FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2012

WEDNESDAY, MAY 4, 2011

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:17 a.m., in room SD–138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin, Lautenberg, and Moran.

COMMODITY FUTURES TRADING COMMISSION

STATEMENT OF HON. GARY GENSLER, CHAIRMAN

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good morning. I'm pleased to convene this hearing to consider the fiscal year 2012 funding request of two key Federal regulatory agencies within the jurisdiction of the Senate Committee on Appropriations Subcommittee on Financial Services and General Government—the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC). Before I go further, let me apologize for being a few minutes late, but I opened a session this morning and it took a few minutes to get that started.

I welcome my distinguished Ranking Member, Senator Jerry Moran, other colleagues who've joined me on the dais today, and others that may arrive during the course of the proceeding.

Joining us today to present testimony on the critical work of these agencies; to share how they've used the resources provided over the past several years; and to explain the details of their budgetary needs for the next fiscal year, are the Honorable Gary Gensler, chairman of the CFTC, and the Honorable Mary L. Schapiro, chairman of the SEC.

The subcommittee has received a statement for the record from Colleen M. Kelley, president of the National Treasury Employees Union, regarding the funding for the SEC. And if there's no objection, I ask that it be included in the record of these proceedings.

The CFTC and the SEC both occupy pivotal positions at the forefront of stimulating and sustaining economic growth and prosperity in America, while protecting the marketplace from fraud and manipulation. Market users, financial investors, and the U.S. economy

rely on the vigilant oversight of these two agencies in today's rapid-paced, evolving, and often volatile, global marketplace.

It's clear that Chairman Gensler and Chairman Schapiro, their fellow commissioners, and their respective staff, have invested inestimable hours in paving the way toward a more reliable regulatory foundation—one that will safeguard the stability and integrity of the futures and securities markets. Particularly at this time in history, we depend on their foresight and leadership to implement promptly, prudently, and transparently the array of comprehensive reforms designed to strengthen our regulatory framework.

The CFTC carries out market surveillance, compliance, and enforcement in the futures arena. It detects, deters, and punishes abusive trading activity and the manipulation of commodity prices which could have a negative impact on consumers and the economy.

Adding to the challenge of the CFTC's mission is a significantly transformed, globalized, electronic, around-the-clock, and highly diversified marketplace. With the enactment of the Dodd-Frank Act financial regulatory reform, the CFTC's mission was substantially expanded to embrace oversight of the swaps marketplace, the vast, once-in-the-shadows world of over-the-counter (OTC) derivatives.

To grasp the vast scope of the CFTC's additional responsibility, it's useful to consider the long-regulated U.S. futures marketplace, historically policed by the CFTC, that has the notional value of approximately $40 trillion—enormous by anyone's calculation. It pales in comparison to the U.S. OTC derivatives marketplace now coming under the CFTC's purview, with a notional value not of $40 trillion, but $300 trillion—nearly eight times the amount of the regulated futures market.

As the investor's advocate, the SEC is responsible for maintaining fair, orderly, and efficient stock and securities markets. The SEC conducts day-to-day oversight of major market participants, monitors corporate disclosure of information to the public, and investigates and pursues civil and criminal enforcement actions.

To fulfill its market oversight and investor protection functions, the SEC must monitor 1,800 investment advisers, 7,500 mutual funds, and more than 5,000 broker-dealers with more than 160,000 branch offices. The SEC reviews the disclosures and financial statements of approximately 10,000 reporting companies, oversees approximately 500 transfer agents, 15 national securities exchanges, 9 clearing agencies, and 10 nationally recognized statistical rating organizations.

With the enactment of the Dodd-Frank Act last July, the SEC's responsibilities grew dramatically. Now the SEC is in the driver's seat for issuing 100 new rules; creating 5 new offices; producing more than 20 studies and reports; overseeing OTC derivatives markets and hedge fund advisers; registering municipal advisers and security-based swap market participants; enhanced supervising of Nationally Recognized Statistical Rating Organizations and clearing agencies; regulating asset-backed securities; and creating a new whistleblower program.

I welcome the opportunity today to look at the critical budgets of these two very, very important agencies. I am pleased that during the past several years that I've been honored to chair the sub-

committee we have substantially and dramatically increased the funding of both of these agencies. In terms of resources in recent years, since fiscal year 2007 funding for the CFTC has increased from $97.9 million to the $202.6 million recently enacted in the fiscal year 2011 continuing resolution—a 107 percent hike in funding over a 4-year period. The SEC's funding has grown from $892 million in fiscal year 2007 to $1.185 billion in fiscal year 2011—a 33 percent hike in funding in that time span.

Compared to the allocation available to the subcommittee last July when we prepared our recommendations, we experienced a significantly reduced overall level for purposes of funding the decisions for the recently enhanced fiscal year 2011 full year continuing resolution. Encountering a substantial reduction in our available funds of more than $3.5 billion, representing a 13 percent cut below what we had to work with last July, was far from ideal.

It also meant an overall decrease of $2.35 billion, or 10 percent below a freeze at the fiscal year 2010 enacted level, making for some tough choices. The fiscal year 2012 forecast does not look rosy. I fully expect to face equally complicated and challenging funding requirements.

PREPARED STATEMENT

I'm going to ask that the remainder of my statement be placed in the record, and I'd like to now turn it over to my Ranking Member, Senator Moran of Kansas, for any opening remarks he might have.

[The statement follows:]

PREPARED STATEMENT OF SENATOR RICHARD J. DURBIN

Good morning. I am pleased to convene this hearing to consider the fiscal year 2012 funding requests of two key Federal regulatory agencies within the jurisdiction of the Appropriations Subcommittee on Financial Services and General Government: the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC).

I welcome my distinguished ranking member, Senator Jerry Moran, and other colleagues who have joined me on the dais today, and others who may arrive during the course of these proceedings.

Joining us today to present testimony on the critical work of their agencies, to share how they have used the resources provided over the past couple years, and to explain the details of their budgetary needs for fiscal year 2012 are the Honorable Gary Gensler, Chairman of the CFTC and the Honorable Mary L. Schapiro, Chairman of the SEC.

The CFTC and the SEC both occupy pivotal positions at the forefront of stimulating and sustaining economic growth and prosperity in our country—while protecting the marketplace from fraud and manipulation.

Market users, financial investors, and the U.S. economy rely on vigilant oversight by these two agencies in today's rapid-paced, evolving, and often volatile global marketplace.

It is clear that both Chairman Gensler and Chairman Schapiro, their fellow Commissioners, and their respective staff have invested inestimable hours in paving the way toward a more reliable regulatory foundation—one that will safeguard the stability and integrity of the futures and securities markets. Particularly at this time in history, we depend on their foresight and leadership to promptly, prudently, and transparently implement the array of comprehensive reforms designed to strengthen our regulatory framework.

The CFTC carries out market surveillance, compliance, and enforcement programs in the futures arena. The CFTC detects, deters, and punishes abusive trading activity and manipulation of commodity prices, which could have negative impacts on consumers and the economy.

Adding to the challenge of the CFTC's mission is a significantly transformed, globalized, electronic, round-the-clock, and highly diversified marketplace. With the enactment of Dodd-Frank financial regulatory reform, the CFTC's mission was substantially expanded to embrace oversight of the swaps marketplace—the vast "once-in-the-shadows" world of over-the-counter (OTC) derivatives.

To grasp the vast scope of the CFTC's additional responsibilities, it is useful to consider that the long-regulated U.S. futures marketplace historically policed by the CFTC has a notional value of approximately $40 trillion. Enormous—by anyone's calculation. But it pales in comparison to the U.S. OTC derivatives marketplace now coming under the CFTC's purview—with a notional value estimated at $300 trillion—nearly eight times the notional amount of the regulated futures markets.

As the "investors advocate," the SEC is responsible for maintaining fair, orderly, and efficient stock and securities markets. The SEC conducts day-to-day oversight of the major market participants, monitors corporate disclosure of information to the investing public, and investigates and pursues civil and criminal enforcement actions against securities law violations.

To fulfill its market oversight and investor protection functions, the SEC must monitor 1,800 investment advisers, 7,500 mutual funds, and more than 5,000 broker-dealers with more than 160,000 branch offices. The SEC reviews the disclosures and financial statements of approximately 10,000 reporting companies, oversees approximately 500 transfer agents, 15 national securities exchanges, 9 clearing agencies, 10 nationally recognized statistical rating organizations (NRSROs), as well as the Public Company Accounting Oversight Board, Financial Industry Regulatory Authority, Municipal Securities Rulemaking Board, and the Securities Investor Protection Corporation.

With the enactment of the Dodd-Frank Act last July, the SEC's responsibilities grew considerably. Now the SEC is in the driver's seat for issuing 100 new rules, creating five new offices, producing more than 20 studies and reports, overseeing the over-the-counter derivatives market and hedge fund advisers; registering municipal advisers and security-based swap market participants; enhanced supervising of NRSROs and clearing agencies; regulating asset-backed securities; and creating a new whistleblower program.

I welcome the opportunity today to conduct critical oversight of these two agencies through a candid discussion of where they are today, where they need to be, and how we can work to provide resources they need to satisfy their vital missions.

I am pleased that over the past several years, this subcommittee has been able to substantially boost the funding approved for the CFTC and the SEC to help address pressing resource needs.

In terms of resources in recent years, since fiscal year 2007, funding for the CFTC has increased from $97.981 million to the $202.675 million recently enacted in the fiscal year 2011 continuing resolution, a 107 percent hike in funding. The SEC's funding has grown from $892.6 million in fiscal year 2007 to $1.185 billion in fiscal year 2011, a 33 percent hike in funding over the time span.

Compared to the allocation available to this subcommittee last July when we prepared our fiscal year 2011 recommendations, we experienced a significantly reduced overall level for purposes of funding decisions for the recently enacted fiscal year 2011 full-year continuing resolution. Encountering a substantial reduction in our available funds of more than $3.5 billion, representing a 13 percent cut, below where we were last July was far from ideal. It also meant an overall decrease of $2.35 billion, or 10 percent, below a freeze at the fiscal year 2010 enacted level—making for many tough choices and painful sacrifices.

The fiscal year 2012 forecast does not look rosy. I fully expect to face equally complicated and challenging funding decisions as we prepare our bill for the ensuing fiscal year.

Looking ahead, for fiscal year 2012, the President seeks funding of $308 million for the CFTC, an increase of $105 million (52 percent) more than the fiscal year 2011 enacted level of $206.7 million, which itself is an increase of $33.98 million, a 20 percent hike, above the fiscal year 2010 enacted level of $168.8 million.

For the SEC, the President's fiscal year 2012 budget seeks base funding of $1.407 billion. This is an increase of $222.5 million (19 percent) above the fiscal year 2011 enacted level of $1.185 billion, not including an additional $33 million in prior-year unobligated balances. The fiscal year 2011 base funding represents an increase of $74 million, or 7 percent, more than the fiscal year 2010 enacted level of $1.111 billion.

Oversight Responsibility.—The Congress probably exercises its most effective oversight of agencies and programs through the appropriations process. It allows an annual check-up and review of operations and spending. Today's hearing provides a valuable opportunity to ask some key questions:

—Are the CFTC and the SEC keeping pace with developments in the markets particularly the emerging prevalence of new-fangled, more complex financial products?
—Do these agencies have the right mix of talent and specialized expertise to be vigilant watchdogs rather than timid lap dogs?
—Are they ahead of the curve, rather than trailing behind, when it comes to stopping unscrupulous, greed-driven schemers who pursue selfish gain at the expense of the unwary and unwitting?
—Do they have nimble, state-of-the-art, sophisticated information technology to augment and support their human capital?
—What are the likely consequences of budget belt-tightening and possibly reduced resources?

I look forward to hearing more about what each of these agencies have been able to accomplish since our last hearing, what resource gaps remain to be filled to make them more robust, responsive regulators, and how do we best get there amid growing deficits and spending cut sentiments.

It will be helpful to hear from both Chairmen their honest appraisals about the resources they will require to achieve their missions, keep pace with change, and becomes as sophisticated as, if not more so, than the entities they monitor—while responsibly managing taxpayer dollars.

STATEMENT OF SENATOR JERRY MORAN

Senator MORAN. Chairman Durbin, thank you very much. Thank you for your kindness and your graciousness to me, and thank you for calling this hearing.

And I welcome the two chairmen, Chairman Gensler and Chairman Schapiro.

As we review the budget submissions for the CFTC and the SEC for fiscal year 2012, I look forward to hearing the details of your requests, your plans to carry out your core missions, and how you propose to implement the Dodd-Frank Act.

Chairman Gensler, as you have said, derivative markets and effective oversight of those markets matter to corporations, farmers, homeowners, and small businesses. We all benefit from effective oversight that promotes fair and orderly derivative markets.

However, to promote such markets and to assist the businesses that are dependent upon them, we must also have an orderly and transparent process which outlines how they should work.

I have heard many concerns expressed that the CFTC is moving too quickly and has not adequately established the cost of new regulations, valuing speed over deliberation. I was pleased to see the CFTC acted last week to give the public more time to comment on the new regulations that you are proposing. While I welcome this extension, I also think that rules have been proposed in a sequence that has created some confusion.

I've heard Chairman Gensler's recent comment about how the CFTC has revealed its mosaic of rules. However, I think a roadmap for implementation, rather than a random mosaic of rules, would be more helpful in getting us on the path to a fair and orderly marketplace and help us establish appropriation priorities. This call for a roadmap is intended to foster transparency and broaden understanding, and for any new regulatory framework to be effective, everyone involved must have a clear appreciation of their roles and responsibilities in the new system and how these changes will evolve in a logical sequence.

In reviewing the budget requests of both the CFTC and the SEC, we recognize that protecting investors is important as first-time investors have turned to markets to help secure their retirements,

pay for homes, and send their children to college. We also understand that your agencies are faced with innovations in the financial services arena that present regulators with increasingly complex markets to regulate. However, we're all aware of our budget deficit and fiscal constraints that will require all agencies to make decisions as to how best to allocate resources.

Technological solutions will be necessary to keep up with the next generation of trading platforms and systems that operate at record-breaking pace. Staffing levels will have to be carefully considered so that they do not become unsustainable. This is not a new challenge. All agencies should be making strategic decisions on resource allocations driven by the agency's mission responsibilities, and grounded in analysis of their workload and their human capital resources and needs. Simply increasing funding does not ensure that an agency can successfully achieve its mission.

In addition to making wise decisions about how to strike a balance between investments in new technology and staffing levels, agencies also must make sound decisions about what type of staff to hire and how best to utilize those positions. In reviewing the recent Inspector General (IG) report on the CFTC rulemaking process, I have concerns about how the CFTC has chosen to utilize staff the last year. For instance, as discussed in the IG report, the CFTC has ineffectively used its Office of the Chief Economist. Not only was this office left unfilled for nearly a year, but the CFTC went on a hiring spree for new lawyers during the same time. The IG report suggests that unless the CFTC can make a wiser hiring decision and engage in meaningful economic analysis, the Congress may need to provide additional direction on how the commission can spend money on hiring and how it should utilize its staff.

In addition to the budget concerns I have another one is that the CFTC, despite tight budget deficits, has engaged in rulemakings that are discretionary and unnecessary according to the CFTC—the only economic analysis available. For example, proposed rulemakings on position limits and core principles are not required by the Dodd-Frank Act. This is not necessary for the CFTC to immediately move toward these rulemakings. Furthermore, the only reliable quantitative data available from the CFTC is a staff report that suggests such rules are unnecessary and, at most, premature. Pursuit of position limits and core principle rulemakings are direct examples of how the CFTC has failed to listen to the economist and failed to prioritize rulemakings under existing budget constraints.

PREPARED STATEMENT

Chairman Gensler and Chairman Schapiro, you both have challenges—significant ones—in front of you. You must improve transparency in our securities market and uncover fraud and deception, while not over-regulating our markets and hindering our economic recovery.

Chairman Durbin, I look forward to working with you as we consider the fiscal year 2012 budget requests for the CFTC and the SEC. Thank you.

[The statement follows:]

PREPARED STATEMENT OF SENATOR JERRY MORAN

Mr. Chairman, thank you for calling this hearing. Chairman Gensler and Chairman Schapiro, welcome.

As we review the budget submissions for the Commodity Futures Trading Commission's (CFTC) and the Security and Exchange Commission (SEC) for fiscal year 2012, I look forward to hearing the details of your requests, your plans to carry out your core missions, and how you propose to implement the Dodd-Frank Act.

Chairman Gensler, as you have said, "derivatives markets and effective oversight of those markets matters to corporations, farmers, homeowners and small businesses." We all benefit from effective oversight that promotes fair and orderly derivatives markets. However, to promote such markets and assist the businesses that are dependent on them, we must also have an orderly and transparent process which outlines how they should work. I have heard many concerns expressed that the CFTC is moving too quickly and has not adequately established the cost of new regulations, valuing speed over deliberation. I was pleased to see that the CFTC acted last week to give the public more time to comment on the new regulations you are proposing. While I welcome this extension, I also think rules have been proposed in a sequence which has created confusion. I have heard Chairman Gensler's recent comment about how the CFTC has revealed its "mosaic" of rules. However, I think a roadmap for implementation, rather than a random mosaic of rules, would be more helpful in getting us on the path to a fair and orderly marketplace and help establish appropriations.

This call for a road map is intended to foster transparency and broaden understanding. For any new regulatory framework to be effective, everyone involved must have a clear understanding of their roles and responsibilities in the new system and how those changes will evolve in a logical sequence.

In reviewing the budget request of the both the CFTC and the SEC, we recognize that protecting investors is important as first-time investors have turned to the markets to help secure their retirements, pay for homes, and send their children to college. We also understand that your agencies are faced with innovations in the financial services arena that present regulators with increasingly complex markets to regulate.

However, as we are all aware, our budget deficit and fiscal constraints will require all agencies to make decisions as to how to best allocate resources. Technological solutions will be necessary to keep up with next generation trading platforms and systems that operate at a record-breaking pace. Staffing levels will have to be carefully considered so that they do not become unsustainable. This is not a new challenge. All agencies should be making strategic decisions on resource allocation driven by the agency's mission responsibilities, and grounded in analysis of their workload and their human capital resources and needs. Simply increasing funding does not ensure that an agency can successfully achieve its mission.

In addition to making wise decisions about how to strike a balance between investments in new technology and staffing levels, agencies must also make sound decisions about what type of staff to hire and how best to utilize those positions. In reviewing a recent Inspector General (IG) report on the CFTC rulemaking process, I have concerns about how the CFTC has chosen to utilize staff over the last year. For instance, as discussed in the IG report, the CFTC has ineffectively used the Office of the Chief Economist. Not only was this office left unfilled for nearly a year, but the CFTC went on a hiring spree for new lawyers during the same time. The IG report suggests that unless the CFTC can make wiser hiring decisions and engage in meaningful economic analysis, the Congress may need to provide additional direction about how the CFTC can spend money on hiring and how it should utilize its staff.

An addition to budget concern I have is that the CFTC, despite tight budgets, has engaged in rulemakings that are discretionary and unnecessary, according to the only the CFTC economic analysis available. For example, proposed rulemakings on position limits and core principles are not required by Dodd Frank. Thus, it is not necessary for the CFTC to immediately move forward with these rulemakings. Furthermore, the only reliable quantitative data available from the CFTC is a staff report that suggests such rules are unnecessary and at most premature. Pursuit of position limits and core principle rulemakings are direct examples of how the CFTC has failed listen to its economists and failed to prioritize rulemakings under existing budget constraints.

Chairman Gensler and Chairman Schapiro, you both have challenging tasks in front of you. You must improve transparency in our securities markets and uncover fraud and deception, while not over-regulating our markets and hindering our economic recovery.

Chairman Durbin, I look forward to working with you as we consider the fiscal year 2012 budget requests of the CFTC and the SEC.

Senator DURBIN. Thank you Senator Moran.
Senator Lautenberg.

STATEMENT OF SENATOR FRANK R. LAUTENBERG

Senator LAUTENBERG. Mr. Chairman, thanks very much for holding the hearing and I ask for unanimous consent that my full statement will be included in the record.

Senator DURBIN. Without objection.

Senator LAUTENBERG. And I take a moment of that time to just say that, how pleased I am to see each of you in your positions. And how delighted I am—delight's the wrong word—how satisfied I am that we're on to something, that we're going to change the way we did business in the past as a result of the finance reform legislation, to make sure that companies understand that there are obligations that they're going to have to meet.

And I look at history. I used to run a company, a very big company—ADP. ADP does the Bureau of Labor statistics every month now, and the company pays more than 35 million people their paychecks and has fresh data to work from. And I learned something as the CEO of that company. As the company grew, I learned that the most satisfied investors are those who see a transparent approach to what's going on in the company. And I see that, the shortcuts to increased compensation without regard for the performance of the company or of the need of the employees.

I furnished the Columbia Business School, my alma mater, with a chair. The chair was endowed in 2001, when I was out of the Senate for 2 years, and the chair was to say that we have to pay more attention to business ethics and corporate governance. And I point out without patting myself too hard on my, on the shoulder, that, that was in 2001, my friends. It was 2001, which preceded 2008 by a long time.

PREPARED STATEMENT

And so, I'm pleased to see that we're finally going to say—hey, you can't get away with the kinds of things that you did before. The public's entitled to know what happens when they put money into an investment, and its our responsibility to help guide them—and not worry so much about whether we're overburdening, but I worry about whether we're underburdening the, your respective agencies and letting things go back to where they were. That should never happen again in America. And I'm going to fight like the devil to make sure you have the resources to do your job with.

[The statement follows:]

PREPARED STATEMENT OF SENATOR FRANK R. LAUTENBERG

Mr. Chairman, each week brings another reminder that our country is slowly—but steadily—recovering from the worst economic downturn since the Great Depression.

Letting Wall Street regulate itself helped trigger this crisis, sending millions of Americans to the unemployment line and causing their retirement accounts to shrink.

Under President Obama's leadership, we're rebuilding the economy from the ground up—laying a foundation that will make our country stronger and better prepared for the future.

The cornerstone of this effort is last year's Wall Street reform law, which includes critical safeguards to protect the economy from another meltdown.

This new law reins in the recklessness of the big banks and creates a watchdog to look out for consumers and make sure financial institutions follow the rules.

In addition, these reforms ensure that ordinary investors get the information they need to make sound decisions—and bring the secretive derivatives market out of the shadows and into the sunlight.

Unfortunately, House Republicans have been persuaded by their friends on Wall Street that the financial industry can regulate itself.

They are trying to stop Wall Street reform by gutting funding for the new law.

Make no mistake: without these new reforms and the funding to carry them out, Wall Street will return to its reckless ways, which will threaten our economic recovery and undermine our ability to create jobs.

As a former CEO, I understand the need for a strong financial sector.

But nothing is more important than putting people back to work and making sure that our economy is never again threatened by the risky bets of Wall Street gamblers.

So I look forward to hearing from today's witnesses about how we can make sure the reform law works the way it was designed and protects the American economy and the American people.

Senator LAUTENBERG. Thank you very much.

Senator DURBIN. Thanks a lot, Senator Lautenberg.

And we'd like to invite our guests to make an opening statement if they'd care to.

Mr. Gensler.

SUMMARY STATEMENT OF GARY GENSLER

Mr. GENSLER. Good morning. Thank you, Chairman Durbin, Ranking Member Moran, and members of the subcommittee. I thank you for inviting me to testify on behalf of the CFTC about the 2012 budget request.

I'm honored also to testify along with SEC Chair, Mary L. Schapiro, with whom we've worked very closely to implement the Dodd-Frank Act, and many other matters.

The CFTC is a good investment for the American public. And though the CFTC is not a price-setting agency, rising prices for basic commodities, agriculture, energy and the like, highlight the importance of having effective market oversight to ensure integrity and transparency.

Each part of our Nation's economy relies on a well-functioning derivatives marketplace. It's essential, as producers, merchants, and other end-users manage their risk. In essence what it does is allows a company to lock in a price at some future date. That's at the core of what we oversee.

This price certainly allows companies to better invest and plan for their business. The business certainty that derivatives markets can provide exists to the degree only that people have confidence in the integrity of the markets, however. And the CFTC was created to oversee futures markets—first in the agriculture markets, later other commodities. But, of course, in the 1980s came along the swaps marketplace, and this new type of derivatives remained unregulated until the Dodd-Frank Act. With the passage of the Dodd-Frank Act, the U.S. swaps market, as the chairman noted—nearly $300 trillion in size, or roughly seven times the size of what

we currently oversee—largely comes under our jurisdiction. Some of it, of course, is over at the SEC.

So, we're working deliberately and efficiently, and I believe transparently, to put in place the rules that the Congress directed us to do. We've now at this point substantially completed that process. And as the Ranking Member said, we have the mosaic out, and we are allowing the public to look at that whole mosaic. We'll only move forward with final rules after we summarize the comments—and with 16,000 comments in, that's going to take some time to summarize and get commissioner feedback—but I think we'll be moving on final rules throughout the summer and into the fall of this year.

As relates to the budget request of $308 million that the President put forward, there are many priorities. I'd like to just highlight, very quickly, four. One is technology. The budget request builds upon the support of this subcommittee that gave us $37 million in technology this year, to move up to $66 million. The swaps marketplace being seven times the size of the futures marketplace, we need that information. And though the Dodd-Frank Act established something called Swap Data Repositories, we're faced with the responsibility of aggregating futures data with swaps data and bringing it together. And what's more—there may be more than one data repository by asset class. And so we'll have to aggregate that information so that we can police the markets, and we need the technology to make sure that we can do that.

Second, is the swap dealers themselves. The Dodd-Frank Act, for the first time, calls for comprehensive regulation of swaps dealers. To accomplish this, the CFTC will establish a new swap dealer and intermediary oversight program, or actually, division. We'll be moving some people over into this. But this area will need about 30 more staff, building upon a base of about 80 people that we currently have in that effort.

Third, is clearinghouses. The Dodd-Frank Act requires a mandate that swaps that are standardized enough, be in central clearing. We currently oversee about 15 clearinghouses. We think that will grow to 20 or 21. With that roughly 50 percent increase of clearinghouses and an eight-fold increase in the underlying product, we're asking for about 30 new staff, bringing the staff in our clearing oversight from 40 up to 70.

And then, last, among these four key priorities is transparency. The Dodd-Frank Act has real-time price reporting. It also has oversight of a new market mechanism called Swap Execution Facilities (SEFs). We're not entirely sure how many there will be. We think, our best estimate is at least 30 or 40 of these new SEFs. We believe that we need at least 60 additional staff, to oversee the markets. That jump is to about 100 in this area, but it's for real-time reporting and transparency.

Now, this is not to say we don't have other priorities—enforcement, overseeing position limit authority, market surveillance—but overall it's bringing our staff up from about 720, where we think we'll end this year, with your help with this $202 million, to a request for 983 people.

PREPARED STATEMENT

We recognize this budget deficit for the Nation presents enormous challenges for this subcommittee and the Congress and the public, but we cannot forget that the 2008 crisis was very real, and it still is very real. Reform will only be effective once we've completed final rules, but, yes, also only after we have significant resources to fulfill this extended mission.

So, I thank you.

[The statement follows:]

PREPARED STATEMENT OF GARY GENSLER

Good morning Chairman Durbin, Ranking Member Moran and members of the subcommittee. I thank you for inviting me to today's hearing on the Commodity Futures Trading Commission's (CFTC) fiscal year 2012 budget request. I am pleased to testify on behalf of the Commission.

