Testimony on the Fiscal Year 2017 Budget Request
of the U.S. Securities and Exchange Commission
by
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Subcommittee on Financial Services and General Government
Committee on Appropriations
United States Senate
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Chairman Boozman, Ranking Member Coons, and Members of the Subcommittee:

Thank you for inviting me to testify today in support of the President's fiscal year 2017 budget request for the Securities and Exchange Commission.[1] At the outset, I want to thank the Chairman, the Ranking Member, and all of the Subcommittee for your support of the SEC's important mission in previous budget cycles. And today, I very much appreciate the opportunity to discuss with you why funding the SEC at a level of $1.781 billion for Fiscal Year (FY) 2017 is necessary for the agency to continue to fulfill its critical responsibilities to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.[2]

The SEC has made great strides in recent years to strengthen its operations and programs, adopting strong measures that protect investors and our markets, and aggressively enforcing the securities laws to punish wrongdoers.

With respect to rulemaking, the agency has proposed or adopted nearly all of the mandatory rulemakings required by the Dodd-Frank Wall Street Reform and Consumer

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[1] A copy of the SEC's FY 2017 Congressional Budget Justification can be found on our website at http://www.sec.gov/about/reports/secfy17congbudgjust.pdf.

[2] 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 President, the full Commission, or any Commissioner. In accordance with past practice, the budget justification of the agency was submitted by the Chair and was not voted on by the full Commission.

Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Startups Act (JOBS Act), in addition to advancing other key rules in mission critical areas. Actions implementing the Congressional mandates have included final rules governing credit rating agencies and the public securitization markets; rules to address over-the-counter derivatives; new means for small businesses to access capital (including rules to expand the Regulation A exemption and permit securities-based crowdfunding offerings); executive compensation disclosures; and the removal of references to credit ratings from SEC rules. In addition to the Congressional mandates, the SEC has also advanced other important policy objectives, including rules to enhance oversight of high-frequency traders; the agency's supervision of investment advisers and mutual funds; and the structure and resiliency of money market funds. The agency has also adopted requirements for comprehensive new controls at critical market participants to strengthen key technological systems.

Beyond the specific rulemakings, the SEC has intensified its review of equity and fixed income market structure issues; undertaken a comprehensive disclosure effectiveness initiative seeking ways to improve the public company disclosure regime for investors and companies; and undertaken the modernization and enhancement of our regulatory regime for the asset management industry. We also have continued to hold securities law violators accountable by bringing cutting-edge cases in record numbers and in all market strata. Systemic enhancements in the SEC's National Examination Program (NEP) – including increased recruitment of industry experts, the augmentation of data analytics capacities, and enhanced training programs – have produced a more effective, efficient program. We are also throughout the agency increasingly harnessing technology to better identify risks, uncover frauds, sift through large volumes of data, inform policymaking, and streamline operations, while at the same time improving internal collaboration and recruiting more staff with specialized expertise and experience.

While these accomplishments and enhancements clearly evidence a stronger and more effective agency, challenges remain if we are to be successful in addressing the growing size and complexities of the securities markets and fulfill the SEC's broad mandates and responsibilities. Currently, the SEC is charged with overseeing approximately 27,000 market participants, including nearly 12,000 investment advisers, almost 11,000 mutual funds and exchange-traded funds, over 4,000 broker-dealers, and over 400 transfer agents. The agency also oversees 18 national securities exchanges, 10 credit rating agencies, and six active registered clearing agencies, as well as the Public Company Accounting Oversight Board (PCAOB), Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), the Securities Investor Protection Corporation (SIPC), and the Financial Accounting Standards Board (FASB). In addition, the SEC is responsible for selectively reviewing the disclosures and financial statements of over 9,100 reporting companies. In recent years, the SEC's responsibilities have also dramatically increased, adding new duties or expanded jurisdiction over securities-based derivatives, hedge fund and other private fund advisers, credit rating agencies, municipal advisors, and clearing agencies, as well as a responsibility to implement a new regime for crowdfunding offerings.

