Testimony before the
Subcommittee on Financial Services and General Government
Committee on Appropriations
United States House of Representatives

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

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Chairwoman Emerson, Ranking Member Serrano, Members of the Subcommittee:

Thank you for the opportunity to testify in support of the President's fiscal year (FY) 2013 budget request for the U.S. Securities and Exchange Commission (SEC).[1] I welcome this opportunity to provide additional information on how the SEC would make effective use of the $1.566 billion that is requested for the coming fiscal year.[2]

With this Subcommittee's support, the SEC has continued to make significant progress in improving core operations. Over the past three years, we have focused intensively on revitalizing and restructuring the enforcement and examination functions. We also have taken steps to enhance safeguards for investor assets, improve internal collaboration within the agency, and improve our risk assessment capacity. These efforts are producing demonstrable results. For example, during FY 2011:

- The Commission filed 735 enforcement actions—more than ever filed in a single year in SEC history. The SEC was better able to discover and stop illegal activity earlier and obtained more than $2.8 billion in penalties and disgorgement ordered. Among the cases filed in FY 2011 were 15 separate actions related to the financial crisis, naming 17 individuals, including 16 CEOs, CFOs, and other senior corporate officers. To date, the SEC has filed financial crisis-related actions against 95 individuals and entities, naming nearly 50 CEOs, CFOs, and other senior corporate officers. In FY 2011, the number of enforcement actions related to investment advisers and broker-dealers also grew, with a total of 146 enforcement actions filed related to investment advisers and investment companies, a single-year record and 30 percent increase over FY 2010. The SEC also brought 112 enforcement actions related to broker-dealers, a 60 percent increase over last fiscal year.
- We implemented a more risk-focused examinations program and completed over 1,600 oversight exams designed to detect and prevent fraud, strengthen industry compliance, monitor new and emerging risks, and inform policy. This risk-focused examination strategy resulted in improved guidance to the financial industry about risky practices and actionable information for enforcement investigations.

[1] A copy of the SEC's FY2013 Budget Congressional Justification can be found on our website at http://www.sec.gov/about/secfy13congbudgjust.pdf.

[2] The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the President or the full Commission. In accordance with past practice, the budget justification of the agency was submitted by the Chairman and was not voted on by the full Commission.

- We implemented a new whistleblower program that is already providing high-quality information regarding otherwise difficult to detect wrongdoing and permitting investigators to focus resources more efficiently.
- We improved our internal financial controls, which resulted in a GAO audit opinion for FY 2011 with no material weaknesses.
- SEC staff, with the assistance of targeted contracted expertise, implemented a number of internal reforms designed to improve the agency's organizational structure, strengthen capabilities, improve controls and efficiencies, and enhance workforce competencies and talent. Successes to date include: launching a program to systematically identify cost saving opportunities; conducting comprehensive assessments of the operations of the Offices of Administrative Services, Financial Management, and Human Resources; implementing a new performance management system; and improving staff training.
- We focused external hiring opportunities on filling strategic vacancies and obtaining specialized industry expertise in areas as diverse as quantitative analysis, algorithmic computerized trading, and structured products.

In addition to improving our core operations, we have worked to implement significant new responsibilities assigned to the agency under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The SEC already has proposed or adopted rules for over three-fourths of the more than 90 provisions in the Dodd-Frank Act that require SEC rulemaking. Additionally, the SEC has finalized 13 of the more than 20 required studies and reports.

SEC Responsibilities

While the agency's budget has grown in recent years, so have our responsibilities and the size and complexity of the markets we oversee. For example, during the past decade, trading volume in the equity markets has more than doubled, as have assets under management by investment advisers, with these trends likely to continue for the foreseeable future.

The SEC has responsibility for approximately 35,000 entities, including direct oversight of about 11,700 investment advisers, 9,700 mutual funds and exchange traded funds (ETFs), and close to 4,500 broker-dealers with more than 160,000 branch offices. We also have responsibility for reviewing the disclosures and financial statements of more than 9,100 reporting companies. The SEC also oversees approximately 450 transfer agents, 15 national securities exchanges, eight active clearing agencies, and nine nationally recognized statistical rating organizations (NRSROs), as well as the Public Company Accounting Oversight Board (PCAOB), Financial Industry Regulatory Authority (FINRA), Municipal Securities Rulemaking Board (MSRB), and the Securities Investor Protection Corporation (SIPC). Due to recent changes in the law, smaller investment advisers will transition from SEC to state oversight during 2012, but with the corresponding addition of advisers to private funds, we estimate that the agency will still oversee approximately 10,000 investment advisers with about $44 trillion in assets under management. Over FY 2012 and FY 2013, we expect to fully implement our new oversight responsibilities with respect to municipal advisors and entities registering with us in connection with the security-based swap regulatory regime.