CFTC MISSION

The CFTC is a good investment for the American public, overseeing vast markets with a relatively small staff. At its core, the mission of the CFTC is to ensure the integrity and transparency of derivatives markets so that hedgers and investors may use them with confidence. Derivatives emerged as tools to allow producers and merchants to be certain of the prices of commodities that they planned to use or sell in the future. Derivatives markets are used to hedge risk and discover prices and work best when they are transparent and free from fraud and manipulation.

The CFTC historically has been charged with overseeing one part of the derivatives market—the commodity futures markets. These markets have been around for more than a century. Initially, there were futures on agricultural commodities, such as wheat, corn, and cotton. The markets have grown to include contracts on energy and metals commodities, such as crude oil, heating oil, gasoline, copper, gold and silver, and contracts on financial products, such as interest rates, stock indexes, and foreign currency. These markets—and our regulatory oversight—affect tens of thousands of farmers, ranchers, oil producers, corporations, municipalities, pension funds, and anybody else who wants to hedge a risk and get the benefits of transparent pricing in competitive markets.

Each part of our Nation's economy relies on a well-functioning derivatives marketplace. It is essential so that producers, merchants, and other end-users can manage their risks. It allows those companies to lock in prices for the future. Such price certainty allows companies to better make essential business decisions and investments. Thus, it is critical that market participants have confidence in the integrity of these price discovery markets.

Though the CFTC is not a price-setting agency, rising prices for basic commodities—agricultural and energy—highlight the importance of having effective market oversight that ensures integrity and transparency.

The CFTC fulfills its statutory mandate through market surveillance, industry oversight and enforcement. We pursue fraud, such as Ponzi schemes, and market manipulation. We oversee futures exchanges and clearinghouses. We process registration applications, rule reviews, appellate filings, and examinations of exchanges and clearinghouses. The CFTC is a cop on the beat that protects markets in commodities and derivatives from fraud, manipulation, and other abuses.

CFTC SCOPE

The CFTC and its predecessors have overseen the commodity futures markets since the 1920s. A new type of derivatives called swaps, however, came around in the 1980s and remained unregulated until the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). That legislation expanded the CFTC's oversight to, for the first time, include both the futures and swaps markets. It also gave the CFTC new regulatory responsibilities. The Securities and Exchange Commission (SEC) will have similar jurisdiction over the securities-based swaps markets.

The swaps market that Dodd-Frank tasks the CFTC with regulating has a notional amount roughly seven times the size of that of the futures market and is significantly more complex. The notional value of the U.S. futures market in December was approximately $36 trillion. Based upon figures compiled by the Office of the

Comptroller of the Currency, the largest 25 bank holding companies currently have $277 trillion notional amount of swaps.

Further, Dodd-Frank expands the CFTC's regulatory authority to include new types of entities, such as swap dealers, swap execution facilities (SEFs), and swap data repositories (SDRs). The swaps market is more complex than the futures markets because it includes customized bilateral hedging arrangements. Whereas all futures trade on exchanges, some swaps will continue to be traded over-the-counter.

IMPLEMENTING THE DODD-FRANK ACT

The CFTC is working deliberatively, efficiently, and transparently to implement the Dodd-Frank Act. At this point, as we have substantially completed the proposal phase of our rule-writing to implement the Dodd-Frank Act. Since the President signed the Dodd-Frank Act last July, the CFTC has promulgated rules covering all of the areas set out by the act for swaps regulation, with the exception of the Volcker Rule, for which the act set a different timeline.

With the substantial completion of the proposal phase of rule-writing, the public now has the opportunity to review the whole mosaic of rules. This will allow market participants to evaluate the entire regulatory scheme as a whole.

To further facilitate this process, last week the CFTC approved reopening or extending the comment periods for most of our Dodd-Frank proposed rules for an additional 30 days.

This time will allow the public to submit any comments they might have after seeing the entire mosaic at once. As part of this, I am hopeful that market participants will continue to comment about potential compliance costs as well as phasing of implementation dates to help the agency as we go forward with finalizing rules.

We will begin considering final rules only after staff can analyze, summarize and consider comments, after the Commissioners are able to discuss the comments and provide feedback to staff, and after the CFTC consults with fellow regulators on the rules.

One component that we have asked the public about is phasing of rule implementation. Over the last 2 days, CFTC staff has worked with the SEC staff to host a roundtable to hear directly from the public about the timing of implementation dates of Dodd-Frank rulemakings. We also opened a public comment file last month to hear specifically on this issue. The roundtable and public comments help inform the CFTC as to what requirements can be met sooner and which ones will take a bit more time.

FISCAL YEAR 2012 BUDGET REQUEST

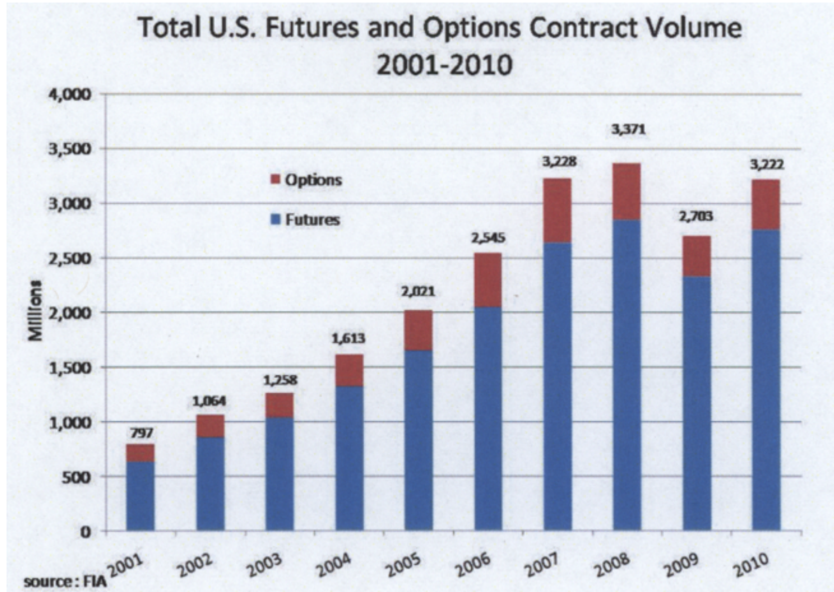
The President's budget proposes that $308 million be appropriated for the CFTC for fiscal year 2012 to remain available until expended through fiscal year 2013. This funding level would enable the Commission to perform its responsibilities both in the oversight of commodity futures markets and in beginning to oversee the swaps markets.

In 2008, both the financial system and the financial regulatory system failed the test for the American public. Though there were many causes to the crisis, the unregulated swaps market played a central role. The President's budget request asks for $106 million more than our fiscal year 2011 funding level because the 2008 financial crisis was very real, and the Congress mandated that regulation be brought to the swaps market. An investment in the CFTC is warranted, because, as we saw in 2008, without oversight of the swaps market, billions of taxpayer dollars may be at risk.

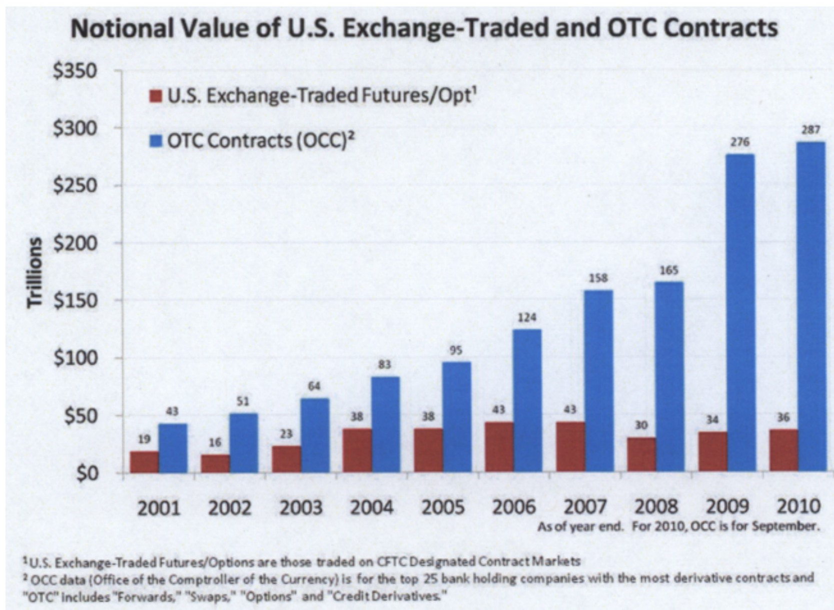
The CFTC's resources are used primarily on staff and technology.

The CFTC peaked in staff in 1992 at 634, but staff levels were cut nearly 25 percent in the early 2000s to our lowest level of approximately 440 in 2007 and 2008. With the help of the Congress, CFTC staffing levels just this past year returned to our levels of the late 1990s—the level needed to oversee the commodity futures markets at that time.

At the end of fiscal year 2010, the CFTC employed 682 thoughtful, experienced, and hardworking staff. In the last 10 years, however, futures trading volume has increased more than fourfold. The number of actively traded futures and options contracts increased more than ninefold. We have moved from an environment with open-outcry pit trading to highly sophisticated electronic markets.



The recently passed continuing resolution appropriates approximately $202 million to the CFTC, which would allow the Commission to grow modestly to approximately 720 employees. The President's fiscal year 2012 budget request would provide funding for 983 employees. Though we are asking for an increase in funding to support approximately 37 percent more staff, it is in light of a congressional mandate that expands our scope more than sevenfold.



Effective oversight of the markets requires that we invest in both staff and technology. We need staff to process registration applications, conduct surveillance, and

rule enforcement reviews, investigate fraud and manipulation, and perform many other functions that computers alone cannot. But we also need technology to pursue automated surveillance to oversee the markets and to make our oversight more efficient.

Despite rapid advances in technology and the increased size of regulated derivatives markets, funding for the CFTC has lagged behind the growth of the markets. While market participants have the technology to automate their trading, we do not yet have the resources to employ modern technology to automate our surveillance.

Last year, we used about 18 percent of our budget—$31 million—on technology initiatives. The continuing resolution requires that we allocate $37.2 million toward technology in fiscal year 2011. The CFTC needs to make further investment in technology to efficiently oversee both the futures and swaps markets. Only through investment in the CFTC will we be able to adequately oversee the commodity futures and swaps markets and protect the American public. The President's fiscal year 2012 budget provides for $66 million to be used on technology, which would increase the proportion of our budget used on technology to more than 21 percent.

To put the CFTC's funding request in perspective, I might note that the CFTC's fiscal year 2010 year-end staff of 682 compares to approximately 800,000 people employed by U.S. brokerage firms, according to the Department of Labor's Bureau of Labor Statistics. That is out of a financial industry that employs 5.6 million people. Furthermore, the CFTC's funding request of $308 million compares to approximately $814 billion in annual revenues of the top 25 bank holding companies according to industry filings with the Federal Reserve. The CFTC's technology budget of approximately $31 million during fiscal year 2010 compares to about $20–25 billion spent by U.S. broker/dealers on technology initiatives per year, according to a presentation recently given to the CFTC's Technology Advisory Committee by the TABB Group.

DETAILED FUNDING REQUEST

The requested funding increase to cover statutory authorities includes resources to accomplish the following goals:

Modernizing Information Technology and Establishing a New Group for Data.—The CFTC's fiscal year 2012 budget request includes $66 million for technology. The requested budget includes $41 million to fulfill our pre-Dodd-Frank information technology requirements. This increase allows the CFTC to invest in technology in an effort to keep pace with the futures marketplace that is becoming increasingly populated by algorithmic and high-frequency traders.

Technology will play a critical role in leveraging financial and human resources as the CFTC executes its expanded oversight and surveillance responsibilities pursuant to the Dodd-Frank Act. Accordingly, the CFTC will establish a new group for the collection, management, and analysis of data. This group will facilitate improved oversight and enforcement in the derivatives markets through the use of technology and data. It also will serve as the primary interface for market participants in adapting to the new data standards and reporting requirements for market data required under Dodd-Frank.

The CFTC's fiscal year 2012 budget request includes $25 million for technology needed to implement Dodd-Frank. The resources requested are necessary for the CFTC to invest in direct data links to SDRs that are being established in the United States and internationally. The CFTC also must have the technology to aggregate and summarize the data for purposes of oversight and surveillance.

Establishing and Staffing a New Swap Dealer and Intermediary Oversight Program.—Dodd-Frank creates two new categories of registrants: "swap dealer" and "major swap participant." Staff will be needed to regulate them for robust business conduct standards, record-keeping and reporting requirements, and capital and margin requirements. To effectively oversee swap dealers and major swap participants, the CFTC will create a new oversight program for these registrants.

Initial estimates are that there could be approximately 300 entities—compared to 127 Futures Commission Merchants (FCMs) that are currently registered with the CFTC (though other intermediaries are registered with the Commission, such as commodity trading advisers and commodity pool operators, the Commission only reviews FCMs due to resource constraints)—that will seek to register as swap dealers, FCMs or retail foreign exchange dealers.

Given the resource needs of the CFTC, we are working very closely with self-regulatory organizations, including the National Futures Association (NFA), to determine what duties and roles they can take on in the swaps markets. In par-

ticular, we proposed rules that swap dealers would be required to be members of the NFA. This could facilitate the NFA taking on responsibilities related to registration and examination of swaps dealers. Nevertheless, the CFTC has the ultimate statutory authority and responsibility for overseeing these markets. Therefore, it is essential that the CFTC have additional resources to reduce risk and promote transparency in the swaps markets.

The CFTC had 82 staff at the end of fiscal year 2010 responsible for overseeing intermediaries relating to pre-Dodd-Frank authorities. An additional 30 full-time equivalent (FTE) staff are requested for the new Swap Dealer and Intermediary Oversight Program for fiscal year 2012, for a total of 112 FTE. The requested FTE resources will be essential to fulfill significant responsibilities related to registrants.

Clearing of Standardized Swaps Through CFTC-registered Derivatives Clearing Organizations (DCOs).—The Dodd-Frank Act requires that standardized swaps be cleared through CFTC-registered DCOs. It also requires that the CFTC review and examine systemically important DCOs for compliance on a yearly basis, which we do not currently have the resources to do. Clearing has lowered risk in the futures marketplace since the 1890s. As of the end of the last fiscal year, the CFTC oversaw 14 DCOs. Based on information we have received from potential new clearinghouses, we anticipate a 50 percent increase in DCOs to 20 or 21. The CFTC currently has 40 FTE allocated to clearing oversight and risk surveillance. We are requesting an increase of 30 FTE during fiscal year 2012 for that team to address the significant increase in the number of DCOs, the more complex nature of the swaps markets and the Congressional mandate that we annually examine systemically important DCOs. This would bring total staffing levels to 70. The requested FTE resources will be essential to fulfill responsibilities related to clearing.

Oversight of SEFs and Designated Contract Markets (DCMs).—The CFTC will need additional staff to implement many new provisions related to the oversight of swaps trading activity as well as to oversee futures trading activities. These include procedures for the review and oversight of an entirely new regulated market category: SEFs. Staff in the Division of Market Oversight must establish and implement procedures for the review of new SEF applications and for the annual examination of the operations of SEFs, as well as any DCMs that offer swaps for trading. While the CFTC currently oversees 16 DCMs, based on industry comments, we that anticipate 30–40 entities will apply to register as SEFs.

Further, additional staff is necessary to evaluate data on swaps trading activity to implement the Dodd-Frank Act's real time reporting provisions and to establish appropriate block trade levels. At the end of fiscal year 2010, the CFTC had 40 staff responsible for our pre-Dodd-Frank responsibilities to oversee futures exchanges. The President's request would increase that level to 62 FTE while adding 38 FTE to implement new Dodd-Frank Authorities during fiscal year 2012 for a total of 100 FTE.

Market Surveillance, Position Limits, and SDRs.—The Dodd-Frank Act substantially expanded the responsibilities of the CFTC's Market Surveillance Unit in a number of critical ways. The Market Surveillance Unit currently administers a CFTC-set position limit regime for a total of nine agricultural futures contracts listed on DCMs. Under the Dodd-Frank Act, resources must be dedicated to implementing and enforcing new aggregate position limits that are required to be adopted that will cover both the futures market and some portion of the swaps market. These limits would apply to 28 agricultural, energy, and metals commodities.

The CFTC also must establish and implement new procedures and monitoring mechanisms to ensure that swaps data is appropriately reported to SDRs. Such data must be properly monitored, maintained and made available to the CFTC and other regulators. In addition, the Commission must have sufficient resources to analyze swaps data, detect and prevent market abuses and systemic problems, and to prepare semi-annual reports on the swaps markets mandated by the Dodd-Frank Act. Initial estimates are that the CFTC will receive at least five SDR applications upon the general effective date of Dodd-Frank.

The CFTC requests resources for 42 FTE to implement these new authorities during fiscal year 2012. The CFTC also is requesting 105 FTE to carry out pre-Dodd-Frank authorities in the areas of market surveillance, trade practice surveillance and data management, and analysis responsibilities. This would bring total FTE for these functions to 147 FTE.

Enhanced Enforcement Authority.—The CFTC's enforcement program is operating with approximately 167 FTE. The Dodd-Frank Act significantly enhanced

and expanded the CFTC's responsibility to police the markets for fraud, manipulation, and other abuses and will result in a substantial increase in the Commission's workload. The CFTC requires 68 additional FTE for the enforcement program in fiscal year 2012 over fiscal year 2010 levels to reach a total of 235 FTE.

Enhancing Consumer Education.—To enhance consumer protection, the CFTC will reorganize the Commission's current consumer education and protection functions into a single office. This group will focus on the design, implementation, and oversight of the CFTC's customer education and outreach program. This program will allow a significant increase in the CFTC's consumer outreach and education. In addition, we will establish a program to implement and administer the whistleblower requirements of the Dodd-Frank Act.

Enhancing Legal Analysis.—As novel and complex legal and economic issues arise in the development and application of rules to implement Dodd-Frank, the Office of General Counsel need to grow from a fiscal year 2010 level of 50 FTE to 70 FTE during fiscal year 2012. This staffing level is essential to support all of its programs.

Regulating Foreign Boards of Trade.—Currently, the Chief Counsel's Office in the CFTC's Division of Market Oversight has a single FTE dedicated to the processing of no-action requests from foreign boards of trade (FBOTs) seeking to permit direct access to their trading platforms by members based in the United States. Currently, 20 FBOTs operate in the United States based upon no-action letters dating back to 1999. We expect those 20 FBOTs to register with the CFTC, plus an additional 6 to 10 FBOTs who have recently expressed an interest in becoming registered. The Dodd-Frank Act's establishment of the new category of registered FBOTs requires an increase of two FTE dedicated to FBOT matters to raise the total to three FTE.

Ensuring U.S. Interests in the Global Marketplace.—The Office of International Affairs, which currently has 9 staff, requires 4 additional professional staff to address the increasing global reach of the futures and swaps markets for a total of 13 staff. Dodd-Frank specifically mandates that the CFTC consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of swaps and futures. Additional staff is required to negotiate memoranda of understanding with other regulatory authorities.

Broadening Economic Analyses.—Swaps vary substantially in terms of economic structure and will require expanded economic analyses. The Office of the Chief Economist, which employed 14 FTE at the end of fiscal year 2010, requires 6 additional FTE for a total of 20 to expand the use of econometric and analytic techniques to the swaps marketplace to gauge the effects of market activities and the regulation of those activities.

CONCLUSION

Financial markets are complex, global and interconnected, and they perform essential functions for American businesses. The derivatives markets allow producers, merchants, corporations, municipalities, nonprofit organizations, pension funds, and other end-users to lower their risk by locking in prices and rates in the future. This helps promote a vibrant economy.

We recognize that the budget deficit presents significant challenges to the Congress and the American public. But we cannot forget that the 2008 financial crisis was very real. Thus the Congress responded and said that the swaps market must be regulated and overseen, significantly expanding the scope of the CFTC. It is important that we align the CFTC's funding with its expanded mission.

The CFTC looks forward to working with the Congress and the administration to address the challenges outlined here and to secure the necessary funding to strengthen market integrity, lower risk, protect investors, promote transparency, and continue to restore health to the economy.

Senator DURBIN. Thank you Chairman Gensler.

Chairman Schapiro.

SECURITIES AND EXCHANGE COMMISSION

STATEMENT OF HON. MARY L. SCHAPIRO, CHAIRMAN

Ms. SCHAPIRO. Chairman Durbin, Ranking Member Moran, and Senator Lautenberg. Thank you for the opportunity to testify in support of the President's fiscal year 2012 budget request for the SEC. And I am, of course, pleased to appear with my colleague, Chairman Gensler.

The $1.4 billion that we are requesting will allow us to adequately staff the SEC to fulfill our core mission of protecting investors, expand our information technology systems so that we can realize operational efficiencies and better keep pace with increasingly sophisticated financial market participants, and carry out our new responsibilities over hedge funds, derivatives and credit rating agencies.

As you know, we have worked tirelessly to make the SEC a more vigilant, agile, and responsive agency over the past 2 years. And we continue moving forward on multiple fronts designed to enhance our effectiveness and ensure robust oversight of the markets.

In addition, we've embarked on a vigorous rulemaking agenda addressing critical issues, including equity market structure, money market fund resiliency, asset-backed securities, consolidated audit trail, and municipal securities disclosure. I believe we've made a number of necessary changes and accomplished a great deal.

But this year we find ourselves at a critical juncture, and that is because the Congress has challenged us not only to continue our reform efforts and to carry out our core responsibilities, but also to fulfill the significant new responsibilities given to the SEC under the Dodd-Frank Act.

As you know, separate and apart from that legislation, the SEC is responsible for essential market—financial market activities, such as pursuing fraud; reviewing public company disclosures; inspecting the activities of investment advisers, investment companies, and broker dealers; and ensuring fair and efficient markets.

Over the past decade, the size and complexity of the securities markets have grown at a rapid pace. Indeed, during the past decade trading volume more than doubled, listed equity market volume alone now averages approximately 8.5 billion shares a day, the number of investment advisers grew by 50 percent, and the assets they manage increased to $38 trillion. Today, the SEC has responsibility for approximately 35,000 entities, including direct oversight of more than 11,000 investment advisers, 7,500 mutual funds, 5,000 broker dealers with more than 160,000 branch offices.

We also review the disclosures and financial statements of approximately 10,000 reporting companies, and we oversee transfer agents, exchanges, clearing agencies and credit rating agencies. Indeed, we oversee some financial firms that regularly spend many

times more just on their technology operations than the SEC's entire budget.

And because of the new legislation, we are taking on considerable new responsibilities for oversight of the OTC derivatives market and hedge fund advisers, registration of municipal advisers and security-based swap market participants, enhanced supervision of credit rating agencies, heightened regulation of asset-backed securities, and the creation of a new whistleblower program.

A budget of $1.4 billion would allow us to hire the experts and acquire the technology we need to effectively carry out both our core responsibilities and to begin to implement the Dodd-Frank Act. Of the 2012 requested amount, we estimate that $123 million will be allocated to begin implementing the provisions of the new law.

This funding request also will support information technology investments of $78 million, including vital new technology initiatives ranging from data management and integration to internal accounting and financial reporting. It will permit the SEC to continue development of risk analysis tools to help us triage and analyze tips, complaints, and referrals. And it will permit us to complete a digital forensics lab that enforcement staff will use to recreate data from computer hard drives and cell phones, to capture evidence of sophisticated frauds.

PREPARED STATEMENTS

Finally, it is important to note that under the Dodd-Frank Act the SEC's fiscal year 2012 funding request will be fully offset by matching collections of fees on securities transactions. Beginning with 2012, the SEC is required to adjust its fee rates so the amount collected will match the total amount appropriated for the SEC by the Congress. Because of this mechanism, the SEC funding will be deficit neutral.

I thank the subcommittee for your support, and I look forward to working with you to improve the SEC's performance of its core mission, to implement our new responsibilities, and to continue protecting investors. And I am, of course, happy to answer any questions that you have.

[The statements follow:]

PREPARED STATEMENT OF MARY L. SCHAPIRO

Chairman Durbin, Ranking Member Moran, members of the subcommittee: Thank you for the opportunity to testify in support of the President's fiscal year 2012 budget request for the Securities and Exchange Commission (SEC).[1] I welcome this opportunity to answer your questions and provide you with additional information on how the SEC would make effective use of the $1.407 billion that is requested for the coming fiscal year.[2]

Over the past 2 years, we have worked tirelessly to make the SEC more vigilant, agile, and responsive, and are moving on multiple fronts to enhance the Commission's effectiveness and provide robust oversight of the financial markets. We have new senior leadership in all key positions and have embarked on a vigorous rulemaking agenda, addressing areas such as equity market structure, investment ad-

[1] A copy of the SEC's FY2012 Budget Congressional Justification can be found on our Web site at http://www.sec.gov/about/secfy12congbudgjust.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.

viser custody controls, money market fund resiliency, asset-backed securities, large trader reporting, pay-to-play, and municipal securities disclosure.

In addition to carrying out our longstanding core responsibilities, last year's enactment of the Dodd-Frank Act has added significantly to the SEC's workload. In the short term, it requires the SEC to promulgate more than 100 new rules, create five new offices, and produce more than 20 studies and reports. The law assigns the SEC considerable new responsibilities that will have a significant long-term impact on the Commission's workload, including oversight of the over-the-counter (OTC) derivatives market and hedge fund advisers; registration of municipal advisers and security-based swap market participants; enhanced supervision of nationally recognized statistical rating organizations (NRSROs) and clearing agencies; heightened regulation of asset-backed securities (ABS); and creation of a new whistleblower program.

My testimony will provide an overview of the SEC's actions and initiatives during the past year. I will then discuss the fiscal year 2012 budget request and the activities that these resources would make possible.

NEW LEADERSHIP, ORGANIZATIONAL REFORM, AND EXPERTISE

Without a doubt, the most critical element to our success in improving the SEC's operations is the Commission's talented staff. Over the past 2 years, we have installed new management across the major divisions and offices of the SEC. These new senior managers are playing a vital role in our efforts to transform the Commission.

During my first year, we brought in new leadership to run the four largest operating units—the Division of Enforcement, the Office of Compliance Inspections and Examinations (OCIE), the Division of Corporation Finance, and the Division of Trading and Markets. We also created a new Division of Risk, Strategy, and Financial Innovation to re-focus the SEC's attention on—and response to—new products, trading practices, and risks.

This past year, we brought on board a new director to oversee the Division of Investment Management, and hired deputy directors in the Divisions of Trading and Markets and Corporation Finance. We also brought on board key leaders to help improve internal operations. This includes the creation of a new Chief Operating Officer position; the hiring of a new Chief Financial Officer to oversee the SEC's budget, accounting, and financial reporting; the hiring of a new Chief Information Officer to oversee the SEC's information technology program; and the hiring of the SEC's first Chief Compliance Officer. At all levels we have focused on hiring individuals with key skill sets that reflect the rapidly changing markets under our supervision.

We're continuing to make significant progress in reforming how the SEC operates. Since 2009, the SEC has carried out a comprehensive review and restructuring of its two largest programs—enforcement and examinations—to ensure effective performance. The Enforcement Division has streamlined its procedures to bring cases more swiftly, removed a layer of management, created national specialized units, and added new staff with new skills to pursue complex fraud and market abuses. The SEC's examinations unit restructured its exam program after a top-to-bottom review, becoming more risk-based in its approach, enhancing staff training, and installing better systems to support examiners. And more recently, we have begun analyzing and implementing recommendations from the Boston Consulting Group, Inc., which the SEC retained to perform an independent organizational assessment pursuant to section 967 of the Dodd-Frank Act.