The size and complexity of the entities the SEC regulates has also expanded exponentially. From 2001 to 2015, assets under management of SEC-registered advisers more than tripled from approximately $21.5 trillion to approximately $66.8 trillion, and assets under management of mutual funds more than doubled from $7 trillion to over $15 trillion. Trading volume in the equity markets from 2001 through 2015 nearly tripled to over $70 trillion.

While the SEC greatly appreciates the confidence that Congress has placed in it in recent appropriation cycles, additional funding is imperative if we are to continue the agency's progress in fulfilling its responsibilities over our increasingly fast, complex, and growing markets. Funding at the requested level will permit the agency to hire an additional 250 staff in critical, core areas and continue to improve our information technology so that we can better oversee today's markets with the sophisticated tools necessary to safeguard investors. Specifically, as described in more detail below and consistent with the planning reflected in our recent requests, the budget for FY 2017 seeks to:

- Increase examination coverage of investment advisers and other key entities who interact with retail and institutional investors;
- Further leverage cutting-edge technology to permit the SEC to better keep pace with the entities, markets, and products we regulate;
- Protect investors by enhancing our enforcement program's investigative capabilities and strengthen our ability to litigate against wrongdoers;
- Further bolster the SEC's economic and risk analysis functions; and
- Hire market and other experts to enable the SEC to more expertly and efficiently discharge its current rulemaking and oversight responsibilities.

As the Subcommittee is aware, the SEC's funding is deficit-neutral, which means that any amount appropriated to the agency will be offset by modest transaction fees (approximately $.02 per $1,000) and therefore will not impact the deficit or the funding available for other agencies.[3] Our appropriation also does not count against the FY 2016 or FY 2017 caps set in the Bipartisan Budget Act of 2015.

Last year was one of important achievements for the SEC, but significant work remains.

[3] Section 991 of the Dodd-Frank Act requires the SEC to collect transaction fees from self-regulatory organizations in an amount designed to directly offset our appropriation.

Below is a summary of some of the accomplishments of the SEC in fiscal year 2015 and of the principal challenges ahead, as well as a more detailed description of key aspects of the FY 2017 budget request.

Many Accomplishments, But Significant Work Remains

Fiscal year 2015 was one of great accomplishment for the agency. The SEC brought an unprecedented number of enforcement cases (807 in total), secured an all-time high for orders directing the payment of penalties and disgorgement (over $4.2 billion), performed exams at a level not seen for the past five years (over 2,200), and, even more importantly, continued to develop cutting-edge cases and smarter, more efficient exams. Aided by enhanced technology to identify and analyze suspicious activity and strengthened by initiatives like self-reporting, SEC staff was able to identify and target the most significant risks for investors across the market. Areas of focus included cybersecurity, market structure requirements, dark pools, microcap fraud, financial reporting failures, insider trading, disclosure deficiencies in municipal securities offerings, and protection of retail investors and retiree savings.

The imperative of investor protection and market fairness was carried forward by all of our divisions and offices. While numbers of course only tell part of the story, the Division of Corporation Finance reviewed the annual and periodic reports of thousands of issuers last year, helping to ensure that investors receive full and fair disclosure about the public companies in which they invest. The Division of Trading and Markets reviewed more than 2,100 filings from exchanges and other self-regulatory organizations (SROs), standing guard for investors over major changes to the markets in which they entrust their savings. The Division of Investment Management reviewed filings covering more than 12,500 mutual funds and other investment companies, where the great majority of individual investors send their hard-earned money. And our economists in the Division of Economic and Risk Analysis produced more than 30 incisive papers and publications, including two major analyses to inform our work on asset management rules.

The agency's accomplishments on the rulemaking front in FY 2015 were particularly noteworthy. The SEC has now executed a vast majority of the voluminous congressional mandates for a wide range of complex rulemakings. In 2015, with the adoption of Regulation A+ and Regulation Crowdfunding, the agency completed all of the major rulemakings directed by the JOBS Act. The SEC also moved into the final phase of implementing the Dodd-Frank Act, focusing on the two major remaining areas of mandates: security-based swaps and executive compensation. We marked two key milestones in the first area: first, with the adoption of rules for reporting and disseminating security-based swap information; and second, with final rules for registering security-based swap dealers. We proposed a process for dealing with bad actors in the security-based swap market and adopted rules to help ensure that non-U.S. dealers participating in the U.S. market play by our rules. These reforms will give us powerful tools to oversee an $11 trillion market and provide investors with unprecedented transparency into trading that had long been dangerously opaque.

