to implement this requirement on July 10, 2013, and the rules became effective on September 23, 2013.[76]

Office of Minority and Women Inclusion

In July 2011, pursuant to Section 342 of the Dodd Frank Act, the SEC formally established its Office of Minority and Women Inclusion ("OMWI"). OMWI is responsible for matters related to diversity in management, employment and business activities at the SEC. This includes developing standards for equal employment opportunity and diversity of the workforce and senior management of the SEC, the increased participation of minority-owned and women-owned businesses in the SEC's programs and contracts, and assessing the diversity policies and practices of entities regulated by the SEC.

To improve diversity in our workforce and in our contracts, OMWI has deployed a broad outreach strategy where the SEC participates in minority- and women-focused career fairs, conferences, and business matchmaking events to attract diverse suppliers and jobseekers to the SEC. As a result of its outreach efforts, in FY 2013, 28.4% of the total contract dollars awarded by the SEC were awarded to women and minority contractors, an increase of 6.5% over the prior year. In FY 2013, 33% of new hires were minorities and 40% were women, up from 31% and 36% respectively in FY 2012. OMWI and the Commission are committed to continuing to work proactively to increase the participation of minority-owned and women-owned businesses in our programs and contracting opportunities and to encourage diversity and inclusion in our workforce.

As required by Section 342 of the Dodd-Frank Act, OMWI also continues to make progress on the development of standards and policies relating to regulated entities and contracting. On October 23, 2013, pursuant to section 342(b)(2)(C) of the Act, the SEC, along with the OCC, the Board, the FDIC, the National Credit Union Administration, and the Consumer Financial Protection Bureau, issued an interagency policy statement proposing joint

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[76] *See* Release No. 33-9214, *Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings* (July 10, 2013), http://www.sec.gov/rules/final/2013/33-9414.pdf. On the same date, the Commission also adopted the final rules to eliminate the prohibition against general solicitation in certain Rule 506 offerings. *See* Release No. 33-9415, *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings* (July 10, 2013), http://www.sec.gov/rules/final/2013/33-9415.pdf.

standards for assessing the diversity policies and practices of the institutions they regulate.[77] The proposed standards are intended to promote transparency and awareness of diversity policies and practices within federally regulated financial institutions. On December 19, 2013, the agencies extended the public comment period from December 24, 2013 to February 7, 2014.[78]

Customer Data Protection

SEC Regulations

On April 10, 2013, to implement Section 1088 of the Dodd-Frank Act, the SEC and the CFTC jointly adopted Regulation S-ID, which requires certain regulated financial institutions and creditors[79] to adopt and implement identity theft programs.[80] Regulation S-ID is effective today and requires covered firms to implement policies and procedures designed to:

- identify relevant types of identity theft red flags;
- detect the occurrence of those red flags;
- respond appropriately to the detected red flags; and
- periodically update the identity theft program.

Regulation S-ID also requires entities to provide staff training, oversight of service providers, and provide guidelines for and examples of red flags to help firms administer their programs.

Regulation S-ID builds upon the SEC's existing rules for protecting customer data, in particular Regulation S-P. That regulation requires registered broker-dealers, investment companies, and investment advisers to adopt written policies and procedures instituting administrative, technical, and physical safeguards for the protection of customer records and information.[81] The policies and procedures must be reasonably designed to ensure the security

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77 *See* Release No. 34-70731, *Proposed Interagency Policy Statement Proposing Joint Standards for Assessing the Diversity Policies and Practices of the Entities Regulated by the Agencies and Request for Comment* (Oct. 23, 2013) https://www.sec.gov/rules/policy/2013/34-70731.pdf.

78 *See Public Comment on the Proposed Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies of Practices of Entities Regulated by the Agencies*, (Dec. 19, 2013) https://www.sec.gov/rules/policy/2013/comments-joint-standards-diversity.shtml.

79 Regulation S-ID applies to SEC-regulated entities that meet the definition of "financial institution" or "creditor" under the Fair Credit Reporting Act.

80 *See* Release No. 34-69359, *Identity Theft Red Flags Rules* (April 10, 2013), https://www.sec.gov/rules/final/2013/34-69359.pdf.