Also during the past year, to the extent permitted by available resources, we worked to improve training and education of SEC staff, to establish a deeper reservoir of experts throughout the SEC, and to modernize information technology, including a centralized system for tips and complaints, enforcement and examination management systems, risk analysis tools, and financial management systems.

ENFORCING THE LAW

Enforcement of the securities laws is the foundation of the SEC's mission. Swift and vigorous proceedings directed at those who have broken the law are at the heart of the SEC's efforts to protect investors.

In the past year, the SEC has continued our structural reforms of the enforcement program. We have created five national specialized investigative groups dedicated to high-priority areas of enforcement; adopted a flatter organizational structure to permit more staff to be allocated to front-line investigations; and created a new Office of Market Intelligence (OMI) to serve as the hub for the effective handling of tips, complaints, and referrals.

The Dodd-Frank Act substantially expands the SEC's authority to compensate whistleblowers who provide the Commission with high-quality information about violations of the Federal securities laws. Last November, the SEC proposed rules mapping out the procedure for would-be whistleblowers to provide information to the Commission. The proposed rules describe how eligible whistleblowers can qualify for an award through a transparent process that provides them an opportunity to assert their claim to an award. Pending the adoption of final rules, enforcement staff has been reviewing and tracking whistleblower complaints submitted to the SEC.

We also have added a series of additional measures to encourage corporate insiders and others to come forward with evidence of wrongdoing. These new cooperation initiatives establish incentives for individuals and companies to fully and truthfully cooperate and assist with SEC investigations and enforcement actions. This program will encourage "insiders" with knowledge of wrongdoing to come forward early, thus allowing us to shut down fraudulent schemes earlier than would otherwise be possible.

These reforms, which were intended to maximize our use of resources and permit the SEC to move more swiftly and strategically, are already showing improvements. Over the past calendar year, court-ordered disgorgements are up 20 percent, while the amount of monetary penalties has almost tripled. Of course, numbers alone don't fully capture the complexity, range, or importance of our enforcement accomplishments. During the past year, the SEC:

—brought significant actions involving issues arising from the financial crisis, including actions against the former Chief Executive Officer and other executives of Countrywide Financial; Citigroup and its former Chief Financial Officer and Head of Investor Relations, Morgan Keegan; Goldman Sachs; State Street Bank; former executives of New Century Financial and IndyMac Bancorp; Brookstreet Securities; and ICP Asset Management and its president;

—obtained multi-million dollar settlements with Tyson Foods, Alcatel-Lucent, Technip, General Electric, and Johnson & Johnson for violations of the Foreign Corrupt Practices Act;

—filed our first case against a State involving municipal securities;

—brought accounting fraud cases against Dell, Diebold, DHB Industries, and Satyam Computer Services;

—charged a corporate attorney and Wall Street trader with insider trading in advance of at least 11 merger and acquisition announcements involving clients of the law firm where the attorney worked;

—charged a Food and Drug Administration (FDA) chemist with trading on confidential information about upcoming announcements of FDA drug approval decisions;

—brought a significant case alleging inappropriate use of confidential customer information by a proprietary trading desk at Merrill Lynch and an action against AXA Rosenberg in the challenging and rapidly evolving area of computer-based quantitative investment management;

—filed a variety of cases to halt Ponzi scheme operators and perpetrators of offering frauds, including those brought in conjunction with the Financial Fraud Enforcement Task Force's Operation Broken Trust sweep—indeed, in each of the past 2 fiscal years we have filed more than twice as many Ponzi cases as we filed in fiscal 2008;

—brought actions alleging illegal trading on confidential information obtained from technology company employees moonlighting as expert network consultants and illegal trading by major hedge funds based on illegal tips; and

—brought an action alleging a $1.5 billion mortgage securities fraud scheme to defraud the U.S. Treasury's Troubled Asset Relief Program.

STRENGTHENING OVERSIGHT

Strong regulation is essential to the fair, orderly, and efficient operation of markets. A vigorous examination program not only reduces the opportunities for wrongdoing and fraud, but also provides early warning about emerging trends and potential weaknesses in compliance programs.

This past year, the SEC reorganized the Commission's national examination program in response to rapidly changing Wall Street practices and lessons learned from the Madoff and Stanford frauds. The SEC strengthened the national exam program to provide greater consistency and efficiencies across our 11 regions and to focus more sharply on identifying the higher-risk firms that it targets for examination. We also implemented new policies requiring examiners to routinely verify the existence of client assets with third-party custodians, counterparties, and customers. Ad-

ditionally, the exam unit now assembles individual specialists with the appropriate skill-sets for the firm they are examining or the issues on which they are focusing. Finally, the SEC has also worked to enhance the training of examiners and bring on board specialists in risk management, trading, and complex structured products.

These reforms are helping to deliver results in the exam program's work to evaluate risks, inform policy, and identify potential wrongdoing. In fact, in January 2011 alone, the Enforcement Division brought three significant cases stemming directly from exams. And going forward, the national exam program will continue to conduct sweeps in critical areas from trading practices to market manipulation to structured products.

IMPROVING MARKET STRUCTURE

No discussion of the SEC's actions over the past year would be complete without a discussion of May 6, 2010—the day our markets dropped more than 500 points in a matter of minutes, only to bounce back minutes later. That event reinforced the importance of our ongoing review of market structure, which we had launched months earlier with a concept release inviting comment on regulation of the changing financial markets.

The U.S. equity market structure has changed dramatically in recent years. A decade ago, most of the volume in stocks was executed manually, whether on the floor of an exchange or over the telephone between traders. Now nearly all orders are executed by fully automated systems at great speed. The fastest exchanges and trading venues are now able to accept, execute, and send a response to orders in less than one-thousandth of a second.

Speed is not the only thing that has changed. As little as 5 years ago, the great majority of U.S. equities capitalization was traded on a listing market—the New York Stock Exchange (NYSE)—that executed nearly 80 percent or more of volume in those stocks. Today, the NYSE executes approximately 22 percent of the volume in its listed stocks. The remaining volume is split among 15 public exchanges, more than 30 dark pools, 3 electronic communication networks, and more than 200 internalizing broker-dealers. Currently, more than 30 percent of the volume in U.S.-listed equities is executed in venues that do not display their liquidity or make it generally available to the public, reflecting an increase over the last year.

The evolution of trading technologies has dramatically increased the speed, capacity, and sophistication of the trading functions that are available to market participants. The new electronic market structure has opened the door for entirely new types of professional market participants. Today, proprietary trading firms play a dominant role by providing liquidity through the use of highly sophisticated trading systems capable of submitting many thousands of orders in a single second. These high-frequency trading firms can generate more than 1 million trades in a single day and now account for more than 50 percent of equity market volume.

Over the past year, the SEC has engaged in a dedicated effort to study and learn from the experiences of May 6, with the aim of taking action to preserve the benefits of the current structure while minimizing its downsides. The SEC worked with Financial Industry Regulatory Authority (FINRA) and the exchanges to develop rules that trigger circuit breakers for certain individual stocks, clarify up front how and when erroneous trades would be broken, and effectively prohibit “stub quotes” in the U.S. equity markets. We adopted a rule that prohibits broker-dealers from providing their clients with unfiltered access to exchanges, and proposed the creation of a large trader reporting system that would enhance our ability to identify large market participants, collect information on their trades, and analyze their trading activity.

We also proposed a new rule that would require the creation of a consolidated audit trail that would enable regulators to track information about trading orders received and executed across the securities markets. Today, there is no standardized, automated system to collect data across the various trading venues, products, and market participants. Each market has its own individual and often incomplete data collection system, and as a result, regulators tracking suspicious activity or reconstructing an unusual event must obtain and merge an immense volume of disparate data from a number of different markets. And even then, the data does not always reveal who traded which security, and when. To obtain individual trader information, the SEC must make a series of manual requests that can take days or even weeks to fulfill. In brief, the SEC's tools for collecting data and surveilling our markets are wholly inadequate to the task of overseeing the largest equity markets in the world.

KEY RULEMAKING

Over the past year, the SEC has pursued an active rulemaking agenda aimed at making our financial markets more secure, providing investors with more and better information, finding ways to make securities markets less volatile and more transparent, and promoting effective corporate governance. Even before passage of the Dodd-Frank Act, the SEC was in the midst of a productive period of rulemaking on diverse topics. Among the key ongoing and recently completed rulemakings are the following:

Municipal Securities.—The SEC adopted rules that provide market participants with more meaningful and timely information regarding the health of municipal securities. In addition, as discussed below, we adopted rules to curtail pay-to-play practices by investment advisers seeking to manage public pensions.

Proxy Enhancements.—The SEC adopted rules to facilitate exercise of shareholders' traditional State law right to nominate directors to corporate boards. We also improved disclosure relating to risk and compensation and revised the e-proxy rules so that additional materials could be provided to shareholders with the company's notice. And, we issued a concept release requesting public input on the mechanics of proxy voting and shareholder communications.

Investment Adviser Disclosure.—In order to ensure that investors receive clear and accurate information from their advisers, the SEC adopted rules requiring advisers to provide clients with brochures that plainly disclose their business practices, fees, conflicts of interests, and disciplinary information.

Mutual Funds Fees and Marketing.—The SEC proposed rules to create a more equitable framework for mutual fund marketing fees, known as 12b–1 fees. We proposed rules to help clarify the meaning of a date in a target date fund's name, as well as enhance information in fund advertising and marketing materials.

Target Date Funds.—The SEC proposed rules that are intended to provide enhanced information to investors concerning target date retirement funds and reduce the potential for investors to be confused or misled regarding these funds.

Money Market Funds.—The SEC took action to permit investors, for the first time, to access detailed information that money market funds now file with the Commission, including their "shadow NAV" (net asset value). While the SEC uses this information in its real-time oversight of money market funds, public disclosure can provide investors and market analysts with useful insight for their evaluation of funds. We also tightened the quality standards that apply to the funds' investments and are working with our regulatory colleagues to assess the various options for making sure these funds are as safe and resilient in the face of market stresses as investors are led to believe.

Asset-backed Securities.—The SEC proposed rules that would revise the disclosure, reporting and offering process for ABS to better protect investors in the securitization market.

Market Access.—The SEC took an important step to promote market stability by adopting a new market access rule. Broker-dealers that access the markets themselves or offer market access to customers will be required to put in place appropriate pre-trade risk management controls and supervisory procedures. The rule effectively prohibits broker-dealers from providing customers with "unfiltered" access to an exchange or alternative trading system. The rule should prevent broker-dealers from engaging in practices that threaten the financial condition of other market participants and clearing organizations, as well as the integrity of trading on the securities markets.

Pay-to-play.—The SEC adopted in June of last year a new rule to address so-called "pay-to-play" practices in which investment advisers make campaign contributions to elected officials in order to influence the award of contracts to manage public pension plan assets and other government investment accounts. The rule, adopted in response to a growing number of reports of such activities across the country, is intended to combat pay-to-play arrangements at the State and local government level in which advisers are chosen based on their campaign contributions to political officials rather than on merit.

In addition to these items, enactment of the Dodd-Frank Act added significant new work to the SEC's agenda, including more than 100 rulemaking provisions applicable to the SEC. To date, the SEC has issued 34 proposed rule releases, 7 final rule releases, and 2 interim final rule releases in connection with the Dodd-Frank Act. We have received thousands of public comments, held hundreds of meetings with market participants, completed seven studies, and hosted five roundtables. Key rulemakings under the Dodd-Frank Act include regulations for the supervision of OTC derivatives, private fund advisers, asset-backed securities, credit rating agen-

cies, corporate governance, rewards for whistleblowers, and specialized disclosure provisions related to conflict minerals, mine safety, and resource extraction.

SEC RESOURCES

This year finds the SEC at an especially critical juncture in its history. Not only does the Dodd-Frank Act create significant additional work for the SEC, both in the short and long term, but the Commission must also continue to carry out its longstanding core responsibilities. These responsibilities—pursuing securities fraud, reviewing public company disclosures and financial statements, inspecting the activities of investment advisers and broker-dealers, and ensuring fair and efficient markets—remain essential to investor confidence and trust in financial institutions and markets.

Over the past decade, the SEC has faced significant challenges in maintaining a staffing level and budget sufficient to carry out its core mission. The SEC experienced 3 years of frozen or reduced budgets from fiscal year 2005 to 2007 that forced a reduction of 10 percent of the Commission's staff. Similarly, the SEC's investments in new or enhanced information technology (IT) systems declined about 50 percent from fiscal year 2005 to 2009.

As a result of increased funding levels in fiscal year 2009 and fiscal year 2010, current SEC staffing levels have only recently returned to the level of fiscal year 2005, despite the enormous growth in the size and complexity of the securities markets since then. During the past decade, for example, trading volume has more than doubled, the number of investment advisers has grown by 50 percent, and the assets they manage have increased to $38 trillion. Six years ago, the SEC's funding was sufficient to provide 19 examiners for each $1 trillion in investment adviser assets under management. Today, that figure stands at 12 examiners per $1 trillion. A number of financial firms spend many times more each year on their technology budgets alone than the SEC spends on all of its operations.

Today, the SEC has responsibility for approximately 35,000 entities, including direct oversight of 11,800 investment advisers, 7,500 mutual funds, and more than 5,000 broker-dealers with more than 160,000 branch offices. We also review the disclosures and financial statements of approximately 10,000 reporting companies. The SEC also oversees approximately 500 transfer agents, 15 national securities exchanges, 9 clearing agencies, 10 NRSROs, as well as the Public Company Accounting Oversight Board, FINRA, Municipal Securities Rulemaking Board, and the Securities Investor Protection Corporation.

In addition to our traditional market oversight and investor protection responsibilities, the enactment of the Dodd-Frank Act has added significant new responsibilities to the SEC's workload. These new responsibilities include a parallel set of responsibilities to oversee the OTC derivatives market, including direct regulation of participants such as security-based swaps dealers, venues such as swap execution facilities, warehouses such as swap data repositories, and clearing agencies set up as long-term central counterparties. In a similar fashion, under the Dodd-Frank Act the SEC has been given responsibilities for hedge fund advisers that are similar to those that the Commission has long overseen with respect to traditional asset managers. These hedge fund advisers include those that trade with highly complex instruments and strategies. Additionally, the SEC has new responsibility for registration of municipal advisers, enhanced supervision of NRSROs, heightened regulation of asset-backed securities, and the creation of a new whistleblower program.

FISCAL YEAR 2011 BUDGET

Under the agreement that was recently approved by the Congress and signed by the President, the SEC's fiscal year 2011 appropriation is $1.185 billion, an increase of $74 million more than the fiscal year 2010 enacted level. While the SEC is still working to finalize an operating budget for the balance of the year that will make effective use of these funds, I want to provide you with some insight into some of the Commission's priorities for the remainder of fiscal year 2011. Specifically, the fiscal year 2011 funding level provided by the Congress will allow the SEC to fill vacancies to meet key strategic needs, perform tasks required by the Dodd-Frank Act, and continue to improve Commission operations.

It will permit us to address important staffing needs, particularly within the Division of Trading and Markets, Division of Enforcement, and OCIE, which will permit us to partially address the SEC's significant staffing capacity gap. These needs include revitalizing core programs such as enforcement and inspections activities, as well as addressing new responsibilities such as enhancing oversight of credit rating agencies and adding staff with expertise in critical areas such as derivatives.

Additionally in the last 5 months of fiscal year 2011, we plan to make needed investments in the development, modernization, and enhancement of information technology that can lead to additional savings or aid staff productivity. We will be making key investments in general IT infrastructure modernization, including refreshing old technology and system hardware and software to avoid loss of productivity, facilitating the migration of the SEC's financial systems to a shared service provider, increasing system capacities to accommodate data growth, and increasing operational efficiencies through better monitoring of system performance. We will also continue making needed investments in systems and technologies needed to facilitate reporting of information required by the Dodd-Frank Act.

Finally, in fiscal year 2011 we will also continue to advance the SEC's efforts to improve Commission operations. I have recently submitted a reprogramming request to improve efficiency by consolidating the functions of the Office of the Executive Director into the Office of the Chief Operating Officer. Also in fiscal year 2011, we expect to undertake major reforms in the Office of Information Technology and Office of Human Resources, which provide critical back-office support to all SEC divisions and offices. The SEC also plans significant investment in the current fiscal year to respond to the recommendations made by the BCG as part of its recent independent assessment of SEC operations and organizational structure.

FISCAL YEAR 2012 REQUEST

The SEC is requesting $1.407 billion for fiscal year 2012, an increase of $222 million more than the new fiscal year 2011 appropriation level. If enacted, this request would permit us to add about 780 positions by the end of fiscal year 2012 for both improvements to base operations and implementation of the SEC's new responsibilities.

It is important to note that the SEC's fiscal year 2012 funding request would be fully offset by matching collections of fees on securities transactions. Currently, the transaction fees collected by the SEC are approximately 2 cents per $1,000 of transactions. Under the Dodd-Frank Act, beginning with fiscal year 2012, the SEC is required to adjust fee rates so that the amount collected will match the total amount appropriated for the Commission by the Congress. Under this mechanism, SEC funding will be deficit-neutral, as any increase or decrease in the Commission's budget would result in a corresponding rise or fall in offsetting fee collections.

The fiscal year 2012 request is designed to provide the SEC with the resources required to achieve several high-priority goals: to adequately staff the Commission to fulfill its core mission; to continue to implement the requirements of the Dodd-Frank Act; and to expand the Commission's IT systems and management infrastructure to serve the needs of a more modern and complex organization. For purposes of my testimony today, I would like to summarize the request in each of these priority areas:

Reinvigorating Core SEC Programs.—Forty percent (312) of the new positions would be used to strengthen and support core SEC operations, including protecting investors, maintaining orderly and efficient markets, and facilitating capital formation. As mentioned before, SEC staffing levels are just now returning to fiscal year 2005 levels, even as the Commission's responsibilities have grown along with the size and complexity of the securities markets. To help restore core capabilities, this budget request would permit us to add 49 positions to the enforcement program that would grow the 5 new specialized investigative units, bolster the agency's litigation program, and expand the new OMI which conducts risk assessment and handles thousands of tips, complaints, and referrals. In our examination program, this request would allow us to add 55 personnel to augment risk assessment, monitoring, and surveillance functions and to conduct additional adviser and fund inspections. The request would also permit 37 staff to be added to the Division of Corporation Finance primarily to conduct more frequent disclosure reviews of the largest companies, 15 additional staff to the Division of Investment Management primarily to enhance oversight of money market funds and specialized products, and 11 new positions to be added to the Division of Risk, Strategy, and Financial Innovation to better equip the SEC to identify and address emerging risks and long-term issues of critical importance.

Implementing the Dodd-Frank Act.—Sixty percent (468 positions) of the new positions would be used to implement the Dodd-Frank Act. Many of these new positions would be used to hire experts in derivatives, hedge funds, data analytics, credit ratings, and other new or expanded responsibility areas, so that the SEC may acquire the deeper expertise and knowledge needed to perform effective oversight. These new positions would support 157 new positions focused

on the derivatives markets; 102 focused on hedge fund advisers; 43 to expand investigations of tips received from whistleblowers; 35 focused on municipal securities and examinations of newly registered municipal advisers; 33 focused on clearing agencies, including annual reviews of those determined to be systemically important; and 26 focused on NSRSOs principally to perform the annual examinations required by the act. Also in fiscal year 2012, the SEC would invest in technology to facilitate the registration of additional entities and capture and analyze data on the new markets.

The total fiscal year 2012 costs to implement the Dodd-Frank Act through these new positions and technology investments will be approximately $123 million. In addition to the new positions requested in fiscal year 2012, we also anticipate that about 300 additional positions and additional technology investments will be required in fiscal year 2013 for full implementation of the Dodd-Frank Act.

Investing in Information Technology.—The SEC's budget request for fiscal year 2012 will support information technology investments of $78 million. This level of funding would support vital new technology initiatives including data management and integration, document management, EDGAR modernization, market data, internal accounting and financial reporting, infrastructure functions, and improved project management. This funding will permit the SEC to develop risk analysis tools to assist with triage and analysis of tips, complaints, and referrals and to complete a digital forensics lab that enforcement staff can use to recreate data from computer hard drives and cell phones to capture evidence of sophisticated frauds. The budget request would also permit the hiring of additional staff in the Office of Information Technology, including experienced business analysts and certified project managers to oversee IT projects and staff to address financial statement and information technology deficiencies identified by the Government Accountability Office (GAO).

Improving the SEC's Management Infrastructure.—The SEC's fiscal year 2012 request would permit the Commission to make further improvements to the Commission's basic internal operations and to bring administrative and support services capabilities into alignment with the requirements of today's SEC, and ensure that the Commission manages its resources wisely and efficiently. The budget request would permit the strengthening of the newly established Office of the Chief Operating Officer, including the development of a more robust operational risk management program and the build-out of a data management program. The budget request also contemplates an appropriate expansion of the SEC's administrative support functions, including the Offices of Financial Management, human resources, administrative services, and Freedom of Information Act and records management. The request also includes the necessary space rent and other noncompensation expenses necessary to support the level of staffing requested for fiscal year 2012. Additionally, the SEC is devoting significant management attention to improving program and management controls, including in response to audits and assessments by the Office of the Inspector General, the GAO, and management's own internal assessments.

Addressing Material Weaknesses in Internal Controls.—In November 2010, the SEC completed its Performance and Accountability Report, the equivalent of a company's annual report. A GAO audit found that the financial statements and notes included in the report were presented fairly and in conformity with U.S. GAAP. It also, however, identified two material weaknesses in internal controls over financial reporting: one in information systems, and a second in financial reporting and accounting processes. The root causes of these weaknesses are gaps in the security and functionality of the SEC's financial system, resulting from years of underinvesting in financial system technologies.

These material weaknesses are unacceptable. Rather than try and solve each particular deficiency in piecemeal fashion, the SEC has committed to investing the time and resources to implement a long-term, comprehensive solution. To avoid the development risks of creating new technology and systems, the SEC is switching to a Shared Service Provider approach, migrating the Commission's financial system to the Department of Transportation (DOT). Other agencies, including the GAO, have migrated to DOT, and they have had very positive results, with clean audits free of material weaknesses. This will be a significant undertaking, which, assuming adequate funding, will culminate in the cutover to the new system in April 2012.

CONCLUSION

Thank you, again, for your support for the SEC'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.

PREPARED STATEMENT OF COLLEEN M. KELLEY, PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION

For a decade now, the National Treasury Employees Union (NTEU) has represented the men and women who work at the Securities and Exchange Commission (SEC). When the NTEU first began to represent the employees, we were able to help make great strides forward in improving the efficiency and effectiveness of the agency. The NTEU supported Investors and Capital Markets Relief Act gave the SEC the authority to develop a personnel system best suited to the Commission's needs and curtailed the staff turnover crisis that vexed the Commission. Employee morale and retention improved dramatically.

However, starting in fiscal year 2005, the SEC began to take a wrong turn. It suffered through 3 years of frozen or reduced budgets resulting in a 10 percent reduction in staff as well as a failure to fully fund merit pay and retirement benefits which both labor and management agreed were needed to attract a workforce with the desired skills and experience. Some employees wondered if the leadership really supported strong and meaningful action against those who would engage in fraud and deception towards consumers and investors.

Under Chairman Mary L. Shapiro, we believe there is a renewed commitment to rigorous protection of consumers. This protection is also enhanced by the Dodd-Frank Wall Street Reform and Consumer Protection Act which will help give the SEC the resources, tools, and authority it needs so that the staff can effectively protect investors. The NTEU had strongly supported passage of this legislation. We are also pleased that recent funding improvements at the SEC have now restored staffing to the 2005 levels.

However, the job is far from done. During the recent period of almost flat funding for the SEC, trading volume more than doubled. Since 2003, the number of investment advisers has grown by roughly 50 percent, as have the number of funds they manage. A $33 trillion industry of 35,000 separate entities is policed for fraud and illegal activities by a mere 3,800 employees of the SEC.

With insufficient funding for even its historic duties, the SEC now has significant new duties under the Dodd-Frank Act. The NTEU believes that the President's request of $1.4 billion is the minimum needed to make sure that the SEC is able to do its job effectively. We ask that the Senate fund the SEC at an amount no less than the President's request.

We understand these are difficult financial times both for the Federal Government and the American public. Therefore, several facts need to be understood. First, while the SEC is an appropriated agency, its funding is offset by fees collected from the securities industry. Because these fees offset the entire SEC budget, proper funding of the SEC does not contribute to the deficit. Second, as American families struggle in the current economic downturn, the SEC has returned billions of dollars to cheated investors. In 2010, the SEC distributed double its budget ($2.2 billion) to these innocent victims. The Congress should not be penny wise and pound foolish when it comes to protecting the investments of American consumers, only to see the victimized lose retirement investments or like time savings.

During the difficulties in passing the fiscal year 2011 budget, the public already saw the flaws of an underfunded SEC. Operating under the fiscal restrictions of the continuing resolution, it was not possible to pursue some quality tips and investigations of potential misconduct, while other investigations were slowed down or delayed. The SEC suffered under a reduced ability to hire expert witnesses for trial and to take testimony of certain witnesses. Funding limitations lessened the number of exams that could be conducted of high-risk registrants, thus increasing the risk of undetected violations.

Rather than a hiring freeze, as was put into place at the SEC during the continuing resolution, the SEC should have funding to hire needed new personnel to implement the provisions of the Wall Street Reform and Consumer Protection Act, as well as to be able to offer a competitive compensation package which allows the SEC to retain and attract staff with skill sets vital to keeping pace with rapidly changing markets and to identify systemic risks that may be created by entities subject to the SEC regulation. The SEC must have a budget that will fully fund its merit pay program as well as agreed-upon retirement benefits.

The NTEU remains ready to work with the subcommittee and the SEC management to help meet the goals needed so employees can do their job of protecting the American consumer and investor.

RULE-WRITING TIMETABLE

Senator DURBIN. Thank you, Chairman Schapiro, and Chairman Gensler, as well.

I don't think it's any surprise that the tables have turned politically here on Capitol Hill since the passage of the Dodd-Frank Act. And with the new Republican majority in the House of Representatives and a larger Republican presence in the Senate, some of the critics of the Dodd-Frank Act and those who voted against it now are questioning not only whether it was a good decision, but whether or not it's being implemented fairly and effectively.

And they have gone so far—many of them—as to just flat out say, "We want to delay this"—for 1 year, 18 months, maybe longer. In the instance of one issue that I'm involved in—2½ years they want to put off the implementation of some of the Dodd-Frank Act provisions. So this go-slow approach is being argued and justified as necessary because the Dodd-Frank Act, in their opinion, either did the wrong thing or, whatever they did, did it too fast, and can't be implemented effectively.

Now, I take a look at some of the comments that have been made, Chairman Gensler, about this, and wonder if you would comment on whether or not the timetable in the Dodd-Frank Act for the new rules, the comment periods and the promulgation of these rules, is in fact one that you can live with, that you can produce a good work product with.

Second, I look at the report of your IG which, who said back in April, just a few weeks ago, that it was their office's feeling that you were focusing too much on the legal side of these rules and not enough on the economic or cost-benefit side of these rules. And that is a legitimate question that I think you should address as well. So could you address those two issues?