During the past year, we also issued proposals for the remaining executive compensation rulemakings required by the Dodd-Frank Act, including disclosure of whether a company allows executives to hedge the company's stock, disclosure of pay versus performance measures of executive compensation, and new disclosures and rules for clawing back incentive compensation erroneously awarded. And following the analysis of some 285,500 total comment letters, 1,500 of them unique, the final pay ratio rule was adopted in August 2015.

Significant, high-priority work for the SEC will continue in FY 2017: from completing the implementation of our mandated rulemakings,[4] to continuing the core initiatives described above,[5] to further strengthening our economic and risk analysis functions, to continuing to improve our technology and operations to make the agency more agile and effective, to ensuring that both our examination and enforcement function are strong and effective to match and address current markets. Outlined below is a brief overview of some of the key components of our budget request that would provide the funding for that work.

Expanding Oversight of Investment Advisers and Strengthening Compliance

The need for significant additional resources to permit the agency to increase its examination coverage of registered investment advisers and investment companies cannot be overstated. Increasing this examination coverage is vital to the SEC's ability to protect investors and the nation's securities markets.

The largest increase in entities registered with the SEC has occurred among investment advisers: a decade ago, there were approximately 9,000 investment advisers managing $28

4 The SEC will continue in 2016 to complete its remaining mandates. Of particular focus and priority will be to finalize the remaining security-based swap rules required of the SEC by Title VII of the Dodd-Frank Act. In February, the agency passed another key Title VII milestone with the adoption of the last set of rules for cross-border dealer activity. Adoption of the substantive requirements for security-based swap dealers – specifically, the rules governing their business conduct and the requirements for their capital, margin, and asset segregation – are expected to be adopted soon.

5 The SEC has actively advanced discretionary rulemaking in a number of areas essential to our mission. Three of the most prominent of these initiatives center on the asset management industry, the structure of the equity markets, and the SEC's disclosure regime. The Commission took action on all three in 2015, and I expect additional actions this year. Going forward, additional rulemaking initiatives to be considered will likely also include: shortening the securities transaction settlement cycle to support industry efforts and reduce potential systemic risk; further enhancing filings through the expanded use of structured data; and finalizing rules to update the intrastate offering exemption and recommendations for a universal proxy. In addition, I expect to continue to develop support from my fellow Commissioners for a uniform fiduciary duty for investment advisers and broker-dealers, and to bring forward a workable program for third party assessments to enhance the compliance of registered investment advisers.

trillion in assets, while the current projection is that these figures will grow to 12,500 investment advisers managing more than $70 trillion in assets by FY 2017. Beyond an increase in the number of advisers and amount of assets under management, additional challenges to examination staff are posed by the increased use of new and complex products by both investment advisers and broker-dealers, an increasing use of technology in registrants' operations that facilitate activities such as high-frequency and algorithmic trading, and the growth of complex "families" of financial services companies with integrated operations that include both broker-dealer and investment adviser affiliates. As a point of reference, a decade ago we had approximately 17 OCIE staff per trillion dollars in investment adviser assets under management, but today have only approximately 8 OCIE staff per trillion dollars.

In FY 2015, SEC staff, through risk-targeted exams, examined approximately 10 percent of registered investment advisers managing more than 30 percent of the assets under management of currently registered advisers. The program also continued its emphasis on the roughly 40 percent of all registered investment advisers that have never been examined through the continuation of the NEP's never before examined adviser initiative started in 2014. Significant additional resources are critical to improve the examination coverage of this important industry. Under the FY 2017 request, a top priority will be to hire 127 additional examiners, primarily to conduct additional examinations of investment advisers, but also to improve oversight and examination functions related to broker-dealers; clearing agencies; transfer agents; SROs, including FINRA and the PCAOB; swap data repositories; municipal advisors; and crowdfunding portals; among others.