81 *See* Release 34-42974, *Privacy of Consumer Financial Information (Regulation S-P)* (June 22, 2000), https://www.sec.gov/rules/final/34-42974.htm. In August 2009, the Commission adopted a related rule prohibiting the use of consumer report information received from an affiliate for marketing purposes, unless the consumer has been given notice and an opportunity to opt out of having the information used for this purpose. *See* Release 34-

and confidentiality of customer records and information, protect against any unanticipated threats or hazards to the security or integrity of customer records and information, and protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer. Regulation S-P also provides protections for the proper disposal of consumer report information and records. These regulations operate in conjunction with other state consumer protection laws, including those state laws that require notification to customers in the event of a data breach.

The guidelines accompanying Regulation S-ID state that the policies and procedures should contain responses to red flags commensurate with the degree of risk posed. In determining an appropriate response, entities covered by Regulation S-ID should consider aggravating factors that may heighten the risk of identity theft, such as a data security incident that results in unauthorized access to account records. Appropriate responses may include, among others:

- Monitoring a covered account for evidence of identity theft;
- Contacting the customer;
- Changing any password, security codes, or other security devices that permit access to a covered account; or
- Notifying law enforcement.

The SEC's authority generally relates to securities transactions and not to retail payment systems, on which the authority generally resides with the banking regulators.

SEC Examination and Enforcement

The SEC monitors and enforces compliance with these rules and regulations through our examination and enforcement programs.[82] In 2013, the SEC's National Exam Program conducted examinations of registrants relating to data protection, including compliance with Regulation S-P. The National Exam Program has included information security as an examination priority in 2014.[83]

60423, *Limitations on Affiliate Marketing (Regulation S-AM)* (August 4, 2009), https://www.sec.gov/rules/final/2009/34-60423.pdf.

[82] In addition, in 2011, the Division of Corporation Finance published guidance that expressed its views regarding the disclosure obligations of registrants relating to cybersecurity risks and cyber incidents. *See* Division of Corporation Finance, *CF Disclosure Guidance: Topic No. 2* (October 13, 2011), http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm.

[83] *See* National Examination Program, Office of Compliance Inspections and Examinations, *Examination Priorities for 2014* at 2 (January 9, 2014), http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf.

In recent years, the SEC's Division of Enforcement has brought actions for failure to comply with Regulations S-P, including a registrant's failure to adopt reasonable policies and procedures that protect customer information from imminent threats and for failure to respond or follow up on security threats despite red flags.[84]

When the SEC is notified that customer information or records have been compromised, the staff's response will depend on the specific facts and circumstances surrounding the event. SEC staff coordinates its response and any resulting investigation as appropriate with other government agencies and law enforcement authorities.

Other Activities to Protect Customer Data

The SEC participates in a number of multilateral initiatives across and between government agencies and the securities industry that focus on protecting customer data. For example:

- In July 2013, Commission staff participated as host regulator in the Securities Industry and Financial Markets Association's ("SIFMA") Quantum Dawn 2 industry test, a simulation designed to test the cyber resilience and crisis management capabilities of the various entities that make up the securities industry, including the SROs and broker-dealers. This one-day simulation included distributed denial of service attacks, the insertion of cyber viruses and the use of an administrator account to sell off targeted stocks. While this exercise identified instances where the industry has made successful efforts to improve its cyber-security capabilities, the results of the test also demonstrated a need for better coordination of information across the industry.

- The Commission is a member of the Financial and Banking Information Infrastructure Committee ("FBIIC"), chaired by the Treasury Department, and the Commission's staff regularly attends FBIIC meetings to discuss the latest cyber threats and business continuity planning efforts within the banking and securities industry. The Commission staff also participates in classified and unclassified briefings organized by security agencies for FBIIC members and the securities industry (through the Financial Services Sector Coordinating Council for Critical Infrastructure and Homeland Security and SIFMA) regarding cyber threats to the financial sector. In addition, the FBIIC collaborates with the FSSCC and the Financial Services Information Sharing and Analysis Center, to facilitate, among other things, the sharing of information concerning cyber threats, vulnerabilities, incidents, potential protective measures and practices.