Mr. GENSLER. I thank you, Mr. Chairman.

I think that the financial crisis was very real. There are still 7 million people probably out of work because of it, and millions who have homes that are worth less than their mortgages, and pensions that aren't securing their futures. And I think part of it was the derivatives market. It's not the only reason for the crisis, but it was a key part of it. Let us not forget AIG.

In terms of our rule-writing, I think that we've been very deliberate. We've been very public. We've had, I think, close to a dozen roundtables and 14 public hearings. We had more than 700 meetings that we posted on our Web site with market participants and investors and the like, and end-users. And we have now out for comment these roughly 50 rules that will be the whole mosaic, and people will come in and give us comments on them.

In terms of the time schedule, the Congress did lay out 1 year. We'll not complete the task in 1 year. We've done the proposal phase in roughly 9 months, working closely with the SEC. I think that we'll only take up final rules as we summarize those comments, get commissioner feedback, regulatory feedback, Congres-

sional feedback. And I think it will take us well through the summer and fall to finalize the rules.

In terms of implementation, we had 2 days of public roundtables. We have a public file on how to implement and phase in the implementation. It will significantly lower the cost to the American public if we phase in the implementation. A big bang at one date doesn't work.

But I think a delay is being considered elsewhere in the Congress. A delay of the effective date to the end of 2012, I think, would be a delay that would put the American public at risk—at risk of markets that are still dark by and large, at risk of a market that's unregulated by and large. The reforms only come into being if we actually get these rules finalized.

INSPECTOR GENERAL REPORT

In terms of the IG report, we welcomed it. We seriously considered, as we moved to final rules, to incorporate recommendations that the IG has made to us. We do have a very fine Office of the Chief Economist with a staff of about 14 economists. We are wishing in this budget request to grow it to 20. But there are also a lot of economists in the rule-writing teams that aren't in the Office of Chief Economist.

COST OF UNREGULATED DERIVATIVES

Senator DURBIN. So, I agree with your premise—that the recession that we're still living through can be traced to many sources, and one of those was an unregulated derivatives market.

Can you give me any examples of what you saw in that market that showed that the lack of regulation, the lack of oversight, led to decisions which were ultimately negative for our economy, and for many families and investors?

Mr. GENSLER. Well, at the core was a lightly regulated, ineffectively regulated insurance company called AIG that had about a $2 trillion derivatives book. And that book had a lot of product called credit default swaps. And then the American public ended up bailing out AIG with $180 billion.

That wasn't the only piece of the crisis, because, also, derivatives make these large financial institutions very interconnected. I believe there should be a freedom to fail—that large financial institutions should be allowed to fail—but the derivatives marketplace so ties them, like in a spider's web, that it's hard for a government, whether it's the Federal Reserve or the Treasury, to allow that. And so, the solution that the Congress passed was—bring transparency to the marketplace, ensure that what can be brought to clearinghouses—a mechanism that's worked more than 100 years—is done, and also to make sure that dealers are well-capitalized and well-regulated.

Senator DURBIN. So who would benefit, if we would either repeal the Dodd-Frank Act when it came to this derivatives market, or if we would delay indefinitely the oversight and regulation which the Dodd-Frank Act calls for?

Mr. GENSLER. I think the American public would be put at great risk. I think that a $300 trillion marketplace—$20 for every $1 in our economy—would still be a dark market. So I don't think many

people benefit. There may be some who would benefit and rationally would like a darker market, where they're in the financial community. But the tens of thousands of end-users of these products need to have confidence in a marketplace where they can rely on that marketplace, see the pricing in the market place. Whether it's a farmer, rancher, a corporation hedging an interest rate risk—they'll benefit from this being well-regulated.

Senator DURBIN. If I can ask you one last question more specific, and one of the criticisms is that, instead of investing in the technology which the CFTC needs, you're in fact adding employees. Would you comment on that? I know you testified that you're requesting more money for technology.

TECHNOLOGY

Mr. GENSLER. The request for 2012 is about doubling technology, and about 35 percent more staff. So, we believe technology is the only way for us to really do this. But since we're taking on a market that's about seven or eight times the size, asking for 35 percent more staff we think is relevant.

Again on technology, at $66 million we'll be a fraction of Wall Street. It's estimated by the TABB Group, investment banks spent $20 billion to $25 billion per year on technology. So we're, you know, we're kind of coming with a pea shooter here, frankly, to a sophisticated market that has a lot more than pea shooters.

Senator DURBIN. When you talk in most general terms about what we're trying to achieve here with the Dodd-Frank Act, if we're going to have regulatory oversight in a market place that was clearly unregulated and led, at least partially led to the decline of the American economy and the loss of so many jobs, the way to stop that reform is to fail to fund an agency like your own, to make sure there are no cops on the beat. And I think that's a serious mistake.

I think what we've got to do is to push forward on this law, to give you the time you need to promulgate these rules, and to give you the resources to enforce them. Otherwise we invite a similar disaster to the one we went through just a few years ago in our economy.

Senator Moran.

Senator MORAN. Mr. Chairman, thank you.

First of all, I'd follow up on your question, because I wasn't certain that I understood Chairman Gensler's answer about—I guess criticism perhaps is a too strong a word, but a belief that the CFTC has focused on hiring individuals to the workforce as compared to investing in technology.

And I think what Chairman Durbin asked you to do was to explain your rationale and to respond to that criticism.

Mr. GENSLER. Well, I think we need both. I think that we can't oversee markets just with computers. You can't send a computer into a judge to plead a case. I'm not aware of any court that allows that. So we really do need humans, as well. On a market that's seven times the size of the markets we currently oversee, we need humans, as well, to answer the questions. We think there may be as many as 200 swap dealers that will look to us for regulatory guidance, interpretations, and so forth. So, in terms of staffing

we're just about back to where we were in the 1990s. We had been shrunk, actually by 23 percent. And then with this subcommittee's help, we grew back.

But on this base of about 680 people that we had at the end of 2010, we believe that to oversee the markets we need to grow at the budget request to 983. But technology is absolutely critical. And technology spending is the larger increase percentage-wise.

Senator MORAN. Mr. Chairman, you and I had a conversation in the Banking Committee about the mosaic. I think there's been a call for a road map. How do you see the difference between those two terms? Your mosaic and perhaps my, or, an industry request for a road map, so that we know what the sequencing is of the rules?

That the mosaic, as I understand the word, would be a set of puzzle pieces that, we're not certain how they all fit together, as compared to, this is the sequence in which we will implement rules under the Dodd-Frank Act at the CFTC.

PHASE IN

Mr. GENSLER. I think they're both important. We've now substantially completed the proposal phase, though we have to address ourselves to the Volcker Rule. What we've asked is the public to give us comments on how to implement the, or phase, the effective dates. And we put out last Friday—and I'm glad to meet with you and go through it—the staff put out 13 concepts in a 4-page document as to how to phase in the implementation. Some people might call it a road map. Some might not.

But those concepts, for instance, say that the clearinghouses, the execution platforms, the dealers have to be open for business, so to speak, have their rulebooks in place at a certain time. The first, the most important thing is that they are compliant with the Dodd-Frank Act and they're open for business. And then market participants would be phased later, like a clearing mandate, later. And we actually laid out in this concept piece how to bucket that into sort of three or four different buckets and how to phase that.

But we're hoping to get more public comment. We have a public comment file through June 10 on this. And then based upon that, the CFTC, working with the SEC, would think about how to phase the implementation, which I think will go well into 2012, the phasing of this.

Senator MORAN. Does the concept that you're talking about speak to each individual rule as to what the sequence is for its implementation, or just within that rule the phase in of that rule?

Mr. GENSLER. The concepts take the entire rule set. So, it speaks to some of them individually, but it was trying to give the public a sense for the entire rule set, so that clearinghouses, execution facilities, and dealers would have to be, sort of, open for business. The concept even said, if we finish for rules, they have to be open for business by December 31 of this year, for instance. But then the transaction compliance would follow later. It laid out six different chapter headings with regard to that. So it was, it wasn't all the way into the granular level, but it was pretty detailed.

Senator MORAN. Would there be information in that concept that would be valuable to us as a subcommittee to determine priorities

in funding, so that we could make decisions about the level of funding necessary to implement this series of rules over the period of time that you're contemplating?

Mr. GENSLER. I think it would be helpful to have that dialogue, though I would say our request is anticipating that we would complete our rules during the course of the calendar 2011 and that we'd be able to be hiring people to actually oversee these markets over fiscal 2012.

There's a commitment that our President made back in September 2009—the G20 commitment—that all of this would be completed and implemented by the end of 2012. We think the Congress, when they said to finish the rules by July 2011, had in mind that this was a very real crisis, and second, that the market needs to lower uncertainty. Our rule-writing creates some uncertainty. To the extent we can finish that, it helps lower uncertainty, and people get on with their work to implement it.

Senator MORAN. Chairman, I appreciate that statement. I think that has great significance. I think one of the real challenges we have for economic recovery is all the uncertainty that's out there in regard to new rules and regulations. And certainty would be a good thing, although we need to make certain that we're doing it in the appropriate manner. So, I share that, in my view there's a balance between getting an answer to the industry, but also making sure it's the right answer.

Finally, let me ask about position limits and core principles. It's a conversation that we've had at every opportunity, both in my days in the House and on the Banking Committee, and now here in the Appropriations Subcommittee. Those are not required rules and regulations. Is there a different priority placed at the CFTC on rulemaking that is not mandatory but discretionary?

POSITION LIMITS AND CORE PRINCIPLES

Mr. GENSLER. What we're doing is trying to bring together the whole package. On position limits, the Congress says specifically that we shall. The word S-H-A-L-L, shall, is in there. Some of the comment letters have come back in and people debate what was the Congress's intent. But there were numerous Congressional hearings. So we put out a proposed rule on position limits, we believe, following Congressional mandate.

In terms of core principles for clearinghouses and for exchanges, we think that we really need to move forward on this because it's the only way that the clearinghouses will be safe. There's a mandate that hundreds of trillions of dollars of swaps have to come into these clearinghouses. And so, our rule-writing in that regard is to make sure the clearinghouses are up to international standards, and that the Europeans will recognize United States clearinghouses.

So I think that, though we can debate whether the Congress said "shall" or "may" in that regard, I think if we didn't write the rules on the clearinghouses, that we wouldn't be up to international standards.

Senator MORAN. My understanding is that the law does say "shall, as appropriate." And so the question about what's appropriate, and, as I understand the law, when you read "as appro-

priate" in context of the Commodity Exchange Authority, it requires the CFTC to make a finding that excessive speculation caused an unwarranted or unreasonable price fluctuation in particular commodity markets.

And I, we've had this conversation before. I keep waiting for the finding by the CFTC. You have an old staff report that somewhat addresses this issue, but I've yet to see the finding by the CFTC that excessive speculation was found in the markets.

Mr. GENSLER. Well, we are not a price-setting agency. But what the agency has used since the 1930s is position limits, as the Congress has mandated since the 1930s, to ensure that the markets have a diversity of actors. Basically that, bona fide hedgers don't come under this, but speculators don't get so concentrated.

We actually had position limits in the energy markets working with exchanges in the 1980s and 1990s. In 2001, the exchanges backed away from that to something called accountability levels, which, on a very regular basis market participants go over the accountability levels. They're no longer stop signs. They're not even yield signs, really. They're just, maybe, honk if you go by it.

And so we've re-proposed, in essence, position limits. We're going to hear from the public. We've gotten 11,000 comments on this. Of our total 16,000, this is where the largest number of comments are. And I think that's partly because of high energy prices and high agricultural prices right now. But it's something the public very much wants us to get right, as you do. And we're going to sort through those 11,000 comments.

Senator MORAN. Thank you, Mr. Chairman.

Senator DURBIN. Senator Lautenberg.

Senator LAUTENBERG. Thanks, Mr. Chairman.

Again, I welcome each of you here to change the game that has been played in the past, and ultimately responsible for the financial disaster, in my view, that we've seen.

Now, Chairman Schapiro, the House recently passed a budget that would reduce funding to 2008 levels. You discuss it in your comments. That would put the SEC funding at $0.5 billion, below the President's request. And yet the SEC expenses, as you mentioned, fully offset by industry fees, and therefore don't add anything to the budget deficit. If the budget was, wound up that way, with that cut to 2008 level, what, in summary, what might that do to prevent you from fully doing the job that you're assigned to do?

Ms. SCHAPIRO. Senator, going back to the 2008 level would have a very profound impact on the agency. It would take our appropriation back to about $906 million. And even after major cuts and factoring in attrition, we would probably have to reduce our staff by more than 740 full-time equivalents to meet the $906 million number. And if the cuts didn't happen until perhaps January 2012, the reduction in staff would exceed 1,000 people on a base of about 3,800. So it would be enormous.

We would have to also eliminate all of our new information technology investment, which is really critical to getting this agency in a position to do the kind of market surveillance and market monitoring that I think we should be doing.

We would do fewer examinations. We would detect fewer violations of the law. We would bring fewer enforcement cases. And our

enforcement program brings lots of money back to harmed investors. Last year, we returned—on a $1 billion budget—$2.2 billion to harmed investors directly, as well as hundreds of millions of dollars to the United States Treasury.

We would have to suspend development of new systems, like the Tips, Complaints and Referrals system, which is allowing us to bring together the massive numbers of tips and complaints the agency receives, track those, triage them and handle them in a more professional and diligent way than has been done historically.

And then, with respect to some of our internal operations—for example, the movement of our financial management systems, which have been flawed over the last several years, to a Federal shared service provider—efforts like that would have to be put on hold.

So, I think it would have a devastating impact on the agency's ability to protect the public from financial fraud.

Senator LAUTENBERG. This, to me it looks like we might wind up back in the 2008 situation if we had to restrict ourselves to the things that you're now planning to do and improve the supervision and the reliability of the marketplace. So it, by no means, in my view, can help to cut the budget or, as I said earlier, to cut staffing when so much is needed.

If we look back at 2008 and even earlier, a whistleblower brought information to the SEC about the evidence, with evidence of the ultimate public swindle, the Madoff scam, stole billions of dollars from investors. And the SEC apparently did very little or almost nothing to pay attention to that opportunity, to learn and to adjust. And I wonder whether any of that was caused by a limited number of people on the staff, or a smaller agency.

Is there a view, Ms. Schapiro, about what might have put the SEC in that kind of a static position, where nothing was done?

Ms. SCHAPIRO. Senator, I think resources, perhaps, was a contributing factor. But I really can't blame the SEC's failure to catch Madoff much earlier on in his fraud and shut it down, solely on a lack of resources. There were a lot of institutional issues within the agency over a long period of time—a lack of cooperation and coordination between enforcement and examinations; a lack of expertise and understanding of the information, perhaps, that the whistleblower brought to the SEC; the lack of tools and supervision of the front-line examiners in getting the job done.

We've done, as you know, an enormous amount of work to try to ensure that we can prevent anything like that from ever happening again, including the new Tips, Complaints and Referrals system, which didn't exist then, but——

Senator LAUTENBERG. But which might—forgive me, but which, all of which can be considerably improved if we put through the budget as the President requested.

Ms. SCHAPIRO. Absolutely. Not just the technology, but also the ability to bring in people with deeper expertise; the ability to train our employees in deeper and more cutting-edge ways; our ability to have more people bring more cases and shut down more Ponzi schemes faster. Over the last 2 years we've brought twice as many Ponzi scheme cases as we did the prior 2 years before I arrived at the agency. So resources, absolutely, would help.

But I just, I don't want to say that the Madoff failures at the SEC are solely the result of inadequate resources.

Senator LAUTENBERG. Yes. I note the effort that would be put forth to make sure that transparency really is there in all kinds of situations.

One of them that's disturbed me—and, again, I come with a corporate background. I spent 30 years with a giant, a company that turned out to be a giant company. And the shareholders very often are not kept up to date with what's taking place.

And one of the most significant, in my view, is the variation in the relationship between the CEO compensation and the average worker in these companies. In 1980, it was a ratio of about 40 to 1. And now we're well more than 300 at times. And the difference in wages is incredible. I mean, the CEO, if the average wage was $40,000 in 1980, the CEO might earn, then, $1.6 million. And now, if that same situation took place, it's well more than $13 million. And that maladjustment, in my view—and I speak to, as a long-time executive, a long-time member of the board of directors, and still a member of the board of directors at the Columbia Business School—that one of the things that's so problematic is that our society is getting lopsided here. And any way that we can produce evidence of what's, the changes that are taking place, is incredibly valuable.

And I thank you, Mr. Chairman, and we have, I have other questions, which I'd like to submit for the record.

Senator DURBIN. Thanks, Senator Lautenberg. Of course, those questions will be submitted in writing.

GASOLINE PRICES

There are, Chairman Gensler, there are a variety of rites of spring in America—the opening of the baseball season; Seder dinners, which I shared this year with Senator Lautenberg; the Easter bunny; and an obscene run-up in gasoline prices, which seems to come about every spring. And Members of Congress—Senate and the House—get into a high state of excitement and anxiety as they hear from their constituents about what these gasoline prices are doing to families and businesses.

Now, over the years I've developed a very careful watchdog of gasoline prices—my wife. And I called her this morning, and she says, "It's up to $4.20 a gallon in Springfield. What are you doing about it?"

And I said, "Luckily, Chairman Gensler is going to be testifying today, and I'm going to ask him a question about it."

And the question comes down to this: I understand, when we talk about the futures markets and the oil prices, that speculation is not illegal, and it serves as a necessary ingredient to add liquidity to the market. But oil prices have risen to $113 a barrel over the last few months—a one-third increase in price, right before the summer driving season, surprise, surprise. And unrest in the Middle East and North Africa has been blamed, though the countries involved represent a very tiny fraction of the sources of oil in America.

The President has called for this integrated look at whether or not there are problems related to speculation and fraud and the

like. Your CFTC Commissioner, Bart Chilton, indicated that hedge funds and other speculators have increased their positions in energy markets by 64 percent since June 2008, to the highest level on record. When it comes to speculation, can the CFTC differentiate between normal speculation, excessive speculation, and manipulation?

Mr. GENSLER. Let me say I share with your wife's view. Last night, I filled up on Connecticut Avenue for $84 for the tank. So I, it's on my mind, too.

We're not a price-setting agency. But, as an agency, we're to make sure that these markets, that hedgers and speculators meet in a marketplace that's transparent, it's open, it's competitive, free of manipulation and fraud, and also using position limits, that there's some diversity, a lack of concentration in these speculators. That's why I think it's so important that we continue to move forward on the rules. The Congress gave us new anti-fraud and anti-manipulation authority. We've proposed rules to implement that. We're yet to finalize the rules, but that broader authority is very important. We do use our current authority, but the broader authority is important. And——

Senator DURBIN. So, the Dodd-Frank Act gives you more tools to deal with——

Mr. GENSLER. Absolutely.

Senator DURBIN [continuing]. Market speculation and manipulation, as it relates to oil prices. And, looking at this from the other side of the coin, efforts to slow down or stop your agency's implementation of the Dodd-Frank legislation will limit the availability of those tools when it comes to things like oil prices speculation.

MARGINS

Mr. GENSLER. Mr. Chairman, that is absolutely correct.

Senator DURBIN. I'm glad you said that.

Now let me ask about margins. I understand that oil speculators provide 6 percent of the value of a futures contract up front when they buy a stock. And some have argued that increasing the margin requirement will reduce the volatility, but still allow for some speculation in the industry. What is your thought?

Mr. GENSLER. The Dodd-Frank Act also addressed margin. Our authorities are limited. They're just to set margin with regard to cleared swaps, as it relates to the safety and soundness of the clearinghouse, and for uncleared swaps, the safety and soundness of the dealers, the financial system as the dealers. And we've put proposed rules out with regard to that.

So it doesn't necessarily address Mr. Chairman's question, but the Dodd-Frank Act's pretty clear that it's about the safety and soundness of the clearinghouses or the dealers themselves when we set these margins.

Senator DURBIN. Thank you, Chairman Gensler. I have to leave and be in a meeting in the House. But Senator Lautenberg has said he'll preside through the close of questions from Senator Moran and himself.

And I thank you both for coming today. We'll submit some questions in writing for you, and I hope you get a chance to respond to them in a timely fashion.

Senator Moran.

Senator MORAN. Mr. Chairman, thank you.

I, too, will submit a number of questions in writing.

I just have one follow-up question, and then a general question for both chairpersons.

I want to go back to our position limit conversation. You said that you put the position limit rule out for comment—in my view, what you were telling me is for, to determine its appropriateness. I was suggesting that position limits are to be determined, are to be under rulemaking where appropriate. And I would just make the point that whether or not it's appropriate is a determination to be made by the economists. And this goes back to the IG report—that determination about the appropriateness should be done by economists, not by lawyers.

And to date, to my knowledge, the only report you have from economists is the 2008 staff report that found no connection between excessive speculation and unwarranted price fluctuations. So, I'd be glad to have this ongoing conversation with you in, in that regard.

SAVINGS

And then, just generally, for both of you, are there any examples of where you and your agency are finding savings—reduced spending—for purposes of helping us offset the increased costs that you're requesting?

Chairman Schapiro.

Ms. SCHAPIRO. I'd be happy to do that, yes. We have a new leadership team in our technology group and a new chief operating officer of the SEC, and one of the charges I've given them is to look for those opportunities to save—particularly when we were under the continuing resolution for such a long period of time.

And so, particularly in the technology space, we've been able to retire some old equipment and utilize more efficient, more cost-effective technologies. That's an opportunity. We are moving to more risk-based approaches with respect to our examination program, so that we are using less of a broad sweep and check the box mentality, and a more focused, deeper dive into those regulatees that might actually present the greatest risk to the investing public.

We are trying to deploy knowledge management systems and e-discovery tools that will allow us again to leverage technology, rather than necessarily having to bring on a lot of human resources to do certain functions that technology does very well.

And if I can give you one sort of quirky example, we learned that at our alternative data center, we could save $375,000 a year on an investment of $120,000, simply by changing our power configuration. So, it gives you a very micro idea of what we're looking at.

But we are trying to go through the SEC very carefully and look for every opportunity to find savings that we can then re-deploy to higher value uses that we think will do more to protect the investing public and to ensure that the markets are operating with efficiency.

That also includes leveraging other entities like self-regulatory organizations as we develop the consolidated audit trail. There will be costs for the SEC in that, but the great majority of the costs will

be borne by the exchanges and FINRA, that will have to develop the plan for the consolidated audit trail, set up the repository for the data, and then we'll develop our own tools to access that data. We're leveraging the Public Company Accounting Oversight Board, we're leveraging private accounting firms—anywhere we can leverage third parties with rigorous oversight by the SEC, we look at those as opportunities to both do a better job, and to find some savings that we can then re-deploy.

Senator MORAN. If you can quantify that, I'd welcome the piece of paper that demonstrates those savings within the SEC.

Ms. SCHAPIRO. We'd be happy to do that.

Senator MORAN. Thank you.

[The information follows:]

COST-SAVINGS INITIATIVES

Opportunity description	Savings opportunity	Potential cost savings	Total upfront cost (spend to save) [1]
Data Storage System and Retirement and Replacement.	Reduce data storage maintenance costs by purchasing new equipment.	$1.4 million over 3 years	$470,000
Server Virtualization and Storage	Eliminate number of physical severs.	$18.6 million over 3 years	$9,100,000
Operational Monitoring and Metrics Management.	Eliminate 30 contractor FTEs	$5.3 million over 6 years	$3,900,000
Power Savings at SEC Alternative Data Center.	Eliminate dedicated power circuits through consolidation at Equinix.	$380,000 each year after first year.	$10,000
HQ Building and 11 Regional Buildings Facilities Access Control Contract.	Replace contract for electronic facilities access control system and surveillance systems with less expensive contract.	$6 million over 5 years	([2])
Delegate Section 31 Fee Verification.	Opportunity as noted in BCG study: rather than utilizing OCIE examination resources, redirect to SROs compliance costs for ensuring SROs are paying SEC the correct amount in section 31 transaction fees.	Current process uses 10 FTE for 4 months.	([3])

[1] Cost projections are estimates and thus are subject to change.
[2] Not applicable.
[3] To be determined.

Senator MORAN. Chairman Gensler.

Mr. GENSLER. Similar to Chair Schapiro's answer, through the continuing resolution, we did. We're only just people and technology, by and large with, of course, some real estate. So, there were a number of savings. Unfortunately, in technology we cut so much that I think that, you know, we need to really, as we earlier talked about, go the other way, to leverage technology to be more efficient.

One of the significant things we've been looking at is, what duties, can we ask the self-regulatory organization, the NFA to do, particularly in terms of registering the new swap dealers, examining the new swap dealers, and we've worked very closely with them as to how they can stand up. They're probably going to have to stand up between 100 and 200 new people to do that, rather than us doing it. But we're working very closely with them.

In terms of technology, it's really, how can we leverage off of what's in the Dodd-Frank Act and these new data repositories so that as much as possible can be picked up by the data repositories? They will charge fees for that, by the way. But it won't be through the taxpayers. And that, we then get direct data access. And we've already had our chief of technology be, in direct dialogue with each of the data repository aspirants—they're not yet registered—as to how we can link up the systems and leverage off of their data.

Senator MORAN. Well, Chairman Gensler you, too, if there's a piece of paper that you could present to me, or to the subcommittee, that outlines the cost savings that are occurring. What I'm looking for is that you would be asking for more money from us, but for these savings within your agency that you've developed for fiscal year 2012.

[The information follows:]

CHECKLIST OF COMMODITY FUTURES TRADING COMMISSION COST-CUTTING INITIATIVES

The Commodity Futures Trading Commission (CFTC) is committed to reducing its operating costs. Over the last 2 fiscal years, more than $65 million over the next 15 years in cost reductions were achieved using proactive contracting practices. The results are presented below.

RENEGOTIATE SPACE LEASES

The estimated negotiated savings cited below totals approximately $48.4 million:

—The CFTC expanded and extended its existing D.C. lease to produce an estimated saving of $42 million over 15 years when compared to the estimated cost to relocate.

—The CFTC expanded and extended its existing Chicago lease resulting in an estimated savings estimated of $6.4 million over 12 years versus the estimated cost to relocate.

NEGOTIATE COST REDUCTIONS ON ACTIVE CONTRACTS

The estimated negotiated savings cited below totals approximately $17.6 million over 5 years.

A brief summary focusing on negotiated cost savings:

IT Support Services.—Estimated savings associated with the award of five contracts totals approximately $15 million over 5 years.

IT Hardware.—Estimated savings associated with the award of two contracts totals approximately $700,000.

Software.—Estimated savings associated with the award of one contract totals approximately $106,000.

HR Benefits and Support Services.—Estimated savings associated with the award of two contracts totals approximately $1.5 million over 5 years.

RENEGOTIATE ON-LINE LEGAL RESEARCH SERVICE RATES

Negotiated rate reductions for online services in the amount of $259,000. Future savings are expected to exceed this amount on an annual basis.

LEVERAGE NASA GOVERNMENT-WIDE ACQUISITION CONTRACT

The estimated negotiated savings cited below totals approximately $688,000.

Administrative Support Services.—Estimated savings associated with the award of two contracts totals approximately $400,000.

Saved $235,000 in the purchase of routers by converting a proposed GSA schedule purchase to a competitive buy.

Saved $53,000 in the purchase of blade servers by converting a GSA schedule purchase to a competitive buy.