The SEC fully recognizes that it is incumbent upon us to maximize our efficiencies and continue our organizational modernization efforts. As we protect investors, we have an obligation to be good stewards of the resources provided to us. We are carefully reviewing our activities to identify ways to reduce levels of review and improve efficiency. In addition, the ability to access common business technologies is permitting us to improve productivity. These ongoing efforts, along with continued congressional support, will be essential to enable the SEC to fulfill its mission even as the financial markets continue to grow in size and complexity.

FY 2013 Request

The SEC is requesting $1.566 billion for FY 2013, an increase of $245 million over the agency's FY 2012 appropriation. If enacted, this request would permit us to add approximately 676 positions for both improvements to core operations and implementation of the agency's new responsibilities.

The FY 2013 funding request would be fully offset by the matching collections of fees on securities transactions. Currently, the fee rate is equal to approximately two cents per every $1,000 of transactions. Under this mechanism, the SEC is deficit-neutral, as any increase or decrease in the SEC's budget would result in a corresponding rise or fall in offsetting fee collections.

The resources requested for FY 2013 would allow us to achieve four high-priority initiatives: (1) adequately staff mission-essential activities to protect investors; (2) prevent regulatory bottlenecks as new oversight regimes become operational and existing ones are streamlined; (3) strengthen oversight of market stability; and (4) expand the agency's information technology systems to better fulfill our mission.

Protecting Investors

Investor confidence in the fairness of financial markets is a critical element in capital formation. As noted earlier, the FY 2013 budget request would enable the Commission to enhance its investor protection activities by directing significant additional staff resources to our enforcement and examinations programs.

Enforcing the Securities Laws: Increasing the resources dedicated to the enforcement program would help improve our ability to identify hidden or emerging threats to the markets and act quickly to halt misconduct, minimize investor harm, and maximize the deterrent impact of our efforts.

Inspection and Examination Program: The investment industry is rapidly evolving, with the development of new products posing new risks to investors and the increased complexity of the markets posing challenges to regulators. In FY 2013, additional resources would bolster the agency's ability to inspect and examine the expanding breadth of entities under our jurisdiction. Without these resources, the increasing complexity of registered firms and the disparity between the number of exam staff and the firms could compromise the effectiveness and credibility of the Commission's inspection and examination program.

Risk Data and Analysis: As the industries we regulate use increasingly sophisticated technology and high-frequency trading algorithms, our ability to use statistical and trend analyses to identify potentially inappropriate or risky industry practices is essential to help inform our enforcement, examination and rulemaking efforts. Under this FY 2013 request, our Division of Risk, Strategy and Financial Innovation would receive resources it needs to continue to develop and implement robust analytical models to identify regulated entities with high-risk profiles.

Preventing Regulatory Bottlenecks

The FY 2013 budget request would enable the SEC to hire new subject matter experts to help make the transition to new rule regimes as smooth as possible and to streamline existing processes for market participants, while still maintaining essential protections for investors.

***Over-the-Counter Derivatives*:** In FY 2013, the Commission's regulatory responsibilities will significantly expand by the addition of new categories of registered entities (including security-based swap execution facilities, security-based swap data repositories, security-based swap dealers, and major security-based swap participants); the required regulatory reporting and public dissemination of security-based swap data; and the mandatory clearing of security-based swaps. To avoid any unintended market disruptions as the new requirements become operational, the agency will need additional staff with technical skills and experience to process and review on a timely basis requests for interpretations as well as registrations or other required approvals. New staff also will be needed to help conduct risk-based supervision of registered security-based swap dealers and participants, including by using newly-available data to identify excessive risks or other threats to security-based swap markets and investors.