Continue to Leverage Technology

The SEC has made substantial progress in modernizing its technology systems, streamlining operations, increasing our use of data analytics, and increasing the effectiveness of its programs. The SEC's FY 2017 budget request, which includes full use of the Reserve Fund, seeks to build on this progress by supporting a number of key information technology (IT) initiatives, including:

- **Expanding data analytic tools** that assist in the integration and analysis of huge volumes of financial market data, employing algorithms and quantitative models that can lead to earlier detection of fraud or suspicious behavior and ultimately enabling the agency to allocate its resources more effectively. For example, SEC staff has used data analytic (including pattern recognition) tools to, among other things, detect potential fraudulent or manipulative trading, identify financial statement outliers or unusual trends indicative of possible accounting fraud, discover possible money laundering, sift through massive volumes of trading data to detect suspicious trading patterns, and flag higher risk registrants for examination prioritization.

- **Increasing investments in Information Security** to address, as a top priority, the ability to monitor and avoid advanced persistent threats. The SEC's IT security program plans to focus its efforts on improved risk management and monitoring and continuing to invest in modernizing and securing the SEC's infrastructure to enhance workflow and document management, the SEC's electronic discovery program, operational resiliency, and internal communications to staff.

- **Redesigning the Electronic Data Gathering, Analysis and Retrieval (EDGAR) system,** an ongoing, multi-year effort to simplify and optimize the financial reporting process to promote automation and reduce filer burden. With a more modern EDGAR, both the investing public and SEC staff will benefit from having improved access to better data. We are also making incremental enhancements to the existing system to improve the user experience, accommodate new submission requirements, and other improvements that are needed prior to the full redesign.

- **Improving examinations through risk assessment and surveillance tools** that will help staff monitor for trends and emerging fraud risks, as well as improving the efficiency of the examination program so it can cover higher risk areas with its resources.

- **Enhancing the Tips, Complaints, and Referral system (TCR)** to bolster its flexibility, configurability, and adaptability. TCR investments will provide more flexible and comprehensive intake, triage, resolution tracking, searching, and reporting functionalities, with full auditing capabilities.

- **Improving enforcement investigation and litigation tracking** to better handle the substantial volume of materials produced during investigations and litigation. Among other initiatives, the SEC needs to build capacity to electronically transmit data for tracking and loading (versus the current practice of receiving content via the mail); implement a document management system for Enforcement's internal case files; and revamp the tools used to collect trading data from market participants.

- **Further modernize SEC.gov** to make one of the most widely used Federal Government websites more flexible, informative, easier to navigate, and secure for investors, public companies, registrants, and the general public.

- **Invest in further business process automation and improvements** to build workflow applications that will improve the efficiency and effectiveness of the agency in serving the public.

To better execute these and other technology initiatives, the FY 2017 request includes eight new positions for the Office of Information Technology (OIT). These staff would serve as project managers, business analysts, and technical resources who will improve technology and data management support for the SEC's business areas. In addition, the positions will enhance information security through monitoring, and drive further improvements in IT equipment management and reporting.

Bolster Enforcement Resources to Address Wrongdoing in Today's Markets

It is vital to the SEC's mission to bring timely, high-quality enforcement actions when violations of the Federal securities laws are identified. In FY 2015, the SEC brought a record number of enforcement actions against those who defrauded investors and violated the law – including many first of their kind actions – and obtained orders for monetary remedies exceeding $4 billion. Building on these very strong efforts, the agency must continue to enhance its enforcement function to keep pace with the growing size and complexity of the nation's markets and to swiftly and aggressively address misconduct.

For FY 2017, the SEC is requesting 52 additional positions for the Enforcement Division. The Division will use the additional requested positions to support its three core functions: intelligence analysis, investigation, and litigation. Specifically, these additional resources will support the Enforcement program's current and future initiatives by, among other things:

- increasing the experienced forensic accountants, attorneys, industry experts, and information technology and support staff needed to promptly detect, prioritize, and investigate areas appropriate for enhanced enforcement efforts (30 positions);

- adding experienced trial attorneys to prosecute the growing number of highly-complex enforcement actions (12 positions);

- enhancing Enforcement's data analytics expertise to assist in the implementation of data intensive projects, state-of-the-art investigative tools (such as eDiscovery and knowledge management), and improved forensic capabilities (5 positions); and

- bolstering staffing for intelligence functions, including the collection, analysis, triage, referral, monitoring, and follow-through on the thousands of TCRs received each year (5 positions).