CONVERT SOFTWARE LICENSES TO ENTERPRISE AGREEMENTS

Negotiated an enterprise license for law office services that saved the CFTC $145,000 compared to the price of individual licenses.

The CFTC is committed to reducing its operating costs. Over the last 2 fiscal years CFTC estimates it saved at least $500,000 in cost reductions were achieved by changing its operating practices.

—Reduce travel costs;
  —Use more teleconferencing and web technology;
  —Modernize travel policies to use restricted fares where appropriate;
  —Centralize employee registration and negotiate larger discounts with conference vendors; and
  —Recover State lodging taxes inadvertently paid by CFTC travelers; and
—Consolidate purchases for common goods and services;
—Implemented 4-digit dialing eliminating the long distance charges on calls made between CFTC offices;
—Put more documents online to cut back on FOIA requests; and
—Set shared printer default settings for "two-sided printing".

Senator MORAN. I thank you for your testimony today and look forward to our ongoing conversation. Thank you.

Mr. Lautenberg.

USER FEES

Senator LAUTENBERG. Thanks.

And just a couple of things that I'd like to get answers to. Mr. Gensler, the CFTC, the only financial regulator that does not offset a portion of the cost through industry user fees. Now, if the derivatives traders don't pay fees to defray the costs of the market oversight, then the taxpayers are the ones who pay the bill. Should the traders continue to—it's always in the way—should the traders continue to get a free ride while the taxpayers foot the bill?

Mr. GENSLER. We think to fulfill our mission, we look forward to working with the Congress in any way that the Congress sees fit to help fulfill the mission and secure the funding. The President's request did put forward a concept of user fees with regard to the swaps marketplace, and if that's beneficial to this subcommittee for us to work with you on that, we'd look forward to doing that, whatever the Congress thinks is the best way to secure the funding.

Senator LAUTENBERG. What would you recommend?

Mr. GENSLER. I'd recommend that we work with you in any way that helps secure the funding.

Senator LAUTENBERG. Thank you.

Ms. Schapiro, credit rating agencies play an influential role in helping investors to make decisions. Part of the SEC's budget request is devoted to closely regulating and examining these agencies. But credit rating agencies continue to be paid by the very people whose products the agencies are evaluating.

What might the SEC do to address this, what I see as a fundamental conflict of interest?

Ms. SCHAPIRO. Senator, there is a conflict of interest there, and so the Dodd-Frank Act did a couple of things to help us address that. One is that we're required to examine credit rating agencies on an annual basis, regardless of the risk a particular agency presents. And so part of our budget request is staffing for the credit rating agency examination team. We're also required to set up an independent office of credit rating agencies, reporting directly to me.

In addition, we have about 10 different rules that we're required to do under the Dodd-Frank Act to address conflicts of interest,

governance, enhanced public disclosure about the performance of ratings, and so forth. And we're working on those rules right now.

I think to get directly to your question, though, there is a requirement for three different studies on credit rating agencies, one of which is to study the feasibility of a wholly different model for credit rating agencies when they're rating structured assets. So that there would be a model potentially where the rating agency would be assigned, by the SEC or by a self-regulatory organization, to the issuer of the structured product, rather than the issuer of the structured product picking the rating agency and perhaps creating a very real conflict of interest.

That study is not due until July 2012. But we're just about to go out with our request for comment to get that study launched. And that will, I think, give us some other ideas about alternative compensation structures that might get at this very important conflict of interest issue.

Senator LAUTENBERG [presiding]. Thank you.

In New Jersey we have a nationally known philosopher whose name is Yogi Berra. And Yogi has an expression that I think is appropriate at the moment. Because if we continue to look at the cost side without the benefit side of putting additional staff to work, of investing in additional technology, it's going to be, as Yogi would say, déjà vu all over again. So, I'd recommend care, thought, and investments that can really pay off handsomely for the future.

With that, I thank, in the words of our chairman, all of you who've participated in preparing for the hearing. I appreciate hearing from the top officials of these two pivotal agencies about their implementation activities and funding needs. And it's fair to say that today's discussion has provided helpful insights into these agency operations, which will be instructive as we further consider the budget proposals and develop our fiscal year 2012 bill over the coming months.

ADDITIONAL COMMITTEE QUESTIONS

The hearing record, as Senator Durbin said, will be, remain open until next Wednesday, May 11, at 12 noon for subcommittee members to submit statements and/or questions to be submitted to the witnesses for the record.

And with that, I thank Senator Moran for his contribution.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO GARY GENSLER

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

ADAPTING OPERATIONS TO EXPANDED RESPONSIBILITIES

Question. The Commodity Futures Commission (CFTC) regulates a futures and options industry that increased from 580 million contracts in 2000 to more than 3.1 billion contracts in 2010—a change of more than 434 percent. During that same decade, customer funds held in Futures Commission Merchants accounts increased from $56.7 billion to more than $170.1 billion, and the value of these contracts is notionally estimated at $40 trillion. With the Dodd-Frank Act signed into law last July, the CFTC is tasked with regulating the swaps markets with an estimated notional value of approximately $300 trillion—roughly 7 to 8 times the size of the regulated futures markets.

How will your staffing and organization need to adapt to keep pace with this growth surge?

Answer. The CFTC must be adequately resourced to police the markets and protect the public. The CFTC is taking on a significantly expanded scope and mission. By way of analogy, it is as if the agency previously had the role to oversee the markets in the State of Louisiana and was just mandated by the Congress to extend oversight to Alabama, Kentucky, Mississippi, Missouri, Oklahoma, South Carolina, and Tennessee.

With seven times the population to police, far greater resources are needed for the public to be protected. Without sufficient funding for the agency, our Nation cannot be assured of effective enforcement of new rules in the swaps market to promote transparency, lower risk and protect against another crisis. It would hamper our ability to seek out fraud, manipulation, and other abuses at a time when commodity prices are rising and volatile.

Until the CFTC completes its rule-writing process and implements and enforces those new rules, the public remains unprotected.

Question. Does CFTC's current organizational structure allow you to meet the challenge?

Answer. The CFTC has been meeting the challenge of writing rules to implement Dodd-Frank though its existing structure supplemented by rule writing teams whose members cut across divisions. As the agency moves out of the rule-writing phase to ongoing oversight of the futures and swaps markets, some changes to the existing organizational structure will be needed to meet the need to oversee new entities such as swaps dealers and better utilize technology.

Question. Are you contemplating restructuring your operations? How? By when do you expect to realign the organization?

Answer. Yes, the agency is undertaking a staff reorganization to effectively implement the Dodd-Frank Act, oversee an increasingly electronic marketplace and manage and utilize agency resources. The agency plans to create two new groups reporting to the chairman's office: a Division of Swaps and Intermediary Oversight and an Office of Data and Technology. Some realignment will occur within existing Divisions and Offices. Further changes are noted in the attached memoranda. The CFTC is planning for the realignment to become effective October 9, 2011. Notice of this planned staff reorganization was provided to the Congress by letter on May 6, 2011, presented below.

COMMODITY FUTURES TRADING COMMISSION,
Washington, DC, May 6, 2011.

Hon. DANIEL K. INOUYE,
Chairman, Senate Committee on Appropriations, Washington, DC.

Hon. THAD COCHRAN,
Vice Chairman, Senate Committee on Appropriations, Washington, DC.

Hon. HAROLD ROGERS,
Chairman, House of Representatives Committee on Appropriations, Washington, DC.

Hon. NORM DICKS
Ranking Member, House of Representatives Committee on Appropriations, Washington, DC.

DEAR SENATORS INOUYE AND COCHRAN AND REPRESENTATIVES ROGERS AND DICKS: The Commodity Futures Trading Commission is undertaking a staff reorganization to effectively implement the Dodd-Frank Wall Street Refoun and Consumer Protection Act, oversee an increasingly electronic marketplace, and manage and utilize agency resources. We are providing this notice pursuant to the Department of Defense and Full-Year Continuing Appropriations Act, 2011.

The enclosed document describes the details of the reorganization. Please do not hesitate to contact me if you have any questions.

Sincerely yours,

GARY GENSLER,
Chairman.

Enclosure

CFTC REORGANIZATION

AUTHORITY:
Title 5, United States Code (USC)
Commodity Exchange Act
Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)

CFTC FY 2011–2015 Strategic Plan

GPRA Modernization Act of 2010 (OMB Memorandum M–I1–17, April 14, 2011)

Recommended CFTC Reorganization

The Commodity Futures Trading Commission (CFTC) is undertaking reorganizing, effective October 9, 2011, to structure its stall for implementation oldie Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act); oversee an increasingly electronic marketplace; and plan for, manage and utilize agency resources. The changes are consistent with the CFTC FY 2011–2015 Strategic Plan approved February 28, 2011.

Create new groups reporting to the Chairman's Office

Create a Division of Swap Dealer and Intermediary Oversight (DS10).

Create a new Office of Data and Technology (ODT).

Realign within Existing Divisions and Offices

Division of Market Oversight (DMO).

Division of Clearing and Intermediary Oversight (DCIO) into the Division of Clearing and Risk (DCR).

Office of the Executive Director (OED).

Other

Rename the Office of Equal Employment Opportunity the Office of Diversity and Inclusion.

Set up a process fir determining the organizational assignment of whistleblower and consumer outreach functions.

Functions

Division of Swap Dealer and intermediary Oversight (DSIO)

With an expanded mission due to the Dodd-Frank Act mandate to regulate the swaps markets, the CFTC will take on new responsibilities, including the registration and oversight of new categories of registrants such as swap dealers and major swap participants. Staff will be needed to regulate them for robust business conduct standards, record-keeping and reporting requirements and capital and margin requirements. To effectively oversee swap dealers and major swap participants, the CFTC will create a new oversight program for these and other registrants.

The primary focus of this new Division will be to oversee the regulation of swap dealers, future commission merchants and other intermediaries to ensure they have adequate financial resources and standards of conduct. This new Division initially Will be staffed through reassignment of employees currently responsible for intermediary oversight in DCIO.

Office of Data and Technology (ODT)

Effective oversight of the highly electronic derivatives marketplace requires a technology organization at the program level directly accountable to the Chairman. Increased mission scope over a broader and more complex data-centric marketplace requires an enterprise-wide, integrated data and technology strategy. Elevating the CFTC technology program to the office level reporting directly to the Chairman recognizes its importance in achieving agency strategic and operational goals and brings focus and transparency to program priorities as addressed in the FY 2011–2015 Strategic Plan. This reprioritization of functions will align the ODT Director, as Chief Information Officer, with the CFTC division and program leadership to foster a shared strategic CFTC technology portfolio, assets and budget. The ODT will have two branches:

Data Management Branch (DMB).—This branch is crucial to effective oversight of an increasingly electronic marketplace. All CFTC mission programs are fundamentally dependent on the timely capture and management of and access to quality and meaningful data. The DMB will ensure a CFTC information architecture based on data integration, integrity and quality. Working across all divisions, DMB will establish agency-wide data needs and an effective CFTC data strategy.

Technology Services Branch (TSB).—The existing functions performed by the Office of Information and Technology Services (OITS), currently located in the Office of the Executive Director (OED), will be reassigned to ODT to partner with DMB and the program divisions/offices to implement technology solutions within a secure and stable IT environment. The Technology Services Branch will maintain the CFTC hardware and software platforms and deliver storage, security and redundancy capacity and capabilities.

Division of Market Oversight (DMO)

With the evolution of the markets and the fundamental changes made to the U.S. financial regulatory system, including new obligations with respect to the oversight of the swaps markets, the CFTC will have increased market monitoring responsibilities over new entities, such as swap execution facilities (SEFs) and swap data repositories (SDRs). Furthermore, the Dodd-Frank Act adds to the CFTC's authorities with regard to real time reporting of swaps transactions, review of new products, aggregate position limits and appropriate block trade levels. Restructuring DMO will enable the CFTC to implement oversight requirements of these new entities and authorities to ensure that the markets operate with a robust surveillance and compliance review system.

Division of Clearing and Risk (DCR)

The Dodd-Frank Act mandates that standardized swaps be cleared through CFTC-registered derivatives clearing organizations (DCOs.) It also requires that the CFTC review and examine systemically important DCOs for compliance with CFTC regulations on a yearly basis, which the CFTC does not currently do. Based on information received from interested parties, a 50 percent increase in the number of DCOs is anticipated. The Division of Clearing and Risk will consist of staff currently assigned to DCIO. It will conduct risk surveillance and examination of DCOs for swaps and futures as well as assess compliance with statutory Core Principles. In addition, it will create an organizational focus on the review and assessment of over-the-counter swaps and other derivatives instruments to determine their suitability for clearing.

Office of the Executive Director (OED)

OED reorganization will facilitate improved agency management and rationalize the structure of new functions that it absorbs, including planning, business management, physical security, Privacy Act compliance, intranet content management and the Office of the Secretariat. Changes also will accommodate increased compliance standards, including records management, personnel security and contingency planning, as well as the transfer of the technology program. This includes standardizing and formalizing business processes and decision-making to support the operational and management activities of the Commission.

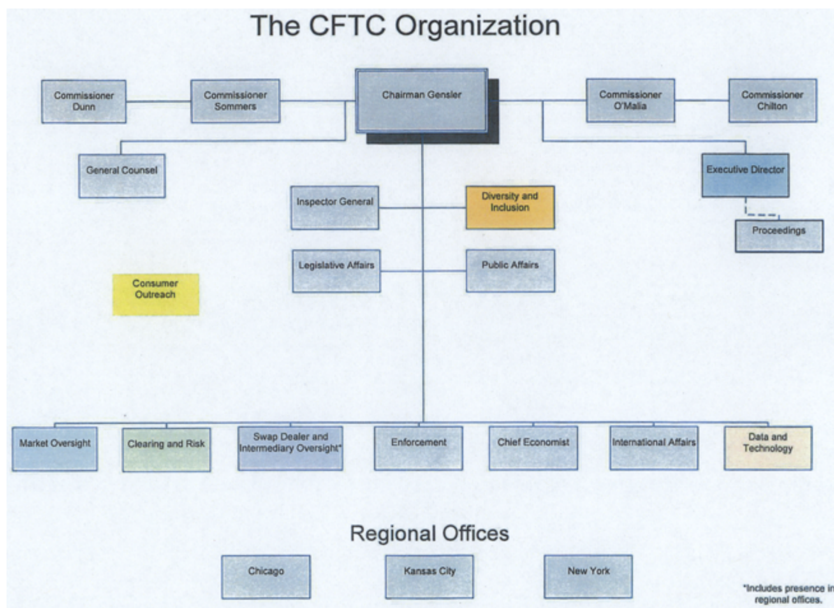
Ensuring that the agency has the capacity and capability to effectively manage an expanded mission requires the establishment of one new functional program and the consolidation of a number of functions. These changes will reduce the number of Executive Director direct reports from eight to five. The direct reports will now consist of Business Management and Planning; Financial Management; Human Resources; Records Management; and Diversity and Inclusion.

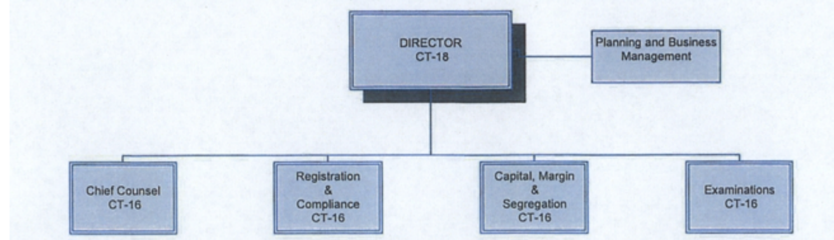
Office of Diversity and Inclusion

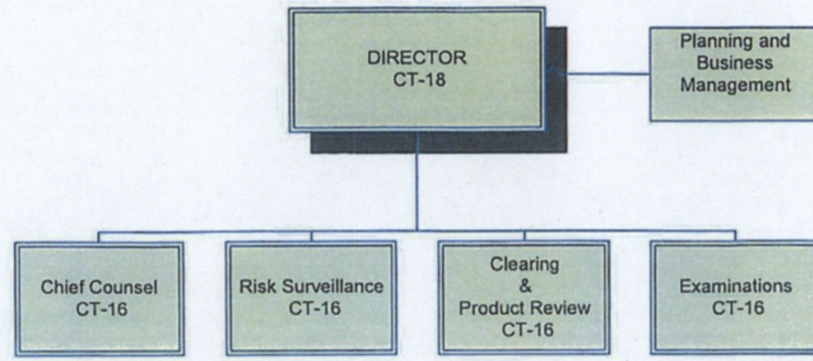
The Office of Equal Employment Opportunity will be renamed the Office of Diversity and Inclusion to accurately reflect the programmatic responsibilities of the Office. In addition to handling complaints filed pursuant to 29 CFR 1614, the current EEO Office ensures that the CFTC has a positive and progressive affirmative employment program that will assist the agency in attracting a diverse workforce. The Office will continue to assess and evaluate the CFTC environment and identify any potential barriers to inclusion, including reviewing practices and policies. The proposed name change is consistent with the names of other Federal agencies (e.g., Federal Reserve Board, Department of Treasury and Office of Personnel Management).

Consumer Outreach Program

The Dodd-Frank Act establishes the CFTC Customer Protection Fund (Fund). The Fund is to be available for payments to whistleblowers who provide information in connection with violations of the Commodity Exchange Act (the Act) and to finance education initiatives designed to help customers protect themselves against fraud and other violations of the Act. A Consumer Outreach Program Working Group of Commission staff will make recommendations by May 31, 2011, for the appropriate organizational structure of the outreach effort.


The CFTC Organization
Commissioner Dunn
Commissioner Sommers
Chairman Gensler
Commissioner O'Malia
Commissioner Chilton
General Counsel
Executive Director
Inspector General
Diversity and Inclusion
Proceedings
Legislative Affairs
Public Affairs
Consumer Outreach
Market Oversight
Clearing and Risk
Swap Dealer and Intermediary Oversight*
Enforcement
Chief Economist
International Affairs
Data and Technology
Regional Offices
Chicago
Kansas City
New York
*Includes presence in regional offices.


Division of Swap Dealer and Intermediary Oversight
DIRECTOR CT-18
Planning and Business Management
Chief Counsel CT-16
Registration & Compliance CT-16
Capital, Margin & Segregation CT-16
Examinations CT-16


Division of Clearing and Risk
DIRECTOR
CT-18
Planning and
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CT-16
Risk Surveillance
CT-16
Clearing
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Product Review
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Examinations
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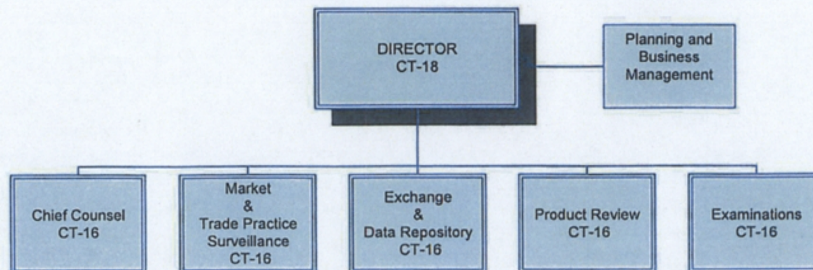
Division of Market Oversight
DIRECTOR
CT-18
Planning and
Business
Management
Chief Counsel
CT-16
Market
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Trade Practice
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Examinations
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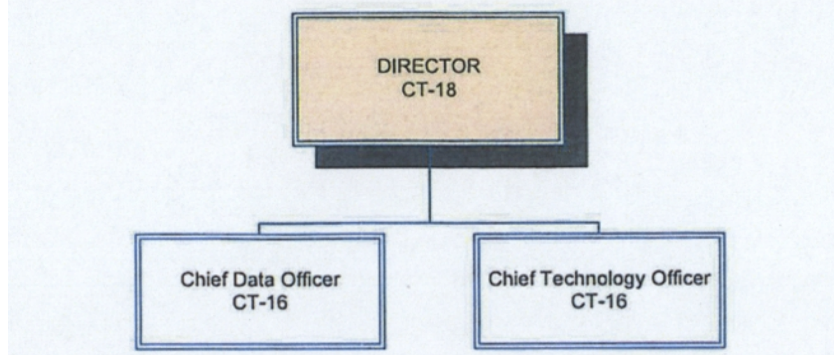

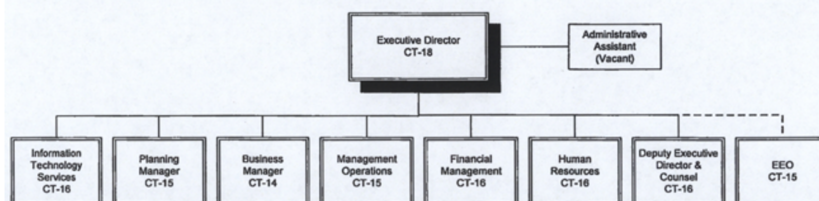

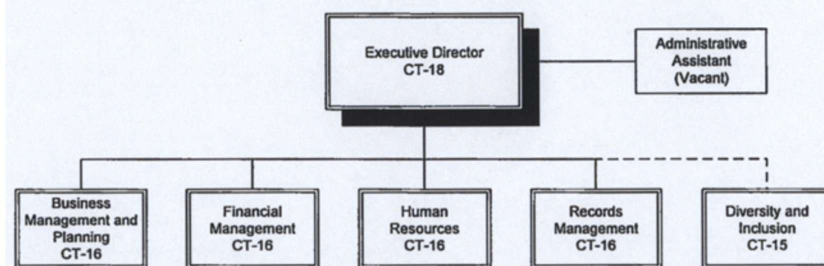

Question. What resources will this require?

Answer. The President's budget proposes $308 million for the CFTC for fiscal year 2012 to remain available until expended through fiscal year 2013. This funding level would enable the Commission to perform its responsibilities both in the oversight of commodity futures markets and in beginning to oversee the swaps markets.

The fiscal year 2012 budget request would provide funding for 983 employees. Though increased funding will support approximately 37 percent more staff, it is in light of a congressional mandate that expands the CFTC's scope by more than seven

times. The request also includes $66 million for technology, of which $41 million would be used to fulfill pre-Dodd-Frank Act information technology requirements. This increase would allow the CFTC to invest in technology in an effort to keep pace with the futures marketplace that is increasingly populated by algorithmic and high-frequency traders.

Question. Chairman Gensler, in your prepared remarks, you mentioned the proposal for setting up a new group for the collection, management, and analysis of data for improved oversight and enforcement in the derivatives markets and as the primary interface for market participants in adapting to the new data standards and reporting requirements for market data required under the Dodd-Frank Act.

When do you anticipate this being launched?

Answer. It is anticipated that the Office of Data and Technology and its Data Management Branch will be launched as part of the staff reorganization discussed above on October 9, 2011.

TECHNOLOGY MODERNIZATION INVESTMENTS

Question. As emphasized in the CFTC's 2011–2015 strategic plan, "effective oversight can only be accomplished if the regulator has access to all revelant activity in the markets."

The volume of information and data is vast. Promptly collecting, synthesizing, managing, and analyzing all of it is paramount in your surveillance work and real-time public reporting. Without question, enhanced cutting-edge technology is essential to the CFTC's capacity to leverage financial and human resources to execute not only your core mission, but for fulfilling the expanded responsibilities under Dodd-Frank reforms.

During the period of successive short-term continuing resolutions (October 1–April 15), the budget for the Office of Information Technology Services was reduced 36 percent in order to preserve existing CFTC staffing levels.

What is your vision for the critical role of technology and automation in policing the futures and swaps marketplaces?

Answer. The CFTC's fiscal year 2012 budget request includes $66 million for technology. This will allow us to pursue automated surveillance to oversee the markets and to make our oversight more efficient.

Despite rapid advances in technology and the increased size of regulated derivatives markets, funding for the CFTC has lagged behind the growth of the markets. While market participants have the technology to automate their trading, we do not yet have the resources to employ modern technology to automate our surveillance.

In fiscal year 2010, we used about 18 percent of our budget—$31 million—on technology initiatives. The continuing resolution requires that we allocate $37.2 million toward technology in fiscal year 2011. The CFTC needs to make further investment in technology to efficiently oversee both the futures and swaps markets. Only through investment in the CFTC will we be able to adequately oversee the commodity futures and swaps markets and protect the American public. The President's fiscal year 2012 budget provides for $66 million to be used on technology, which would increase the proportion of our budget used on technology to more than 21 percent.

Question. How would you characterize the CFTC's current state as compared to the industry you regulate?

Answer. The CFTC's fiscal year 2010 year-end staff of 682 compares to approximately 800,000 people employed by U.S. brokerage firms, according to the Department of Labor's Bureau of Labor Statistics. That is out of a financial industry that employs 5.6 million people. Furthermore, the CFTC's funding request of $308 million compares to approximately $814 million in annual revenues of the top 25 bank holding companies according to industry filings with the Federal Reserve. The CFTC's technology budget of approximately $31 million during fiscal year 2010 compares to about $20–25 billion spent by U.S. broker/dealers on technology initiatives per year, according to a presentation recently given to the CFTC's Technology Advisory Committee by the TABB Group.

Question. What new investments are called for?

Answer. Technology will play a critical role in leveraging financial and human resources as the CFTC executes its expanded oversight and surveillance responsibilities pursuant to the Dodd-Frank Act. Accordingly, the CFTC will establish a new group for the collection, management, and analysis of data. This group will facilitate improved oversight and enforcement in the derivatives markets through the use of technology and data. It also will serve as the primary interface for market participants in adapting to the new data standards and reporting requirements for market data required under the Dodd-Frank Act.

The CFTC's fiscal year 2010 budget request includes $25 million for technology needed to implement the Dodd-Frank Act. The resources requested are necessary for the CFTC to invest in direct data links to swap data repositories that are being established in the United States are internationally. The CFTC also must have the technology to aggregate and summarize the data for purposes of oversight and surveillance.

Question. What is your timetable for enhancing the CFTC's automated capabilities?

Answer. The President's budget request for fiscal year 2012 would support $66 million in information technology spending for the CFTC. Of that amount $25 million will be required to begin the implementation of Dodd-Frank Act rules. The CFTC will begin developing a number of technology solutions in fiscal year 2011 and 2012. This includes: automated surveillance of commodity futures, options and swap markets; ensuring that the CFTC data is compatible with industry data; identifying fields that describe transactions and transacting entities; associating swaps market data with futures market data; and implementing a number of other technology priorities. The technology implementation timetable will be driven by the sequence and phasing of the effective dates of final rulemakings. In fiscal year 2011 and 2012, the focus will be support for registration and compliance filings, providing connectivity for direct access to SDRs, addressing margin requirements and assimilating data needed for determining and enforcing position limits. The CFTC plans to update automated surveillance systems and integrate swaps and futures data and systems.

Question. What can reasonably be accomplished this year?

Answer. The fiscal year 2011 information technology (IT) program budget is $37.2 million. The largest percentage of the CFTC IT budget supports the ongoing operations of mission-essential systems and infrastructure for all divisions. With this funding, the CFTC can meet emerging business requirements, determine business requirements for new technology solutions, implement new technology solutions, and provide operations support.

Question. When you testified before the subcommittee a year ago, you stressed that "timely reporting of quality and meaningful market information is not possible with current legacy systems (one with position data and one with trade data)". Has anything changed on that front?