***SRO Rule Approvals*:** The Commission is responsible for reviewing and processing self-regulatory organizations' proposed rule changes to evaluate the impact on the protection of investors, the public interest, and the national market system. The Dodd-Frank Act imposed new procedural requirements with respect to the SEC's processing of proposed rule changes, which has placed further demands on an already complex and resource-intensive process. The volume of annual requests has increased by over 80 percent in the last five years, with the Commission receiving over 2,000 requests for approval or guidance in 2011. The FY 2013 request is intended to provide additional resources so that market participants do not face greater uncertainty, costs, and delays in obtaining Commission action on new products, trading rules, and platforms.

***Facilitating Capital Formation for Smaller Companies*:** Companies of all sizes need cost-effective access to capital to grow and develop, and any unnecessary or superfluous regulations may impede their ability to do that. The Division of Corporation Finance has commenced a comprehensive assessment of the Commission's rules with respect to public reporting obligation triggers, the restrictions on general solicitation in private offerings, new capital raising strategies for smaller companies, and communications in both private and public offerings. In FY 2013, the Division expects to continue to devote significant attention to development and consideration of possible rule changes designed to facilitate access to capital for smaller companies in a manner that maintains appropriate investor protections. To assist with this effort, over the past year, the Commission formed an Advisory Committee on Small and Emerging Companies to provide the

Commission with advice and recommendations on potential actions to facilitate small business capital formation and reduce burdens on small business.

Economic Analysis: As the Commission undertakes additional rulemaking and evaluates existing rules, continued access to robust, data-driven economic analyses is necessary to develop efficient rules and evaluate the effectiveness of our existing regulations. Under the FY 2013 budget request, the Division of Risk, Strategy and Financial Innovation would be able to hire additional economists and industry experts to support these needs.

***Providing Interpretive Advice*:** As the Commission implements the rules required under the Dodd-Frank Act, there will be a need for additional staff to respond to the demand from companies, investors, and their advisors for interpretive advice about the new rules. In FY 2013, for example, we expect a heightened number of interpretive inquiries from public companies on new rules relating to listing standards for executive compensation, disqualification of felons and other bad actors from certain exempt offerings, and specialized disclosure rules with respect to conflict minerals and payments to foreign or U.S. governments by resource extraction issuers.

Strengthening Oversight of Market Stability

The rapidly expanding size and complexity of the markets presents enormous oversight challenges. In FY 2013, the SEC will need to hire specialists in a number of areas to strengthen our oversight of the markets, protect against known risks, and best enable our markets to facilitate economic growth.

***Clearing*:** Currently, the average transaction volume cleared and settled by clearing agencies is approximately $6.6 trillion a day. The SEC estimates six new clearing entities will register with the SEC in FY 2013, totaling 14 active registered clearing agencies. The SEC has approximately ten examiners devoted to the eight currently active registered clearing agencies, with limited on-site presence in only three of the eight entities. Additionally, the SEC has only approximately twelve other staff principally focused on monitoring and evaluation of risk management systems used by the existing clearing agencies, and will need to expand these efforts to address the expected increase in number of clearing agencies and rule filings raising risk management issues. Accordingly, in the FY 2013 budget request we propose to add positions to support these functions.

Market Structure Improvements: In FY 2013, the Commission will continue its efforts to monitor and respond to significant market events, such as the severe market disruption of May 6, 2010. In response to market structure issues, the Commission is currently evaluating a proposed "limit-up/limit-down" mechanism that would help enhance market stability by preventing trades in individual securities from occurring outside of a specified price band. The Commission also continues to review proposed amendments to the existing market-wide circuit breakers that are designed to address extraordinary volatility across the securities and futures markets and to make the circuit breakers more useful in the fast-paced electronic trading dynamics of today's markets. Importantly, the Commission also is likely to move forward on the establishment of a consolidated system for tracking trading orders received and executed across the securities markets, which will enhance the data available to securities regulators for a range of critical analytical and regulatory purposes.

***Money Market Funds*:** I have also asked the Commission staff to prepare recommendations on structural reforms to money market funds to lessen their susceptibility to runs and to enhance the protections afforded investors. These reforms would supplement the rules limiting the portfolio risk in money market funds that the Commission adopted in FY 2010. The Division of Investment Management plans to expand and improve its monitoring and oversight of money market funds and bring on additional staff with industry and data analysis expertise in this highly specialized area.