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[84] *See, e.g., In the Matter of Stephen Derby Gisclair*, SEC Release No. 34-70742 (October 23, 2013), http://www.sec.gov/litigation/admin/2013/34-70742.pdf;
In the Matter of Frederick O. Kraus, SEC Release No. 34-64221 (April 7, 2011), http://www.sec.gov/litigation/admin/2011/34-64221.pdf; and *In the Matter of Commonwealth Equity Services, LLP*, SEC Release No. 34-60733 (September 29, 2009), http://www.sec.gov/litigation/admin/2009/34-60733.pdf.

- The Commission is a member of the Financial Services Sector Committee of the Critical Infrastructure Partnership Advisory Council established by the Department of Homeland Security to facilitate the coordination between federal infrastructure protection programs with the infrastructure activities of the private sector and of state, local, territorial and tribal governments.

- The Commission is a member of the President's Identity Theft Task Force that was established by Executive Order 13402.[85] The President's Task Force is comprised of representatives from 17 agencies and was created to coordinate federal agencies' efforts to combat identity theft. It has made several recommendations over the years relating to the prevention of identity theft, assistance to victims of identity theft, deterrence of identity theft, and a call for legislative action to close gaps in federal criminal statutes to more effectively prosecute and punish identity theft-related offenses.

In addition to these efforts to protect individual consumers' data, in March 2013 the Commission proposed new rules to require certain key market participants (e.g., registered national securities exchanges, certain alternative trading systems, FINRA, and certain clearing agencies) to have comprehensive policies and procedures in place to better insulate market infrastructure technological systems from vulnerabilities.[86]

SEC Resources

Under the Dodd-Frank Act, the SEC collects transaction fees that offset the annual appropriation to the SEC. Accordingly, regardless of the amount appropriated to the SEC, our funding level will not take resources from other agencies, nor will it have an impact on the nation's budget deficit. Since FY 2012, the SEC has not received a significant increase in resources to permit the agency to bring on the additional staff needed to adequately carry out our mission.

This is especially true in light of the Dodd-Frank and JOBS Acts' significant expansions of the SEC's jurisdiction, but would remain true had those extensive additional responsibilities not been added. These new responsibilities cannot be handled appropriately with the agency's existing resource levels without undermining the agency's other core duties, particularly as we turn from rulewriting to implementation and enforcement of those rules.

Additional resources will be vital. We need additional staff experts to focus on enforcement, examinations, and regulatory oversight. The SEC also is aiming to continue investing in its technology capabilities to implement the law and police the markets. In particular, we hope to strengthen our ability to take in, organize, and analyze data on the new markets and entities under the agency's jurisdiction. Additional funding will be essential to that

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[85] Executive Order 13402, "Strengthening Federal Efforts To Protect Against Identity Theft," 71 FR 93 (May 15, 2006).

[86] *See* Release No. 34-69077, *Regulation Systems Compliance and Integrity* (March 8, 2013), http://www.sec.gov/rules/proposed/2013/34-69077.pdf.

effort. Also critical will be the SEC's continued use of the Reserve Fund, established under the Dodd-Frank Act. The SEC dedicated the Reserve Fund to critical IT upgrades, and, if funding permits, plans to continue investing in areas such as data analysis, EDGAR and sec.gov modernization, enforcement and examinations support, and business process improvements.

If the SEC does not receive sufficient additional resources, the agency will be unable to fully build out its technology and hire the industry experts and other staff needed to oversee and police our areas of responsibility, especially in light of the expanding size and complexity of our overall regulatory space. Our nation's markets are the safest and most dynamic in the world, but without sufficient resources, it will become increasingly difficult for our talented professionals to detect, pursue, and prosecute violations of our securities laws as the size, speed, and complexity of the markets grow around us.

Conclusion

To date, the Commission has made tremendous progress implementing the considerable rulemaking mandated by the Dodd-Frank Act. As the Commission strives to complete the remaining work, I look forward to working with this Committee and other stakeholders in the financial marketplace to adopt rules that protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation – as well as take appropriate measures to enhance financial stability and limit potential systemic risks. Thank you for inviting me to share our progress with you. I look forward to answering your questions.