Answer. The CFTC has continued to improve the quality of the trade data that it receives by migrating additional exchanges to a standards-based data feed. We expect to complete the migration for exchanges with relatively low volume by the end of fiscal year 2011. Overall, the quality of futures trade and position data is improved. Challenges remain regarding a consistent ability to correlate trade and position data, but we have begun work on the high-level design of the IT architecture needed to solve them.

Question. What impediments does the CFTC currently face in becoming—and remaining—as sophisticated and savvy as possible when it comes to technological support for your work?

Answer. The swaps marketplace is seven times the size of the futures marketplace, and technology is necessary to manage our regulatory responsibilities. The CFTC will require significantly more resources to undertake regulation of the swaps market, to assimilate and analyze data from SDRs and to respond in a timely fashion to inquiries from market participants.

RULEMAKING

Question. Before the ink was dry on the Dodd-Frank Act last July, the CFTC hit the ground running to comport with explicit statutory timetables for issuance of proposed rules and studies for the governance of the swaps marketplace and other components of the comprehensive reform.

Under your leadership, Chairman Gensler, the CFTC established 31 discrete staff teams concentrated on specific aspects of the array of rules. As of today, the CFTC has issued more than 40 proposed rules for public comment and has demonstrated laudable transparency in making available on its Web site the public comments it has received as well as information about meetings held with external stakeholders and interested persons.

The staff of the CFTC has assumed an unprecedented workload and uninterrupted schedule to develop the rule proposals.

What are the lessons learned since July as you have pursued the rulemaking challenge?

Answer. Since July, the CFTC has issued more than 50 notices of proposed rulemaking to implement the Dodd-Frank Act. During that time, Commissioners and

CFTC staff have held hundreds of meetings with the public and market participants and have received more than 20,000 comments. From these meetings and comments, the CFTC has learned a great deal about existing market structures, including how swaps are transacted and how market participants structure their clearing and credit arrangements. This information has been extremely valuable in crafting proposed rules and will be important in finalizing those rules.

Question. What benefits do you expect to derive from extending and reopening the comment period on the proposed rules?

Answer. In late April, the CFTC voted to reopen the comment period on most of the Dodd-Frank proposed rules for an additional 30 days to give market participants another opportunity to comment on the entire mosaic of the rulemakings. The additional comment period allowed the CFTC to gain further insights from market participants and the public regarding proposed rules and their interaction.

Question. What guidance has emerged from the 2-day session the CFTC and the Securities and Exchange Commission (SEC) jointly held this week for how the final rules will be phased-in?

Answer. On May 2 and 3, the CFTC and SEC jointly held a staff roundtable to obtain the views of the public and market participants concerning the implementation of title VII of the Dodd-Frank Act. During those sessions, participants described what steps they would need to take to implement proposed Dodd-Frank rules. Participants also provided information about the interdependencies of various parts of title VII, including clearing, trading and reporting, and advised the CFTC about how implementation might be logically phased.

Question. What's next on your agenda?

Answer. The CFTC will consider final rules through the summer and fall months. To that end, the CFTC has scheduled five Commission meetings thus far: two in July, one in August and two in September.

Question. When do you project that the full mosaic of rules will be finalized?

Answer. The CFTC is beginning to take up final rules this summer and expects to continue finalizing rules through the fall.

Question. Is there a nexus between your timetable for finalizing the rules and having the trained staff on board and supportive technology in place to ensure that transactions are monitored and rules enforced?

Answer. We anticipate issuing final rules to implement the Dodd-Frank Act through the summer and fall and bringing on necessary staff and technology improvements throughout fiscal year 2012 and fiscal year 2013. We have begun the process to fill many important positions.

POSITION LIMIT REQUIREMENTS AND OIL SPECULATION TASK FORCE

Question. In 2008, as energy and grain prices set new records, speculators in derivatives were blamed by some for price volatility and for price levels that many observers believed were not justified simply by the underlying economic fundamentals of supply and demand. The CFTC maintained that markets were functioning normally and that the price discovery process was not being distorted.

The enactment of Dodd-Frank included several provisions designed to insulate commodity prices from the impact of excessive speculation and manipulation. For example, under section 737, the CFTC is directed to establish position limits—a cap on the size of the bets—for both swaps and futures.

January 22, 2011, was the statutory deadline for the new position limit rules. It is my understanding that the CFTC has delayed the rules issuance in order to collect more data.

With oil and gas prices soaring daily, there's mounting concern about the role of speculators in driving the price surge, and questions being raised about what needs to be done to curb it.

A few weeks ago, President Obama announced the formation of a new inter-agency working group led by Attorney General Holder to examine the gas price situation. Representatives of both the CFTC and SEC are among the membership of this task force. Among the topics to be explored are fraud in the oil markets, developments in the commodity markets, investor practices, supply and demand factors, and the role of speculators and index traders in the futures markets.

A similar interagency task force was formed back in 2008. The CFTC also conducted its own study of swap dealers and index traders to determine if their activity was affecting prices in crude oil and agricultural markets. In neither of these studies was a connection made between speculative trading and rising prices.

If speculation is not illegal and serves as a necessary ingredient that adds liquidity to the markets, are there not other mechanisms, such as position limits, margin

requirements, and other expectations that could—or should—be invoked to address this situation?

Answer. The CFTC fulfills its mission to oversee the futures markets through market surveillance, industry oversight, and enforcement. The CFTC pursues fraud and market manipulation and oversees futures exchanges and clearinghouses. The CFTC is a cop on the beat that protects markets in commodity derivatives from fraud, manipulation, and other abuses.

A critical reform of the Dodd-Frank Act relates to position limits. Position limits have served since the Commodity Exchange Act (CEA) passed in 1936 as a tool to curb or prevent excessive speculation that may burden interstate commerce.

Importantly, the Dodd-Frank Act directs the CFTC to establish position limits for both futures and swaps in a very specific manner. First, the act directs the CFTC to establish position limits, as appropriate, for futures contracts for agricultural commodities and exempt commodities (including crude oil, gasoline, and other energy commodities). Second, the act directs that the CFTC concurrently establish position limits on swaps that are economically equivalent to those futures contracts. Third, the act requires the CFTC to establish aggregate limits across the futures and swaps markets. On January 26, the CFTC published a proposed rule to implement these statutory directives. The comment period closed on March 28. The CFTC will evaluate the comments received before proceeding to a final rulemaking. It is essential to complete the task of implementing the aggregate position limits regime, congressionally mandated to guard against the burdens of excessive speculation.

Question. Chairman Gensler, when do you expect the CFTC to act on the requirement for strict position limits on the amount of oil speculators could trade in the energy futures?

Answer. On January 26, the CFTC published a proposed rule to set position limits for crude oil contracts and other physical commodities. The comment period closed on March 28, and the CFTC received more than 12,000 comments. The CFTC will thoroughly review these comments and proceed to developing a final rule.

ENFORCEMENT: PRESERVING MARKET INTEGRITY AND PROTECTING MARKET USERS

Question. Detecting and deterring against illegitimate market forces requires CFTC's steady vigilance and swift response. In fiscal year 2010, the CFTC filed 57 enforcement actions −14 percent more than in fiscal year 2009 and 43 percent more than in fiscal year 2008. The enforcement filings involve allegations of manipulation, fraud, abuse, and other violations of the CEA.

Furthermore, the CFTC opened 419 investigations of potential violations of the CEA and CFTC regulations. That's an all-time high, far exceeded the target, and is a 66 percent increase more than the 251 investigations opened in fiscal year 2009. In addition, in fiscal year 2010, The CFTC obtained $200 million in restitution, disgorgement, and civil monetary penalties in previously filed or existing cases.

Let me preface my questions by saying that these statistics are impressive. You and your staff are to be commended. However, does this mean there is more illicit activity going on or that the CFTC is becoming more adept at rooting it out?

Answer. A combination of factors contributed to increased enforcement activity by the CFTC. For example, during the past 2 fiscal years the Division of Enforcement hired additional staff attorneys and investigators to keep up with the demands of the docket; the Division has received a larger number of referrals over the past 2 fiscal years from a variety of lead sources (ranging from customer complaints to referrals from other financial regulators), which increased the number of investigations opened; and the CFTC has been granted new oversight authority (for example, the CFTC filed 13 cases in January 2011 based upon new FOREX registration obligations imposed earlier this fiscal year).

Question. What's projected for fiscal year 2011? Are you on track to build on last year's successes?

Answer. Yes. With less than two-thirds of fiscal year 2011 complete, the CFTC has filed 70 enforcement actions—already more than the number of cases for fiscal year 2010. Approximately 300 new investigations have been opened during this fiscal year.

Question. How well is the CFTC able to measure the deterrent effect of these enforcement actions? Is there a message to fraudsters?

Answer. In response to violations of the CEA and CFTC regulations, the Commission has the authority to seek restitution, disgorgement, imposition of civil monetary penalties, trading restrictions, and registration bans. These remedies are designed to ensure that wrongdoers are punished, and they also serve a deterrent effect. In appropriate cases, the CFTC refers matters to the Department of Justice (DOJ) for criminal prosecution. The CFTC publicly discloses all enforcement actions by posting

each case filing on the Commission's Web site and issuing press releases in connection with every action filed and judgment obtained. The message to wrongdoers is clear: actions that harm customers or markets will be prosecuted.

Question. How rapidly are you able to collect restitution, disgorgement of ill-gotten gains, and civil monetary penalties imposed against violations of the Federal commodities laws? What is the recovery rate?

Answer. Since fiscal year 2002 more than $1.6 billion has been imposed in restitution and disgorgement orders. Judgments entered in CFTC enforcement actions for restitution and disgorgement have been imposed to compensate victims for their losses and direct violators to pay the victims. As a result, restitution and disgorgement are not collected by the Government.

From fiscal year 2002 to March 2011, more than $1.7 billion in civil monetary penalties (CMP) have been imposed. Of that amount, more than $500 million has been collected and deposited in the U.S. Treasury. All CMP debts are handled by the Department of the Treasury for collection actions and resolution. If the Department of the Treasury is unsuccessful in expeditiously collecting the CMP debt and there is sufficient reason to conclude that full or partial recovery of the debt can best be achieved through litigation, the CFTC refers the debt to the DOJ for enforced collection and resolution as appropriate.

Question. What has been the impact of more sophisticated information technology to monitor and detect fraud more readily given the complexity of transactions? How well is the eLaw Program working?

Answer. The Divisions of Market Oversight and Enforcement employ a variety of nonpublic investigative methods to monitor and evaluate trading activity. The Division of Enforcement's eLaw Program has proven effective as a comprehensive litigation management program, which is currently being upgraded. The eLaw Program has facilitated information sharing across the Division of Enforcement and increased the efficiency of document and audio search and review, as well as data analysis. eLaw also has increased the efficiency and organization of case development and management, including investigations and litigation, reduced the duplication of research and analysis, enhanced coordination with other agencies and provided the Division with expanded capacity to retain significant historical data.

The eLaw Program's addition of a computer forensics capability has increased the efficiency of electronic evidence preservation, collection and analysis. With the addition of in-house computer forensics, the Enforcement Division no longer has to incur high-vendor costs or delays from outsourcing the work. This includes the addition of a forensics lab that facilitates proper storage and control of electronic evidence for chain of custody purposes. The forensics program has provided a foundational framework for ensuring that electronic evidence to be used in enforcement matters is admissible in court.

The workload for the eLaw Program has grown exponentially since its inception. Additional staffing and resources will facilitate the timely and effective services provided by the systems and personnel upon which the program relies. In addition, as derivatives markets expand and become more sophisticated, and as the CFTC's authority to regulate those markets expands, the updated eLaw Program will ensure that personnel can undertake the sophisticated analyses necessary for efficient enforcement investigations.

Question. Are there any statutory or administrative impediments that prevent the CFTC from doing more to combat fraud? What tools do you lack?

Answer. In the coming months, the CFTC will begin integrating a broad range of enforcement tools, such as increased fraud, manipulation, and disruptive trading practices authority authorized by the Dodd-Frank Act. The CFTC's proposed anti-manipulation rule would set in place a broad new ability to effectively combat fraud and manipulation. The proposed rulemaking promotes fair and efficient markets, for the first time allowing the CFTC to explicitly act against fraud-based manipulation. The Congress also gave the CFTC authority to prohibit trading practices that are disruptive of fair and equitable trading. With adequate resources, these and other authorities will be used by the CFTC to promote and ensure fair and orderly trading, free from fraud, manipulation, and other abuses.

AUDIT FREQUENCY

Question. The CFTC regulates the activities of 64,700 registrants who handle customer funds, solicit or accept orders, or give trained advice. Among these registrants are commodity pool operators, futures commission merchants, floor brokers, floor traders, and associated persons (salespersons). The CFTC delegates oversight authority to the National Futures Association, a self-regulatory organization (SRO).

The CFTC is limited to conducting reviews of Commission registrants, on average, just once every 3 years, thereby diluting the ability to check compliance. The CFTC also would prefer to perform regular and direct reviews of all exchanges and intermediaries and to assess their compliance with the CEA rather than relying on designated SROs for these reviews.

What would be the advantages of performing more frequent reviews, (e.g., annual ones)?

Answer. Direct examination of market intermediaries is a key component of the oversight program for SROs and registrants. Direct examinations are essential to assessing the effectiveness and thoroughness if an SRO's financial surveillance program. They also provide independent verification of audit work completed by SRO's staffs. Direct examinations also allow the CFTC to take immediate action when necessary to assess compliance with the CFTC's financial requirements to protect customers and ensure orderly markets. As registration and other requirements for swap dealers and major swap participants come into effect, these examinations will provide CFTC staff with critical information about the operation of these entities and their compliance with CFTC requirements.

Question. Would more frequent reviews require adding staff with expertise in trading and build CFTC's knowledge base of how exchanges' various electronic trading platforms operate and how violations may occur on and across electronically traded markets?

Answer. More frequent reviews would require adding staff with trading expertise. Having staff with expertise regarding how exchanges' electronic trading platforms operate is key to assessing exchanges' self-regulatory programs and compliance with core principles, as well as understanding how violations can occur across markets. In the past, exchanges typically did not trade the same products. However, in the past few years, exchanges have been listing and trading similar products. For example, some metals trade at both NYSE Liffe and COMEX and ELX trades; Eurodollar futures and Treasury Note futures—products that trade on CME and CBT, respectively. Protecting the public interest requires that the CFTC understand how all of the exchanges' electronic trading platforms work and how a trade on one exchange can be executed to facilitate a trading violation at another exchange.

Question. To what extent do you believe there is a risk that an ineffective self-regulatory program may go undetected or a systemic risk may not be identified if frequency of reviews remains triennial?

Answer. More frequent reviews will allow the CFTC to have current information on the effectiveness of surveillance programs and to identify and address potential issues on a timelier basis. The number of entities that must be assessed is expected to increase considerably as a result of the Dodd-Frank Act. Swap dealers and major swap participants will be required to register and to comply with applicable requirements regarding business conduct, reporting and record-keeping, capital, and margin. These entities will be subject to review by the CFTC or an SRO with respect to their compliance with the applicable requirements. Resources will be necessary to establish and implement programs for direct review by CFTC staff of these new registrants and for oversight of SROs that may have primary responsibility for review of these entities.

COST-BENEFIT ANALYSIS ISSUE

Question. In the CFTC's draft 2011–2015 Strategic Plan, the agency declares that the Commission will adopt as policy President Obama's Executive order signed January 18, 2011, entitled "Improving Regulation and Regulatory Review" and apply that standard to all future and ending rulemakings under Dodd-Frank and seek to streamline existing rules and regulations as well.

There's been criticism of late that suggests that the CFTC is not adhering to this Executive order. I suspect some of that hype may be a stalling tactic to put the brakes on Dodd-Frank reforms.

I think CFTC has made it abundantly clear that as an independent agency, the CFTC is exempted from the Executive order, and that the CFTC follows its statutory mandate that require the consideration of the costs and benefits of the actions before issuing a rulemaking.

Section 15(a) of the CEA enumerates five broad areas of market and public concern that shall be taken into account in evaluating costs and benefits. These are:

—protection of market participants and the public;

—efficiency, competitiveness, and financial integrity of markets;

—price discovery;

—sound risk management practices; and

—other public interest considerations.

The CFTC has discretion to give greater weight to any one of these criteria, and could determine that, notwithstanding the costs, a particular rule is necessary or appropriate to protect the public interest or accomplish any of the purposes of the law.

Can you explain your approach to rulemaking and help dispel the myth that you are deviating from the spirit of the Executive order when it comes to conducting regulatory cost-benefit analysis as you roll-out the implementation of the Dodd-Frank regulations?

Answer. The CFTC's practices are consistent with the Executive order's principles. The CFTC conducts cost-benefit analyses in its rulemakings as prescribed by the Congress in section 15(a) of the CEA. The statute includes particularized factors to inform cost-benefit analyses that are specific to the markets regulated by the CFTC. Thus, we will continue to fulfill the CEA's statutory requirements.

The CFTC has benefited from public comments relating to the costs and benefits of proposed rules. To further facilitate this process, the CFTC approved reopening or extending the comment periods for most of our Dodd-Frank proposed rules for an additional 30 days through June 3, 2011. Commissioners and staff have met extensively with market participants and other interested members of the public about our rulemakings. CFTC staff hosted a number of public roundtables so that rules could be proposed in line with industry practices, minimizing compliance costs while fulfilling the Dodd-Frank Act's statutory requirements. Information about each of these meetings, as well as full transcripts of the roundtables, is available on the CFTC's Web site.

PROMOTING MARKET TRANSPARENCY THOROUGH PUBLICIZED INFORMATION

Question. Each week, the CFTC publishes its "Commitments of Traders" (COT) report. This provides a breakdown of each Tuesday's open interest for markets in which 20 or more traders hold positions equal to or above the reporting levels established by the CFTC. Since September 2009, the reported data has been disaggregated to break out managed money and swap dealer activity in the futures and option markets. The CFTC also produces an index investment data report, which summarizes index investment activity in commodity markets, a bank participation in futures and option markets report, and a Cotton On-Call report.

All of these efforts to make information available to the public are important.

What are your plans to continue similar efforts to promote transparency in the swaps market through the development and publication of reports for that market?

Answer. The CFTC currently publishes COT reports that include aggregate data from futures and options exchanges. Pending the outcome of Dodd-Frank rulemakings and the availability of adequate resources, similar transparency efforts will be undertaken with respect to the swaps market. The CFTC's proposed rule requiring the reporting of positions in certain swaps will provide crucial data that will be incorporated in COT reports.

Question. What other efforts are underway—or planned—at the CFTC to heighten access to information and thus promote more open government?

Answer. The CFTC is committed to promoting transparency of both the markets and the agency. We have posted on our Web site a list of all meetings held with outside organizations related to Dodd-Frank rulemakings. This allows the public to see what information is provided to the agency during the rulemaking process.

Further, we plan to implement new transparency initiatives in the coming weeks. Specifically, we will release data sets that provide information on the daily volume of trading that represents changes in daily net market exposure. The CFTC also seeks to make COT data more user-friendly. At present, users are presented with a fixed list of reports. Proposed changes will present options from which users can choose to generate the reports and formats that come closest to serving their needs.

Question. The amount and detail of trade data collected and analyzed at the CFTC is unprecedented among regulatory financial agencies. The backbone of the CFTC's market surveillance program is the large trader reporting system. I understand that the SEC is exploring a similar system. Based on your experience at the CFTC, what best practices or lessons learned might benefit what Chairman Schapiro is contemplating?

Answer. Trader identification that permits aggregation according to common ownership and control, and that allows for meaningful classification of traders would ease analysis and formatting of published reports. We are working closely with the SEC to share our experience with large trader reporting.

WORKING WITH SWAP EXECUTION FACILITIES (SEF)

Question. Currently the CFTC oversees 17 Designated Contract Markets (DCMs) for trading in futures. It is my understanding that the CFTC anticipates that some 30–40 entities will apply to become SEF, potentially tripling the CFTC's oversight requirements. New responsibilities include routine monitoring and surveillance to screen for potential market manipulation, disruptive trading practices, and violations, as well as changing market conditions and developments.

Is the range of 30–40 still your projected estimate on the growing universe over which the CFTC will need to exercise vigilance?

Answer. The range of 30–40 possible SEFs was an estimate based on the number of entities that expressed interest in establishing SEFs. The CFTC staff continue to receive inquiries from entities that may register as SEFs. The actual number of entities that ultimately will file applications is uncertain.

Question. What additional resources will be required for CFTC to even minimally satisfy its new oversight in the swaps arena?

Answer. The CFTC will need additional staff to implement many new provisions related to the oversight of swaps trading activity. These include procedures for the review and oversight of an entirely new regulated market category: SEFs. Staff in the Market and Product Review and Market Compliance units must establish and implement procedures for the review of new SEF applications and for the annual examination of the operations of SEFs. The CFTC has requested a total of 62 FTE to fulfill its pre-Dodd-Frank responsibilities. A total of 56 FTE are requested to implement new Dodd-Frank Authorities. This includes an additional 38 FTE for fiscal year 2012 and an additional 18 FTE for fiscal year 2013.

Question. What does the CFTC consider to be the optimum frequency for conducting "rule enforcement reviews" (RERs) of DCMs and eventually SEFs as well?

Answer. Annually.

Question. What resource needs does that necessitate?

Answer. The President's budget request for fiscal year 2012 would support the expenditure of $16.6 million for market oversight. This would provide the resources necessary to increase the frequency of reviews.

QUESTIONS SUBMITTED BY SENATOR BEN NELSON

Question. With the ongoing volatility in the marketplace, I think we can all agree on the necessity of implementing the Dodd-Frank Act in a sound and reasonable timeframe to avoiding reckless speculation.

However, I also want us to be mindful that we achieve regulation without strangulation.

Dodd-Frank contained critical protections to ensure that nonfinancial end-users who use future contracts in a legitimate matter to hedge against higher prices are not hampered by unnecessary regulations.

Specifically when it comes to the Commodity Futures Trade Commission's (CFTC) implementation of rules relating to the definition of a swap dealer, the end user exception, and position limits.

Chairman Dodd and Chairwoman Lincoln drafted a letter to the CFTC urging the Commission to be mindful of these specific protections in its implementation of the law, which I would like to introduce for the record.

Is the CFTC following congressional intent when it comes to protecting commercial end users so they are not adversely impacted by the Dodd-Frank's regulatory framework?

Answer. To ensure the financial integrity of swap dealers and security-based swap dealers, the Congress directed that prudential regulators, the Security and Exchange Commission (SEC) and the CFTC establish capital and margin requirements. The Dodd-Frank Act also requires that standardized swaps be cleared by central counterparties to lower risk. The CFTC's proposed rules would not require clearing or margin for uncleared swaps to be paid or collected on transactions involving nonfinancial end-users hedging or mitigating commercial risk.

Question. As I mentioned in my opening statement, the run up in commodity prices, in particular oil and gas prices are having a major impact on Nebraska families, farmers, and businesses that rely on affordable fuel for personal commuting, farming, and conducting day-to-day commerce.

In 2008, the CFTC found that the oil record was partly driven by speculators driving up prices. Does the CFTC believe this to be the case again with the run up in commodity prices? How much has this speculation inflated oil and gas prices?

What steps is the CFTC taking to address this?

Answer. The CFTC fulfills its mission to oversee the futures markets through market surveillance, industry oversight, and enforcement. The CFTC pursues fraud and market manipulation and oversees futures exchanges and clearinghouses. The CFTC is a cop on the beat that protects markets in commodity derivatives from fraud, manipulation and other abuses.

A critical reform of the Dodd-Frank Act relates to position limits. Position limits have served since the Commodity Exchange Act passed in 1936 as a tool to curb or prevent excessive speculation that may burden interstate commerce.

Importantly, the Dodd-Frank Act directs the CFTC to establish position limits for both futures and swaps in a very specific manner. First, the act directs the CFTC to establish position limits, as appropriate, for futures contracts for agricultural commodities and exempt commodities (including crude oil, gasoline, and other energy commodities). Second, the act directs that the CFTC concurrently establish position limits on swaps that are economically equivalent to those futures contracts. Third, the act requires the CFTC to establish aggregate limits across the futures and swaps markets. On January 26, the CFTC published a proposed rule to implement these statutory directives. The comment period closed on March 28. The CFTC will evaluate the comments received before proceeding to a final rulemaking. It is essential to complete the task of implementing the aggregate position limits regime, congressionally mandated to guard against the burdens of excessive speculation.

Question. In the current fiscal climate we are faced with many difficult questions when it comes to funding.

While were able to boost the CFTC budget by $34 million more than fiscal year 2010 levels for the remainder of fiscal year 2011, it appears we face an even more difficult situation for funding fiscal year 2012.

Can you speak to the limitations the CFTC would have in regulating contracts and providing oversight and transparency to the over-the-counter derivatives swaps trading market if we are merely able to maintain fiscal year 2011 levels in fiscal year 2012?

What would the impact be if were faced with the prospect of being able to only provide fiscal year 2008 levels or the level the House recently passed in their fiscal year 2012 budget proposal?

Answer. A return to the CFTC's fiscal year 2008 funding level would represent a 45 percent reduction from current levels. Had such a level been enacted for the CFTC mid-way through fiscal year 2011, CFTC staffing would have had to be reduced by 442 FTE—a 65 percent reduction.

If the CFTC's funding returned to the fiscal year 2008 level, the Commission would be unable to fulfill its statutory mission. Every program would be affected, including market surveillance, industry oversight and enforcement. We would be unable to pursue fraud, such as Ponzi schemes, and market manipulation. We would inevitably develop a backlog of registration applications, rule reviews and appellate filings. This would leave significant uncertainty in the marketplace.

Question. Over the Easter recess, President Obama directed Attorney General Eric Holder to create an Oil and Gas Price Fraud Working Group to "monitor oil and gas markets for potential violations of criminal or civil laws to safeguard against unlawful consumer harm."

It is my understanding that in addition to the Department of Justice the group is composed of representatives from the Federal Trade Commission (FTC), the Department of the Treasury, and the CFTC.

I was hoping you could speak to the role CFTC is play in this working group and what we hope to accomplish with this new working group.

Answer. The CFTC serves as a co-chair of the Oil and Gas Fraud Working Group, whose membership also includes State Attorneys General, the FTC, the Departments of Energy, Agriculture and the Treasury, the SEC, the Board of Governors of the Federal Reserve System and the Federal Bureau of Investigations. On May 6, 2011 Attorney General Holder, as chairman of the group, informed the members that the "[w]orking Group will enable us to formalize our collaborative effort, share current oversight activities, avoid duplication, and combine our resources and expertise." Members are actively working toward these goals, covering topics such as confidential information sharing between agencies, evaluating lessons learned from prior fraud enforcement involving multiple regulator collaboration and coordination, and continued discussions regarding market fundamentals, trends and oversight.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

Question. The recently enacted continuing resolution states that of the funding provided, "not less than $37.2 million shall be for the highest-priority information

technology (IT) activities in the Commission" to address important IT needs such as automated surveillance, collecting order and trade data, integrating technology across swaps and futures markets, improving data transparency and linking the Commodities Futures Trading Commission (CFTC) with Swap Data Repositories (SDR). Please identify the highest-priority IT activities that will be funded from within this amount.