With respect to the latter two priorities, analysis of large datasets, including SEC filings and trading data in equities, options, municipal bonds, and other securities, helps to limit investor harm by increasing the chances of detecting misconduct and detecting it earlier. The SEC's Enforcement program expects the improved data analysis capabilities derived from the agency's investments in IT will yield additional important case leads in FY 2017. As a result, the Enforcement program would dedicate 10 of the requested positions to further develop its data analytic function, increasing the number of staff responsible for reviewing and triaging incoming TCRs and bolstering the number of staff to whom TCRs are sent for further investigation.

The Enforcement program also requires additional staffing to promptly detect complex frauds and other difficult-to-detect misconduct, whether it occurs at hedge funds, broker-dealers, or "boiler rooms"; respond to misconduct in the changing equity markets relating to algorithmic trading and dark pools; address large-scale insider trading and stock manipulation; and keep pace with a rapidly evolving industry. As a result, 30 of the positions the SEC is seeking in FY 2017 would be to reinforce its investigative functions. These new positions will help the Division continue progress on existing investigations and handle its increasing case load, while quickly investigating and bringing emergency actions as necessary in matters where investors' money may dissipate if immediate action is not taken.

Finally, 12 of the new positions the SEC is requesting in FY 2017 would reinforce its litigation operations nationwide. This increased allocation will enable the SEC to handle the higher proportion of enforcement actions that are being filed as contested matters as well as to follow through on its commitment to litigate any case where it believes admissions of wrongdoing are necessary to achieve greater public accountability.

Focus on Economic and Risk Analysis to Support Rulemaking and Oversight

The SEC remains committed to strengthening the economic and risk analysis functions of its Division of Economic and Risk Analysis (DERA) and for FY 2017 plans to add six new positions to DERA. DERA is our fastest growing division, and this additional growth would continue to deepen the Division's expertise in support of rulemaking initiatives affecting the capital markets as well as initiatives to detect violations of the securities laws.

The DERA positions requested would focus on areas including exchange-traded funds, microcap stocks, the derivatives markets, and asset-backed securities. These staff would work with colleagues across the SEC to proactively monitor these markets from a systemic perspective, as well as to develop analytical tools to assist the Division of Enforcement in analyzing and identifying potential illicit activity in these areas.

Meet Expanded Rulemaking and Oversight Responsibilities

The agency is also requesting seven additional positions in FY 2017 for its Division of Trading and Markets. In FY 2017, the Division plans to use the additional positions requested to undertake new market-related responsibilities resulting from ongoing or recently completed rulemakings, as well as continuing to improve the agency's market supervision. Three of these positions would help the Division implement its new or enhanced responsibilities to oversee clearing agencies and swap data repositories. The other four would help improve the SEC's analytics and reporting on broker-dealers' finances, internal controls, and risk management practices; process rule proposals from a growing number of SROs; and provide interpretive guidance related to the derivatives markets.

The SEC is also requesting seven new positions for the Division of Investment Management to implement key policy objectives. These personnel would conduct ongoing data analysis, including new data that would be submitted to the SEC as part of the investment company reporting modernization initiative. In addition, they would monitor issues related to asset management risks (including those related to liquidity, derivatives, stress testing and transition planning rulemaking initiatives), provide interpretive advice, and respond to exemptive applications.

Conclusion

Thank you again for the opportunity to present the President's FY 2017 budget request. The SEC has made great progress with the recent funding increases approved by Congress, and I deeply appreciate the President's and Congress' continued support of the agency. I look forward to working with the Subcommittee to provide the SEC with the resources it needs to fulfill its important responsibilities to investors and our capital markets. I would be happy to answer any questions.