Exchange Traded Funds: Exchange Traded Funds, or ETFs, are rapidly growing, increasingly complex financial products whose activities raise significant disclosure, conflict of interest, market structure, and macro-prudential issues. In FY 2013 the SEC plans to augment its ability to respond effectively to product innovation and potential market stresses in this area. The new positions requested for this work would require individuals with specialized industry or legal expertise who would assist in evaluating novel and complex ETF products, structures, trading mechanisms, and index replication methodologies.

Cyber Security: Financial entities are recognized as particular targets for attempted cyber attacks. The SEC already has in place a program that monitors cyber security at the various securities exchanges, but the growing number of trading and clearing platforms will require additional staff to further enhance this function in FY 2013.

Leveraging Information Technology Systems

The preceding discussion demonstrates that growth in both the size and complexity of U.S. markets requires that the SEC leverage technology to continuously improve its productivity, as well as identify and address the most significant threats to investors. The SEC's budget request for FY 2013 would support IT investments of approximately $100 million. This level of funding would enable the Office of Information Technology to dedicate adequate resources to new or ongoing projects in areas such as data management, integration and analysis; document management; disclosure review; and internal accounting and financial reporting. Additionally, the SEC plans to continue multi-year initiatives to improve the enforcement and examinations programs' capabilities to intake and process thousands of tips, complaints, and referrals received annually, as well as massive amounts of electronic evidence. The SEC also plans to make additional investments in electronic discovery, its forensics laboratory, and reporting tools.

As part of our effort to improve key technology, the SEC also intends to use the Reserve Fund established by the Dodd-Frank Act to address important multi-year technology initiatives. For FY 2013, the SEC plans to use $50 million from the Reserve Fund for continued modernization of EDGAR and SEC.gov, as well as additional IT projects. The EDGAR database is used by companies and individuals to file periodic reports and information with the SEC and allows SEC staff and the public to search the filings. With 18-21 million daily page hits, SEC.gov is one of the Federal Government's most viewed web sites and a critical gateway for both businesses and individuals to access massive amounts (13.5 terabytes) of financial filer information maintained by the SEC. However, both EDGAR and SEC.gov were developed in the 1990s and use outdated software design and scripting language. We propose to invest approximately $26 million in overhauling EDGAR and SEC.gov to create new, modernized systems that would improve the agency's ability to meet Commission requirements and satisfy public needs; simplify the interchange between filers and the SEC to reduce filer burdens; and reduce the long-term costs of operating and maintaining the systems. An additional $9 million will be used to improve data structure and database performance, verify data, and construct a single data repository and central staging area for all EDGAR and SEC.gov data.

The remainder of the Reserve Fund in FY 2013 would be used on a number of other IT projects, including development of Market Oversight and Watch Systems that will provide the SEC with automated analytical tools to review and analyze market events, complex trading patterns, and relationships; development of fraud analysis and fraud prediction analytical models; and deployment of natural speech, text, and word search tools to assist our fraud detection efforts. Additionally, the SEC plans to enhance our analytical tools, databases, and intake systems for market data, mathematical algorithms, and financial data.

Summary of Requested Staff Positions

The FY 2013 request would allow the agency to continue to add needed staff to address the existing and increasing responsibilities described above, including the following:

- 191 positions in the enforcement program, to expand and focus our investigative function, strengthen our litigation capabilities, bolster our Office of Market Intelligence as well as the intelligence functions in our Regional Offices, and augment our abilities to collect delinquent debt and distribute funds to harmed investors.
- 222 positions in our exam program, to help close the widening gap between the number of examiners and the growing size and complexity of registered firms we oversee, including hedge fund advisers, derivatives market participants, and municipal securities advisors.
- 110 staff in our Divisions of Trading and Markets, Investment Management, and Risk, Strategy, and Financial Innovation to implement new regulatory regimes for over-the-counter derivatives and private fund advisers; deepen our expertise and oversight for money market funds and specialized products; and establish a deeper reservoir of experts who can conduct risk and economic analysis and spot emerging trends and practices.
- 46 positions in the Division of Corporation Finance to allow more focus with greater frequency on the financial statements and other disclosures of large and financially significant companies.
- 20 additional experienced business analysts and certified project managers to oversee the complex and large-scale projects in the agency's expanding technology portfolio.
- 48 positions to ensure that the agency's administrative and support services capabilities, including those of the Offices of Financial Management and Human Resources, are in alignment with the requirements of an expanded SEC, and to ensure that the agency manages its resources wisely and efficiently.

Conclusion

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