The highest priority of the CFTC IT budget is to support the ongoing operations of mission-essential systems and infrastructure for all divisions. With this funding, the CFTC can meet existing business requirements, provide operations support, collect business requirements for new technology solutions and implement new technology solutions. The major services provided in this area include:

—Establishment of a technology roadmap with the capability and capacity to integrate futures and swaps data and market oversight;
—Market and financial surveillance;
—Enforcement litigation support, data discovery and forensics;
—Automated surveillance modeling; and
—Large trader data, financial data and trade data receipt, loading and mining.

Question. As the full-year continuing resolution has been enacted, please provide details to the subcommittee as to how the CFTC plans to spend remaining fiscal year 2011 funding. According to the Chairman's prepared testimony, the CFTC is prepared to hire approximately 40 additional staff in fiscal year 2011. Please provide the subcommittee with specific information on the basis of the Chairman's hiring figure and the CFTC's intended deployment of the additional personnel. In addition to information about hiring plans, please also provide specific information as to the impact those hiring decisions will have on the staffing increases requested by the CFTC for fiscal year 2012.

Answer. The fiscal year 2011 spending plan allocates $202,269,650 across 2 fiscal years, the majority of which will be obligated before September 30, 2011.

The CFTC expects to have about 720 staff on-board by September 30 and to utilize 667 full-time equivalent staff-years. Twelve of the new positions will implement the CFTC's reorganization. The remaining hires will be used to fill critical staffing needs across the CFTC. The display below identifies the expected distribution of CFTC staff at the end of fiscal year 2011.

DISTRIBUTION OF CFTC STAFF

Division/office	2011 distribution by division at 720 FTE level	Percentage of staff
Division of Enforcement	172	23.9
Division of Market Oversight	126	17.5
Division of Clearing and Risk	59	8.2
Division of Swaps Oversight	79	11.0
Office of Data and Technology	88	12.2
Office of the Executive Director Office of General Counsel	69	9.6
Office of Chairman and Commissioners	50	6.9
Office of the Chief Economist Office of Proceedings	42	5.8
Office of International Affairs Office of Consumer Outreach	15	2.1
Total	720	100.0

Question. Please provide more details regarding the CFTC's fiscal year 2012 request for its technology budget, including specific information as to breakdown of the budget request for the newly proposed of Office of Technology.

Answer. The following table breaks down the request.

[In millions of dollars]

Description	Amount
Investments in CFTC SDR data aggregation, order Data Collection and Standardization, Implement Advanced Computing Platforms for High-Frequency, Algorithmic Trading Surveillance, and Enforcement	10
Systems integration of existing large trader and trade systems with swaps data, for systems enhancement such as aggregated position limit surveillance, and significant upgrades to the FILAC systems for SEFs and SDRs	9
Capital equipment and software purchases	14
Telecommunication services	5

[In millions of dollars]

Description	Amount
Support services such as financial and legal information services, operations and maintenance, systems analysis for ISS, TSS, eLaw, as well as other smaller mission-supporting systems and general operational support	24
IT supplies, operations, and maintenance including intra-governmental payments or cross-services agreements with other government agencies for Internet access and Web site maintenance, personnel payroll system, GSA telephone services and COOP facilities	4

Answer. The CFTC's fiscal year 2012 budget request includes $66 million for technology. Of that amount $25 million will be required to begin the implementation of Dodd-Frank Act rules. The CFTC will begin developing a number of technology solutions in fiscal year 2011 and 2012. This includes: automated surveillance of commodity futures, options and swap markets; ensuring that CFTC data is compatible with industry data; identifying fields that describe transactions and transacting entities; associating swaps market data with futures market data; and implementing a number of other technology priorities. The technology implementation timetable will be driven by the sequence and phasing of the effective dates of final rulemakings. In fiscal year 2011 and 2012, the focus will be support for registration and compliance filings, providing connectivity for direct access to SDRs, addressing margin requirements and assimilating data needed for determining and enforcing position limits. The CFTC plans to update automated surveillance systems and integrate swaps and futures data and systems.

Despite rapid advances in technology and the increased size of regulated derivatives markets, funding for the CFTC has lagged behind the growth of the markets. While market participants have the technology to automate their trading, we do not yet have the resources to employ modern technology to automate our surveillance.

In fiscal year 2010, we used about 18 percent of our budget—$31 million—on technology initiatives. The continuing resolution requires that we allocate $37.2 million toward technology in fiscal year 2011. The CFTC needs to make further investment in technology to efficiently oversee both the futures and swaps markets. Only through investment in the CFTC will we be able to adequately oversee the commodity futures and swaps markets and protect the American public. With an appropriation to support $66 million to be used on technology, the CFTC would increase the proportion of its budget used on technology to more than 21 percent.

Question. The CFTC has recently notified the subcommittee of its intent to undertake a reorganization, effective October 9, 2011, to restructure its staff, creating a new Division of Swap Dealer and Intermediary Oversight, a new Office of Data and Technology, and realigning other divisions and offices including the Division of Market Oversight, the Division of Clearing and Intermediary Oversight and the Office of the Executive Director. The CFTC's fiscal year 2012 budget request did not reflect this reorganization. Please provide the subcommittee with details on the new spending plan the CFTC is proposing for fiscal year 2012, including the impact of the reorganization on staffing.

Answer. The reorganization will require the same FTE level as previously requested. The attached document details the breakdown of FTE utilization under both the fiscal year 2012 budget request and under the planned reorganization.

Department	Employees
Fiscal Year 2010 Budget Current Organizational Structure:	
DOE	235
DMO	250
DCIO	182
OITS	92
OED	73
OGC	70
CH/COMM	38
OCE	20
PRO	10
OIA	13
CP/WB	....
Total	983

Department	Employees
Fiscal Year 2012 Budget Proposed (February) Organizational Structure:	
DOE	235
OSEF&STDCM [1]	100
MTPS&DMA [2]	147
FBOT [3]	3
Subtotal	250
SDIO [4]	112
CORS [5]	[5] 70
Subtotal	182
OITS	92
OED	73
OGC	70
CH/COMM	38
OCE	20
PRO	10
OIA	13
CP/WB	....
Total	983
Fiscal Year 2012 Budget Proposed (May) Organizational Structure (Effective October 2011):	
DOE	235
DMO	[1] 229
DCR	74
DSIO	108
ODT	[1] 113
OED	73
OGC	70
CH/COMM	38
OCE	20
PRO	10
OIA	13
CP/WB	([2])
Total	983

[1] Oversight of Swap Execution Facilities and Swaps Trading on DCMS located on page 8 of the electronic version of the CFTC fiscal year 2012 President's budget.
[2] Market and Trade Practice Surveillance; Data Management and Analysis located on page 8 of the electronic version of the CFTC fiscal year 2012 President's budget.
[3] Foreign Boards of Trade located on page 9 of the electronic version of the CFTC fiscal year 2012 President's budget.
[4] Swap Dealer and Intermediary Oversight located on page 7 of the electronic version of the CFTC fiscal year 2012 President's budget.
[5] Clearing Oversight and Risk Surveillance located on Page 7 of the electronic version of the CFTC fiscal year 2012 President's budget.
[6] ODT Total FTE is comprised of 92 OITS FTE and 21 FTE transferred from DMO's Information Group.
[7] Appropriate organization structure to be determined.

Question. During the question and answer portion of our hearing, you referenced that you have economists working on each of the rule-writing teams. Specifically, you said: "We do have a very fine staff of economists. It's about 14. We are wishing in this budget request to grow to 20, but there are also a lot of economists in the rule writing teams that aren't in the Office of Chief Economist." Beyond the 14 economists working in the Office of Chief Economist, could you please list the names of each of the economists dedicated to the rule-writing teams and list the rules they have worked on?

Answer. When the Dodd-Frank Act was enacted, we established 30 rulemaking teams made up of staff from across divisions. An additional team was added to deal with necessary conforming changes to existing CFTC regulations. Below is a list of these teams and lead divisions with the subject of their rule writing responsibility. For each team the names of economists who are not part of the Office of Chief Economist are listed, along with their job titles and divisions.

RULEMAKING TEAMS

Team	Title
Team 1—Registration (SD and MSPs)	([1])
Team 2—Entity definitions:	
Kuserk, Gregg	Senior Economist
Seong, Somi	Economist
Troia, Rosario	Financial Economist
Team 3—Business Conduct Standards—Counterparties	([1])
Team 4—Business Conduct Standards—Internal:	
Rothenberg, John Paul	Economist
Team 5—Capital and margin for non-banks:	
Rothenberg, John Paul	Economist
Team 6—Segregation and bankruptcy cleared—DCIO	([1])
Team 7—DCO Core Principles—DCIO	([1])
Team 8—Process of Review, Mandatory Clearing—DCIO	([1])
Team 9—Governance—DCIO	([1])
Team 10—System Important DCO Rules, Title VIII—DCIO	([1])
Team 11—End-User Exemptions—OGC:	
Horn, Marshall	Director, Market Surveillance Branch
Team 12—DCM Core Principles—DMO:	
Forkkio, John	Supervisory Industry Economist
Kass, David	Industry Economist
Leonova, Irina	Financial Economist
Price, Gregory	Industry Economist
Benton, Steven	Industry Economist
Murray, Martin	Supervisory Economist
Team 13—SEF Registration Requirements—DMO:	
Benton, Steven	Industry Economist
Kass, David	Industry Economist
Leonova, Irina	Financial Economist
Price, Gregory	Industry Economist
Team 14—FBOT Registration Requirements—DMO:	
Colling, Phillip	Industry Economist
Team 15—Rule Certification and Approval—DMO:	
Babula, Ronald	Economist
Murray, Martin	Supervisory Economist
Team 16—SDR Registration Standards—OGC:	
Schubert, Anne	Economist
Team 17—Swap Data Recordkeeping and Reporting—DMO:	
Irina Leonova	Economist
Kuserk, Gregory	Senior Economist
Pullen, George	Economist
Rothenberg, John Paul	Economist
Schubert, Anne	Economist
Larry Grannan	Economist
Team 18—Real Time Reporting—DMO:	
Leahy, Thomas	Chief, Product Review Branch
Pullen, George	Economist
Team 19—Agricultural Swaps and Commodity Options—DMO:	
Lachenmayr, Christa	Economist
Murray, Martin	Supervisory Economist
Team 20—Retail Forex—DCIO	([1])
Team 21—Product Definitions—OGC:	
Kuserk, Gregory	Senior Economist
Seong, Somi	Economist
Troia, Rosario	Financial Economist
Team 22—Portfolio Margining Procedures—DCIO	([1])
Team 23—Anti-Manipulation—ENF:	
Cusimano, Jeremy	Economic Advisor to the Director
Kass, David	Industry Economist
Team 24—Disruptive Trading Practices—ENF:	
Cusimano, Jeremy	Economic Advisor to the Director
Kass, David	Industry Economist
Team 25—Whistleblowers—ENF	([1])
Team 26—Position Limits—DMO:	
Danger, Kenneth	Industry Economist

RULEMAKING TEAMS—Continued

Team	Title
Kass, David	Industry Economist
Littlefield, Thomas	Economist
Sherrod, Stephen	Acting Director of Market Surveillance
Outen, James	Industry Economist
Team 27—Investment Advisor Reporting—DCIO	([1])
Team 28—Volker Rule—DCIO	([1])
Team 29—Alternatives to Relying on Credit Ratings—OGC	([1])
Team 30—Fair Credit Reporting Act and GLB—OGC	([1])
Team 31—Conforming Rules—DCIO:	
Choo Lee-Ken	Industry Economist

[1] Any Economists on these teams are from the Office of the Chief Economist.

In addition, DMO is the lead staff division for eight of the rulemaking teams. The division director is Richard Shilts, who is an economist.

QUESTIONS SUBMITTED TO MARY L. SCHAPIRO

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

CREDIT RATING AGENCIES

Question. Under the Dodd-Frank regulatory reform law enacted last July, Federal agencies are required to scrub their rule books of references to credit ratings, forcing them to find alternative measures for creditworthiness.

During the credit boom, banks and other investors put great stock in the prime ratings given to mortgage bonds that later soured. The Congress was concerned that, by referencing ratings in its rules, the Federal Government may have been putting its imprimatur on the ratings.

Recently, the Securities and Exchange Commission (SEC) issued a proposed rule to eliminate references to credit ratings from the so-called "net capital rule" that requires a brokerage firm to maintain sufficient liquid assets against its proprietary securities in order to protect customers in case it fails. Currently, this rule allows brokerages to hold less capital against certain securities that hold high ratings from at least two registered credit-rating firms.

The SEC proposal would replace the former credit rating with a brokerage's own internal assessment of the securities' creditworthiness. This change would affect about 480 brokerages that hold proprietary securities, some of which will have to incur costs to come up with an in-house process that serves as a replacement for outside ratings.

One of your fellow Commissioners contends that this change would harm investors and force the SEC to spend more resources on its broker examinations to ensure brokerages are complying with the rules.

What mechanisms does the SEC plan to put into place to ensure that the substitute credentialing by brokerages are sound and reliable?

If the rating determination is left up to each brokerage won't that spawn an array of varied and inconsistent standards?

Wouldn't it be more prudent and efficient for the SEC to design an objective standard?

Answer. On April 27, 2010, the SEC proposed to remove references to credit ratings of Nationally Recognized Statistical Rating Organizations (NRSROs) in certain rules under the Securities Exchange Act of 1934, including the Commission's net capital rule for broker-dealers.

Under the proposal, the SEC sets forth a list of factors that a broker-dealer could consider when determining the net capital treatment of preferred stock, nonconvertible debt, and commercial paper. The factors are intended to facilitate a determination by a broker-dealer as to whether a security is subject to a "minimal amount of credit risk." If it is, the security could qualify for more favorable net capital treatment than securities of lesser credit quality. The range and type of specific factors considered would vary depending on the type of securities subject to review. A broker-dealer's process for establishing creditworthiness and its written policies and procedures documenting that process would be subject to review in regulatory examinations by the SEC and self-regulatory organizations (SROs). A broker-dealer that does not establish, maintain, and enforce written policies and procedures rea-

sonably designed to assess creditworthiness would be subject to disciplinary action for noncompliance with the rule and could be required to recalculate its net capital.

This is not the first time the SEC has proposed to remove references to credit ratings in Commission rules. The SEC issued a concept release in 1994 on the general idea of removing references to NRSROs in its rules. In 2003, the SEC again sought comment on whether it should eliminate the NRSRO designation from Commission rules, and, if so, what alternatives could be adopted to meet the Commission's regulatory objectives. Most recently, in July 2008, the SEC made specific proposals to remove rule references to ratings by NRSROs. In response, the SEC received many comments that raised serious concerns about removing the credit rating references. In October 2009, the SEC adopted several of the proposed reference removals and re-opened for comment the remaining proposals. In each of these concept releases and rule proposals, commenters generally did not support the removal of references to NRSRO ratings from SEC rules and provided few possible regulatory alternatives.

The SEC recognizes the concerns raised by commenters that replacing credit ratings—which provide an objective benchmark—with more subjective approaches could increase costs to broker-dealers and the Commission. Accordingly, in the current proposal, the SEC seeks comment on the potential impact of moving from an objective standard to a more subjective standard and whether alternate and more reliable means of establishing creditworthiness exist.

Question. Do you think that it is possible to restore the reputation of credit rating agencies? What enhanced role does SEC play in regulating credit rating agencies?

Answer. The Dodd-Frank Act augmented the SEC's oversight authority for credit rating agencies registered as NRSROs and mandated that the Commission adopt rules in a number of areas with respect to NRSROs. The SEC began the process of implementing these mandates with the adoption of a new rule in January 2011 requiring NRSROs to provide a description of the representations, warranties, and enforcement mechanisms available to investors in an offering of asset-backed securities—as well as how those representations, warranties, and enforcement mechanisms differ from those of similar offerings. On May 18, 2011, the SEC proposed new rules and amendments to existing rules that would implement the balance of the Dodd-Frank Act's NRSRO rulemaking mandates. The proposals would enhance the SEC 's existing rules governing ratings and rating agencies by, among other things, requiring NRSROs to:

—report on internal controls;
—protect against conflicts of interest;
—establish professional standards for credit analysts;
—provide public disclosure about the credit rating and methodology used to determine the credit rating, when publishing a rating; and
—enhance their public disclosures about the performance of their credit ratings.

In addition, as required by the Dodd-Frank Act, the SEC has begun conducting annual exams of NRSROs.

SEC ORGANIZATIONAL STRUCTURE STUDY

Question. In response to a directive in section 967 of the Dodd-Frank Act, the SEC retained the services of an independent consultant to analyze the Commission's structure and operation, and to suggest reforms. The Boston Consulting Group (BCG) was hired. Among the recommendations outlined in the March 10 report are that the SEC should "hire staff with high-priority skills," "invest in technology systems," and "improve oversight over self-regulatory organizations."

Has the SEC evaluated the BCG findings and recommendations?

What has been the internal response to the report?

Is the SEC unified in its reaction?

What steps are being taken to address the recommendations?

What is the estimated cost of implementing the reforms the BCG recommended?

To what extent will resources made available for fiscal year 2011 be utilized to move forward with any of the changes recommended?

Although the President's fiscal year 2012 budget was submitted about 6 weeks before the BCG report, to what extent does the spending proposed for next year incorporate any aspects that would address the BCG findings?

Answer. The BCG report has provided the SEC with valuable insights into how the SEC might continue its efforts to ensure a vigilant, agile, and responsive organization. Because the scope of the BCG report's recommendations touch on virtually every aspect of the SEC's operations and offices, determining the appropriate course of action to take in response and implementing those actions will require careful internal coordination and a significant commitment of staff and other resources.

Both during the period of study by the BCG and now with regard to the final report, the SEC has been committed to the concept of this independent assessment. We welcome the opportunity to review our structure, processes, and the full range of our business operations with the goal of improving their efficiency and effectiveness to meet our mission objectives. Accordingly, I believe that the overall response within the SEC to the BCG report has been a positive one, and Commission management is unified in its commitment to excellence.

Since the report's issuance the SEC has been moving rapidly to evaluate, prioritize, and implement many of the BCG findings and recommendations. I have designated our Chief Operating Officer, Jeff Heslop, to manage the logistics of the follow-up process. We've divided the BCG recommendations into two dozen discrete work-streams, each of which has been assigned to a division or office director or other senior executive tasked to lead the follow-up work. Initially, we are analyzing the recommendations to determine whether we agree with them and, if so, to develop an implementation plan and schedule. We have also established an Executive Steering Committee to provide critical oversight, to review implementation plans, and decide how best to prioritize, sequence, and coordinate the significant follow-up work resulting from the two dozen work-streams. Further, we have established a dedicated Program Management Office that is responsible for tracking and reporting on the SEC's implementation efforts. These efforts are being funded to the extent permitted by the SEC's overall fiscal year 2011 appropriation.

In a number of cases, we are already taking follow-up actions. For instance, we have agreed with the recommendation to consolidate the functions of the Office of the Executive Director and the Office of the Chief Operating Officer and received reprogramming approval from our House and Senate Appropriations Subcommittees to take this action.

The BCG has estimated that approximately $42 million to $55 million in up-front costs will be required to implement the recommendations, in addition to the costs associated with the significant commitment of SEC management and staff time. A significant portion of these implementation costs ($21 to $28 million) would be for additional investments in information technology systems. The SEC did not have the opportunity to consider the costs of implementing the BCG recommendations in developing its fiscal year 2012 budget request, which as you note was submitted to the Congress more than a month before the SEC received the BCG's final report.

One of the key findings from the BCG report is that the SEC does not have sufficient human resources to complete the requirements of Dodd-Frank while maintaining its activities as currently performed. We would note that the BCG's estimate of the size of this staffing "capacity gap" is generally consistent with the SEC's own estimate as reflected in our fiscal year 2012 budget request. Specifically, the BCG estimates that, in fiscal year 2012, the SEC's five major divisions and examinations program collectively will experience a capacity gap of at least 400 to 450 full-time equivalent (FTE). This is consistent with our budget request for these programs for fiscal year 2012, which seeks an increase of 424 FTE for these programs compared to fiscal year 2011.[1]

RESPONSIVENESS TO TIPS, COMPLAINTS, AND REFERRALS (TCRS)

Question. What has the SEC accomplished in the past year to address concerns that the Commission was historically woefully unresponsive to TCRs submitted to the Commission citing potential violations of the rules and securities laws?

Answer. In January 2010, the Division of Enforcement established the Office of Market Intelligence (OMI) to be the central intake point of all TCRs sent to the SEC by the public. The OMI has established policies, procedures, and workflow processes to analyze and research TCRs and assign out those TCRs that merit further assessment by investigative or exam staff.

Question. Are all of the incoming TCRs presently channeled to one centralized destination within the SEC for review regardless of the mode of transmission (e.g., e-mail, letter, hotline, etc.) or substantive nature of the issue?

Answer. All tips and complaints, regardless of the mode of transmission or the substantive nature of the issue, are entered into the TCR Intake and Resolution System. The system centralizes TCRs and provides work flow and audit capabilities such that all tips and complaints can be tracked from entry to disposition. With respect to referrals, we have a legacy system that we are in the process of incor-

[1] The SEC's fiscal year 2012 budget seeks 424 additional FTE for the enforcement program (130); the examinations program (148); Corporation Finance (38); Trading and Markets (58), Investment Management (24); and RiskFin (26).

porating into the TCR Intake and Resolution System. As a result, referrals are not yet centralized in the TCR Intake and Resolution System.

Question. Which office within the SEC is primarily responsible for managing TCRs?

Answer. The OMI in the Division of Enforcement and the Office of Compliance Inspections and Examinations (OCIE) are the two offices within the SEC that review all TCRs. These two offices coordinate review processes to ensure that tips and complaints receive similar analysis. Investor complaints that do not concern violations of the Federal securities laws are handled by the Office of Investor Education and Assistance.

Question. Do you have an automated intake system in place at this time?

Answer. Yes. Tips and complaints can be entered by the public into the SEC's online electronic questionnaire located at www.sec.gov. The information entered automatically populates an internal database of tips and complaints—the TCR Intake and Resolution System. The public may also send tips and complaints via email, letter, or fax. Tips and complaints received by email, letter, or fax are entered by SEC staff into the same internal database of tips and complaints.

Question. Does the system track and monitor the tips?

Answer. Yes. The TCR Intake and Resolution System has the capability to track all tips and complaints from entry to disposition.

Question. Does it provide a means to link and search for multiple similar complaints against a single entity?

Answer. Yes. The TCR Intake and Resolution System has search capabilities that enable staff to link and search for similar complaints against a single entity.

Question. Does the system generate an acknowledgment to the individual or firm that submitted the TCR?

Answer. If the tip or complaint is entered through the SEC's Web site using the online questionnaire, the submitter will receive an acknowledgment of receipt as well as a reference number associated with his or her submission. If the tip or complaint is mailed or emailed, the staff will send a letter or email acknowledging receipt of the tip or complaint.

Question. That additional resources are required to further strengthen the SEC's capacity to acquire and manage an effective and functional automated TCR?

Answer. The TCR Intake and Resolution System was designed with the ability to add additional functionality such as an automated triage engine and other analytical tools. We are currently pursuing triage functionality to enhance our capabilities.

Question. To what extent does SEC management interface with your Inspector General (OIG) to cross-match complaints and tips and referrals that may be routed to each of you to identify redundancy and duplication? If that is not occurring, would doing so pose any issues?

Answer. All tips and complaints received by the SEC are required to be entered into the TCR system. Staff in the OIG will forward tips and complaints that they receive to the OMI for entry into the system. Prior to entry, the staff's protocol requires a search of the system to determine whether the tip or complaint has already been entered.

STRENGTHENING EXAMS AND OVERSIGHT—FREQUENCY OF REVIEWS

Question. A vigorous exam program serves as a vital early warning system and weakness detector.

I understand that the SEC employs a "risk-based" strategy for conducting exams of investment advisers. Under this approach, resources are concentrated on those firms and practices that have the greatest potential risk of securities law violations that can harm investors.

Your fiscal year 2012 budget justification materials indicate that the SEC examined only about 9 percent of the investment advisers in fiscal year 2010 down from 14 percent in 2008.

Is that level sufficient or acceptable, in your judgment?

What are the drawbacks of sporadic inspections of a limited universe?

What would it take to increase the number and frequency of reviews?

Does the percentage decline from fiscal year 2008 to fiscal year 2010 suggest that the SEC is reviewing fewer entities or have the number of advisers grown such that you are actually conducting more exams? (e.g., 14 percent of 1,000 = 140; 9 percent of 1,600 = 144).

Are you at least conducting initial screenings of the entire universe to identify the highest-risk ones?

Are you potentially missing some high-risk reviews because you are not able to examine 91 percent of them?

Your data also reflect that SEC exams identify deficiencies in 72 percent of the firms that are reviewed and that 42 percent of the ones with deficiencies are categorized as "significant" suggesting a high potential to cause harm or reflect recidivist conduct. It is also noteworthy that SEC intends to use more rigorous exam protocols this year and, coupled with growth in the number of regulated entities, SEC expects even lower percentages of registrants being examined.

Isn't it conceivable with new entities coming under regulatory purview that more exams are in order rather than fewer?

What resources would you need to expand exam staffing and support?

Is it possible to require more detailed and rigorous self-exams and reporting requirements imposed?

In response to the Madoff scandal and the revelation of the embarrassing ineptitude that delayed catching this criminal, what new mandates are now in place? Are SEC examiners now routinely verifying the existence of client assets in the custody of third parties, counterparties, and customers?

Answer. Current examination resources can indeed only cover a small portion of the registered investment advisers (IAs) that we are responsible for examining. Moreover, several factors are increasing the strain on our examination resources:

—increased development and use of new and complex products, including derivatives and exchange-traded funds;
—growth of technology to facilitate such activities as high-frequency trading; and
—growth of "families" of financial service firms with integrated operations that include both broker-dealer and IA affiliates.

In addition to these industry factors, the examination program now routinely verifies with third parties the assets held by IAs, an important, but labor-intensive process. As a consequence of all of these factors, fewer IA examinations were conducted in fiscal year 2010 than in fiscal year 2008, even as the population of IA registrants increased during that period.

Although we expect that, under the Dodd-Frank Act, States will assume responsibility for examining most IAs with less than $100 million in assets under management by early 2012, the act also expanded the SEC's examination-related responsibilities to include municipal advisors, new categories of securities-based swap registrants, advisers to private funds, and other new registrants. Overall, absent any increase in resources, the expected size of the SEC-regulated community in fiscal year 2012 will dwarf the size of the current examination program to an even greater extent than is the case today.

In light of these resource constraints and in order to more effectively carry out our regulatory responsibilities, the OCIE is pursuing a more risk-based approach to the examination program. Key elements of this approach include:

—An initial screening of IAs, through the review of all Form ADV filings. We have developed a wide range of metrics to help us identify high-risk firms and improve the chances that our examination resources are focused on the right firms.
—Sharing the results of this initial risk assessment with regional offices, which add their localized knowledge of firms to develop a more refined list of high-risk firms.
—Analysis of additional sources of information, including past examinations; SEC filings; third-party information; information from other regulators; and information gathered from other examinations.
—Analysis of other risk-related information, including the size or interconnectedness of a firm; opportunities for fraud (e.g., direct access to customer funds); financial concerns about the firm; other characteristics of a firm; and the date of last exam.

Once we have selected a candidate for an examination, we will focus the scope of the examination based on a thorough understanding of the registrant's business, affiliations and potential conflicts of interest, and a high-level review of the firm's management controls and compliance systems.

For each function included in the scope of the examination, we will conduct further review of key risk management, compliance and control functions, and test selected control processes the registrant has in place to manage compliance and fraud risk. This gives us a better sense of whether the registrant has an effective "culture of compliance," and may also encourage firms to have more rigorous compliance and self-examination programs.

While we have been working diligently to improve our exam program, we need more examiners, expertise, and further technological resources. With the addition of approximately 200 FTE positions sought in the 2012 budget, we will be able to conduct more examinations and improve our overall coverage of the industry, as well as better fulfill our new responsibilities under the Dodd-Frank Act. We also

should be able to improve our risk analysis approach so that those examinations will be more likely to focus on the areas in greatest need of attention.

The SEC recently released a staff report to the Congress on enhancing investment adviser examinations. The study, required by section 914 of the Dodd-Frank Act (914 Study), concludes that the SEC's investment adviser examination program requires a source of funding sufficiently stable to prevent examination resources from being outstripped by future growth in the number of registered advisers (i.e., that the resources are scalable to any future increase—or decrease—in the number of registered investment advisers). The 914 Study identified three options for the Congress to consider:

—Impose "user fees" on SEC-registered investment advisers that could be retained by the Commission to fund the investment adviser examination program;
—Authorize one or more SROs to examine, subject to SEC oversight, all SEC-registered investment advisers; or
—Authorize Financial Industry Regulatory Authority (FINRA) to examine dual registrants for compliance with the Advisers Act.

The SEC expressed no view as to the advisability of any of these three options.[2]

CIRCUIT BREAKER RULES IN RESPONSE TO MAY 2010 FLASH CRASH

Question. One year ago this week, the now notorious May 6 "flash crash" sent the Dow Jones industrial average plunging some 700 points in minutes, exposing flaws in the electronic marketplace dominated by high-speed trading.

In response, the SEC instituted new trading curbs last June as a pilot program. These single-stock circuit breakers apply to securities in the S&P 500 Index and Russell 1000 Index as well as certain exchange-traded funds.

Under the existing circuit breaker pilot, trading in a stock pauses across the U.S. equity markets for a 5-minute period if the stock experiences a 10 percent change in price over the preceding 5 minutes. The pause gives the markets the opportunity to attract new trading interest in an affected stock, establish a reasonable market price, and resume trading in a fair and orderly fashion. I understand that the circuit breaker pilot is currently set to expire on August 11, 2011.

A month ago (April 5, 2011), the SEC announced that national securities exchanges and the FINRA filed a proposal to establish a new "limit up-limit down" mechanism to address extraordinary market volatility in U.S. equity markets. If approved by the SEC, the new limit up-limit down mechanism would replace the existing single-stock circuit breakers

This proposed "limit up-limit down" mechanism would prevent trades in listed equity securities from occurring outside of a specified price band, which would be set at a percentage level above and below the average price of the security over the immediately preceding 5-minute period. For stocks currently subject to the circuit breaker pilot, the percentage would be 5 percent, and for those not subject to the pilot, the percentage would be 10 percent.

The percentage bands would be doubled during the opening and closing periods, and broader price bands would apply to stocks priced below $1. To accommodate more fundamental price moves, there would be a 5-minute trading pause—similar to the pause triggered by the current circuit breakers—if trading is unable to occur within the price band for more than 15 seconds.

Have the circuit breakers performed as intended? If not, why not?

Answer. One of the key purposes of the trading pauses imposed under the circuit breaker pilot was to provide an opportunity for trading interest to normalize after a stock has been subject to substantial price moves in a short period of time. In a number of instances when the circuit breakers have been triggered, the ensuing trading pause has had this intended effect. However, there may be room for improvement in terms of the actual mechanism that is used to guard against excessive volatility. In particular, because the circuit breakers are triggered only after a trade occurs outside of the applicable percentage threshold, there has been a propensity for the circuit breakers to be triggered by erroneous trades.

Question. What advantages or improvements do you expect to gain by replacing the circuit breakers with the limit up/limit down mechanism?

Answer. In contrast to the single-stock circuit breaker, which may be triggered by an erroneous trade, a limit up-limit down mechanism, which would prevent trades in individual securities from occurring outside of a specified price band, would help to prevent erroneous trades from occurring in the first place.

[2] Commissioner Walters issued a separate statement in which she supported the second option—authorizing an SRO to oversee investment advisers. *See* http://www.sec.gov/news/speech/2011/spch011911ebw.pdf.

In addition, unlike the single-stock circuit breaker, the limit up-limit down mechanism will feature a 15-second "limit state" that is triggered before a trading pause may be initiated. Once triggered, the market for that security may exit the limit state in 1 of 2 ways. If the quotation that triggered the limit state (i.e., an offer at the lower price band, or a bid at the upper price band) is either cancelled or executed against in its entirety, the market for that security will exit the limit state and return to regular trading. If the quote is not cancelled or executed against in its entirety, then a trading pause is initiated for that stock once the 15-second period has run. In instances where the limit state was triggered by an erroneous quote or a momentary gap in liquidity, as opposed to a more fundamental price move, the "limit state" feature thus allows the market to quickly correct itself by cancelling or executing against the quotation that triggered the limit state, allowing regular trading to resume instead of automatically initiating a trading pause.

Question. What's the timetable for action on the limit up/limit down proposal?

Answer. The proposed limit up-limit down National Market System (NMS) Plan was published in the Federal Register on June 1, 2011, and the 120-day period for SEC approval ends on September 29, 2011 (although the period for approval or disapproval may be extended to 180 days). If the SEC approves the plan, the plan participants have proposed that the initial date of plan operations be 120 days following publication of the approval order in the Federal Register. In particular, plan participants proposed that once the plan is operational, it will be implemented in two phases. Phase I will be launched on the initial date of plan operations, and will cover stocks in the S&P 500, the Russell 1000, and a list of select exchange-traded products. Phase II of the plan, which will apply to all remaining NMS securities, will be implemented 6 months thereafter.

MARKET MAKER QUOTING OBLIGATIONS

Question. What other initiatives or market structure measures has the SEC pursued in response to the flash crash?

Answer. One of the phenomena that occurred on May 6, 2010 was that trades were executed at irrational prices as low as one penny or as high as $100,000. These trades occurred as a result of so-called "stub quotes", which are quotes generated by market makers (or the exchanges on their behalf) at levels far away from the current market in order to fulfill continuous two-sided quoting obligations even when a market maker has withdrawn from active trading. In the following months, the SROs filed, and the SEC approved, proposals establishing minimum quoting obligations for market makers. Specifically, for stocks that are in the S&P 500, Russell 1000, and a select list of exchange-traded products, market makers must submit a quote for one round lot of shares at 8 percent away from the National Best Bid or Offer (NBBO) between the hours of 9:45 a.m. and 3:35 a.m. For quotes in these securities that are submitted between 9:30 and 9:45 a.m., and between 3:35 and 4 p.m., this quoting obligation changes to 20 percent away from the NBBO. For securities that are not included in the S&P 500, Russell 1000, or the select list of exchange-traded products, market makers must submit a quote at 30 percent away from the NBBO.

In connection with the recently filed proposals to extend the single-stock circuit breaker pilot to all remaining NMS securities, using either a 30 percent threshold (for securities in that group that are trading at or above $1) or a 50 percent threshold (for securities in that group that are trading below $1), the SROs proposed corresponding changes to the market maker quoting obligations. If those proposals are approved, market makers would be obligated to quote one round lot at 28 percent away from the NBBO for those securities trading at or above $1 (and thus subject to the 30 percent circuit breaker threshold), and 30 percent away from the NBBO for those securities trading below $1 (and thus subject to the 50 percent circuit breaker threshold).

In each of these cases, a market maker's quote may "drift" an additional 1.5 percent away from the NBBO before a new quote within the applicable band must be entered.

CLEARLY ERRONEOUS PILOT PROGRAM

Another initiative following May 6 was the approval of a pilot program establishing uniform clearly erroneous standards. To provide market participants more certainty as to which trades will be broken and allow them to better manage their risks, the national securities exchanges and FINRA proposed new trade break procedures, which were approved by the SEC on a pilot basis in September 2010.

These rules clarified the process for breaking erroneous trades. The rules will make it clearer when, and at what prices, trades will be broken by the exchanges

and FINRA. Specifically, for stocks that are subject to the circuit breaker program, trades are broken at specified levels depending on the stock price:

—For stocks priced $25 or less, trades are broken if the trades are at least 10 percent away from the circuit breaker trigger price.

—For stocks priced more than $25 to $50, trades are broken if they are 5 percent away from the circuit breaker trigger price.

—For stocks priced more than $50, trades are broken if they are 3 percent away from the circuit breaker trigger price.

Where circuit breakers are not applicable, the exchanges and FINRA will break trades at specified levels for events involving multiple stocks depending on how many stocks are involved:

—For events involving between 5 and 20 stocks, trades are broken that are at least 10 percent away from the "reference price," typically the last sale before pricing was disrupted.

—For events involving more than 20 stocks, trades are broken that are at least 30 percent away from the reference price.

On May 6, the markets only broke trades that were more than 60 percent away from the reference price in a process that was not transparent to market participants. By establishing clear and transparent standards for breaking erroneous trades, the new rules help to provide clarity in advance as to which trades will be broken, and allow market participants to better manage their risks.

Other Initiatives

Revision of the Market-wide Circuit Breakers.—The SEC is working with the Commodity Futures Trading Commission (CFTC), as well as with the securities and futures exchanges, to develop a framework for SRO rule proposals to implement changes to the current market-wide circuit breakers originally implemented in 1988 (and last revised in 1998). The goal is to modify these circuit breakers to better address the type of volatility experienced on May 6, 2010, and to better conform with today's market structures and trading dynamics.

Expansion of the Circuit Breaker Pilot To Cover all NMS Securities.—On May 6, 2011, the SROs filed proposed rule changes to extend the single-stock circuit breaker pilot program to all remaining NMS securities. The triggering percentage would be 30 percent for securities in this group that are trading at or above $1, and 50 percent for securities in this group that are trading below $1. Absent the SEC extending the timeframe, the deadline for approving or disapproving these filings is June 26, 2011.

Market Access Rules.—The compliance date for Rule 15c3–5, which imposes restrictions on sponsored and direct market access, is July 14, 2011, although some market participants have requested a short extension of the compliance date for some aspects of the rule. This rule contains regulatory risk management procedures that may assist in reducing erroneous trades.

Other Initiatives.—The SEC continues to consider the recommendations made by the Joint CFTC–SEC Advisory Committee on Emerging Regulatory Issues in its Summary Report. The SEC also continues to work towards implementing a consolidated audit trail for the U.S. equity market.

Question. What lessons were learned as a result of May 6, 2010?

Answer. From the extreme price movements observed on May 6, a number of key lessons emerged. One key lesson is that under stressed market conditions, the automated execution of a large sell order can trigger extreme price movements, especially if the automated execution algorithm does not take prices into account. Moreover, the interaction between automated execution programs and algorithmic trading strategies can quickly erode liquidity and result in disorderly markets. As the events of May 6 demonstrate, especially in times of significant volatility, high-trading volume is not necessarily a reliable indicator of market liquidity.

May 6 was also an important reminder of the inter-connectedness of our derivatives and securities markets, particularly with respect to index products. The nature of the cross-market trading activity was confirmed by extensive interviews with market participants, many of whom are active in both the futures and cash markets in the ordinary course, particularly with respect to "price discovery" products such as the E-Mini and SPY.

Another key lesson from May 6 is that many market participants employ their own versions of a trading pause—either generally or in particular products—based on different combinations of market signals. While the withdrawal of a single participant may not significantly impact the entire market, a liquidity crisis can develop if many market participants withdraw at the same time. This, in turn, can lead to the breakdown of a fair and orderly price-discovery process, and in the extreme case trades can be executed at stub-quotes used by market makers to fulfill their contin-

uous two-sided quoting obligations. As demonstrated by the CME's Stop Logic Functionality that triggered a halt in E-Mini trading, pausing a market can be an effective way of providing time for market participants to reassess their strategies, for algorithms to reset their parameters, and for an orderly market to be re-established.

A further observation from May 6 is that market participants' uncertainty about when trades will be broken can affect their trading strategies and willingness to provide liquidity. In fact, in interviews with staff of the SEC, many participants expressed concern that, on May 6, the exchanges and FINRA only broke trades that were more than 60 percent away from the applicable reference price, and did so using a process that was not transparent.

Finally, the events of May 6 clearly demonstrate the importance of data in today's world of fully-automated trading strategies and systems. This is further complicated by the many sources of data that must be aggregated in order to form a complete picture of the markets upon which decisions to trade can be based. Varied data conventions, differing methods of communication, the sheer volume of quotes, orders, and trades produced each second, and even inherent time lags based on the laws of physics add yet more complexity. Whether trading decisions are based on human judgment or a computer algorithm, and whether trades occur once a minute or thousands of times each second, fair and orderly markets require that the standard for robust, accessible, and timely market data be set quite high. Although the SEC and CFTC staff did not believe that significant market data delays were the primary factor in causing the events of May 6, the analyses of that day reveal the extent to which the actions of market participants can be influenced by uncertainty about, or delays in, market data.

IT WEAKNESSES

Question. Today, there is no standardized, automated system to collect data across the various trading venues, products, and market participants. Each market has its own individual and often incomplete data collection system, and as a result, regulators tracking suspicious activity or reconstructing an unusual event must obtain and merge an immense volume of disparate data from a number of different markets. And even then, the data does not always reveal who traded which security, and when.

To obtain individual trader information, the SEC must make a series of manual requests that can take days or even weeks to fulfill. In brief, the SEC's tools for collecting data and surveilling our markets are wholly inadequate to the task of overseeing the largest equity markets in the world.

How can we get a handle on this situation?

What kind of system is needed?

Have there been cost estimates of what it would take to create and deploy such a system?

Answer. As you noted, there currently is no standardized, automated system to collect order and trading data across the various trading venues and market participants. To track suspicious activity or to reconstruct an unusual event in the marketplace such as last year's May 6 market disruption, regulatory staff at the SEC , the exchanges and FINRA currently must merge an immense volume of disparate data from a number of different markets and often must make a series of manual requests, a process that can take days or even months to complete.

In order to address this situation, in May 2010, the SEC proposed a rule to require the exchanges and FINRA to create and implement a consolidated audit trail that would electronically capture customer and order information for all orders for equities and options, across all markets, for the entire life of an order. Under the proposal, the SEC and the SROs would have access to consolidated audit trail data for surveillance and other regulatory purposes. I believe that this consolidated audit trail would enhance the ability of the SEC and the SROs to detect and assess potentially illegal activity.

The estimated costs, as well as the estimated benefits, are discussed in the SEC release proposing the consolidated audit trail. Most of the costs for the creation and implementation of the consolidated audit trail would be borne by the industry. However, I anticipate that the SEC would need to incur costs in order to make full use of the consolidated audit trail. For example, SEC staff would need the technology infrastructure to access and run analyses on the consolidated audit trail data. If the SEC approves the consolidated audit trail proposal, I expect that a portion of our fiscal year 2012 budget will be used to begin to develop the Commission's capacity to use the information to be collected by such an audit trail.

Does your proposal to spend $78 million (about 5.5 percent) of the $1.407 billion budget you are seeking for fiscal year 2012 include initiatives to address these IT deficiencies?

Answer. In addition to the Consolidated Audit Trail, the proposal to spend $78 million for fiscal year 2012 also includes some initiatives to address the SEC's IT deficiencies; however, most of the SEC's IT infrastructure and security deficiencies are planned to be addressed through initiatives from the fiscal year 2011 budget and process improvements.

Question. I note that the CFTC is proposing to devote 21 percent of its proposed $307 million fiscal year 2012 budget to information technology enhancements? What is your view on whether devoting a mere 5 percent to IT is sufficient given the circumstances?

Answer. The budget request for the CFTC would dedicate 21 percent of its fiscal year 2012 budget to information technology, both for operations and maintenance and for enhancements. For the SEC, the equivalent figure for technology spending in fiscal year 2012 would be about 12 percent of its requested appropriation. When combined with expected technology spending out of the SEC's Reserve Fund, the total percentage is 14 percent. We believe this amount would be sufficient to continue modernizing the SEC's technology environment and advance key initiatives, such as the TCR system; the migration of our financial system to a Federal Shared Service Provider (SSP); the Consolidated Audit Trail system; EDGAR and SEC.gov modernization; and Dodd-Frank Act deployments.

TACKLING MATERIAL WEAKNESSES IN INTERNAL CONTROLS

Question. A Government Accountability Office (GAO) audit of the SEC's November 2010 Performance and Accountability Report identified two material weaknesses in internal controls over financial reporting: one in information systems, and a second in financial reporting and accounting processes.

These are not new findings, but have been identified by the GAO in several previous audits. Chairman Schapiro, I note that you fully and freely acknowledge these material weaknesses are unacceptable.

I understand that the SEC has decided to invest the time and resources to implement a long-term, comprehensive solution. Instead of creating new technology and systems, the SEC is switching to a SSP approach, migrating the SEC's financial system to the Department of Transportation (DOT).

Other agencies, including the GAO, have migrated to the DOT, and they have experienced very positive results, with clean audits free of material weaknesses. This will be a significant undertaking, which, assuming adequate funding, will culminate in the cutover to the new system in April 2012.

What do you estimate it will cost to migrate to a SSP?

Will the plan involve annual payments to the DOT for providing the service?

What will it save in the long run?

Are you planning to take steps immediately using fiscal year 2011 resources to prepare for the transition?

Answer. In its fiscal year 2010 financial audit of the SEC, the GAO found that the SEC's financial statements were presented fairly, in all material respects, and in conformity with U.S. generally accepted accounting principles. The GAO noted two material weaknesses: one in information systems and a second in financial reporting and accounting processes. You correctly note that I find these material weaknesses to be unacceptable.

The SEC is working this fiscal year on a number of fronts to correct the deficiencies noted by the GAO. In order to make its internal controls strong and sustainable over the long term, the SEC has decided to move its financial system and transaction processing to a Federal SSP, the DOT's Enterprise Services Center. After a planning phase was completed in January 2011, the implementation phase of the project began in February 2011 and will culminate in the cutover to the new system in April 2012.

The total budget for the initial deployment, including for the design and setup of the system and the conversion of the SEC's data, is $25 million, of which the SEC will need about $12 million in fiscal year 2011 and $13 million in fiscal year 2012. Once the SEC cuts over to the DOT's financial system, the SEC will make annual payments for operations and maintenance, equal to about $5.5 million per year. Although the SEC did not undertake this initiative primarily for cost savings, the SEC does expect that its ongoing, annual costs will be lowered by about $1.4 million per year after the migration.

BROKER DEALER AND INVESTMENT ADVISERS STANDARDS OF CONDUCT

Question. Brokers and dealers and investment advisers have been held to different standards of conduct in their dealings with investors. In very general terms, a broker-dealer is held to a suitability standard, and an investment adviser is held to a fiduciary duty standard.

The "suitability" standard requires that brokers and dealers assess their customers' knowledge of securities and their financial situations and recommend securities that are suitable for their customers. Courts have imposed on a fiduciary an affirmative duty of "utmost good faith, and full and fair disclosure of all material facts," as well as an affirmative obligation "to employ reasonable care to avoid misleading" one's clients.

Section 913 of the Dodd-Frank Act entitled "Study and Rulemaking regarding Obligations of Brokers, Dealers, and Investment Advisers," is the major provision setting out a new approach for defining standards of conduct for these financial industry professionals. It requires the SEC to conduct a study to evaluate the effectiveness of the current legal or regulatory standards of care for brokers, dealers, and investment advisers and whether there are legal gaps, shortcomings, or overlaps in the standards, and enumerates 14 areas of consideration for this study.

Has this study been conducted? If not, when do you expect it to commence and conclude?

Answer. Yes, the study required under section 913 ("Study on Investment Advisers and Broker-Dealers") was completed and submitted to the Congress in January 2011.

Question. Chairman Schapiro, do you believe that when investors receive similar services from similar financial service providers that those providers—irrespective of their particular title—should be held to the same standard of conduct?

Answer. Yes, I believe that when investors receive similar services from similar financial service providers, they should receive similar protections—regardless of the label applied to that financial service provider. As the staff's Study on Investment Advisers and Broker-Dealers notes, we know that the difference between an investment adviser and a broker-dealer is often lost on an investor. What remains difficult to justify is why there should be different rules and standards of conduct for the two roles—especially when the same or substantially similar services are being provided.

QUESTIONS SUBMITTED BY SENATOR BEN NELSON

Question. I understand the financial crisis raised a number of concerns about municipal securities markets. However, I believe the Securities and Exchange Commission's (SEC) proposed rule to require municipal advisors to register with the SEC goes too far.

While I do think that professional financial advisors should be registered, appointed members of municipal entities, like the ones I appointed in Nebraska as Governor, should not have to register as "municipal advisors."

In Nebraska these citizens are appointed by elected officials and are held accountable by those officials. I don't believe the registration process is relevant to the activities of a public utility board or the members of a State educational finance authority's board.

Do you anticipate modifications to the final rule that would clarify that appointed members of municipal entities, like elected members, are considered "municipal employees" and are therefore excluded from the definition of a municipal advisor?

Answer. As you know, on December 20, 2010, the SEC proposed for public comment rules that would govern the registration of municipal advisors and, among other things, proposed guidance and solicited comments on the appropriate treatment of appointed members of a governing body. We have received approximately 1,000 comment letters on the proposal, including many that address this important issue, and we are reviewing them carefully.

Section 15B(e)(4)(a) of the Securities Exchange Act, as added by the Dodd-Frank Act, provides that the term "municipal advisor" includes a person (who is not a municipal entity or an employee of a municipal entity) that "provides advice to or on behalf of a municipal entity or obligated person with respect to a municipal financial product or the issuance of municipal securities." Accordingly, our proposal would only require nonemployee-appointed officials, such as board members of local public entities, to register if they provide advice with respect to a municipal financial product or an issuance of municipal securities to or on behalf of a municipal entity or obligated person, or if they undertake a solicitation of a municipal entity.

Public input is critically important to us in crafting rules. We will certainly give the comments we have received on this issue careful consideration before adopting a final rule.

Question. In the current fiscal climate we are faced with many difficult decisions when it comes to the budget.

While we were able to increase SEC funding by $74 million more than the fiscal year 2010 enacted level of $1.111 billion in the continuing resolution, I anticipate that providing additional funding in fiscal year 2012 will be even more difficult.

Can you speak to the impact on the SEC's ability to regulate markets and enforce securities laws if we are only able to maintain fiscal year 2011 levels in fiscal year 2012?

What would the impact be if the SEC were funded at fiscal year 2008 levels or the level the House recently passed in their fiscal year 2012 budget proposal?

Answer. We greatly appreciate the subcommittee's strong support in recent years. The additional $74 million provided in fiscal year 2011 will allow the SEC to fill vacancies to meet key strategic needs, begin to perform some of the agency's new responsibilities, and continue to improve agency operations.

For fiscal year 2012, it is first important to note that the SEC's budget will be fully offset by matching collections of fees on securities transactions. Thus, the SEC's fiscal year 2012 appropriation at any level would have no direct impact on the deficit.

In addition, as I stated in my testimony, it is important to note that over the last 20 years, the SEC's budget and workforce have fallen far behind the growth in the size and complexity of the securities markets. During that time, the average value of securities transactions per day has risen by about 2,500 percent and the value of investment adviser assets has grown by about 3,070 percent. Although the SEC's workforce grew over this period, it did not nearly keep pace. This mismatch between the changes in the markets and in the SEC has been exacerbated since 2005. Between 2005 and 2007, the SEC's workforce and technology investments had to be cut back, and they are only now returning to 2005 levels. In 2005, the SEC's funding was sufficient to provide 19 examiners for each $1 trillion in investment adviser assets under management. Now that figure stands at 12 examiners per $1 trillion.

Today, the SEC has responsibility for approximately 35,000 entities, including direct oversight of 11,800 investment advisers, 7,500 mutual funds, and more than 5,000 broker-dealers with more than 160,000 branch offices. We also review the disclosures and financial statements of approximately 10,000 reporting companies. The SEC also oversees approximately 500 transfer agents, 15 national securities exchanges, 9 clearing agencies, 10 Nationally Recognized Statistical Rating Organizations, as well as the Public Company Accounting Oversight Board, Financial Industry Regulatory Authority, Municipal Securities Rulemaking Board, and the Securities Investor Protection Corporation. In addition, last year the SEC received vast new or enhanced responsibilities to oversee derivatives, hedge fund advisers, municipal advisors, and credit rating agencies.

The Boston Consulting Group's (BCG) study, mandated by section 967 of the act, concluded that although there are opportunities for redirecting resources to the agency's top priorities, the SEC still faces a "capacity gap" and needs significantly more staffing resources to effectively carry out its responsibilities. The BCG study estimated that this gap in fiscal year 2012 is equal to 400–450 additional staff in the agency's five divisions and Office of Compliance Inspections and Examinations, in line with the President's fiscal year 2012 request.

Keeping the SEC's fiscal year 2012 funding at the fiscal year 2011 appropriated level of $1.185 billion would have serious consequences for the SEC. The agency would be unable to hire expertise in new areas such as derivatives, hedge fund advisers, credit rating agencies, and others. The agency also would be unable to fulfill strategic staffing needs in our long-standing core programs, such as for enforcement investigations, investment adviser examinations, and enhanced reviews of disclosure filings of large companies. In addition, the SEC would face reductions in the technology investments needed to strengthen operations and effectively oversee the markets, at a time when technology is more important to the markets than ever before, and when the firms the SEC regulates annually spend many times more on technology than the entire SEC budget.

Cutting the agency's fiscal year 2012 funding to the levels of fiscal year 2008 would be devastating. If the SEC were to receive an fiscal year 2012 appropriation reflecting its fiscal year 2008 level, reflecting the overall approach taken in the House's fiscal year 2012 budget proposal, the agency's funding would be $906 million, or $279 million less than our fiscal year 2011 appropriation—a 24 percent reduction. A reduction of this magnitude would make significant cuts in staff and IT

unavoidable and would undoubtedly dismantle most of the important achievements of the past 2 years to make the SEC more vigilant, agile, and responsive.

Under this scenario, the SEC would need to take dramatic action to cut its workforce. Even after factoring in projected attrition, a 24 percent cut in the Commission's budget would require a personnel reduction of approximately 1,120 additional FTE—nearly one-third of our workforce. To achieve this reduction through a RIF alone would require eliminating 1,760 positions outright. A furlough to achieve this reduction would have to cover the entire SEC workforce for approximately 85 workdays. The most dramatic impact would inevitably be on the largest programs—enforcement, examinations, and disclosure review.

If the SEC were to cut IT investments to achieve a 24 percent reduction in the overall agency budget, the impact would be immediate and damaging. For example, the SEC would have to eliminate all new IT investments and suspend all ongoing development work on IT systems. Major technology initiatives would have to be halted, such as those to track tips, complaints, and referrals; strengthen the agency's financial controls; enhance enforcement and examination management systems; and bolster data analytics capabilities.

QUESTIONS SUBMITTED BY SENATOR THAD COCHRAN

Question. You mention recent challenges the Securities and Exchange Commission (SEC) faced in maintaining staffing levels and budgets sufficient to carry out its core mission. Following its investigation of Stanford Financial, the Office of the Inspector General (OIG) identified several problems at the SEC. However, none of these problems involved inadequate funding or inadequate staffing. This year the agency reorganized its national examination program in part as a response to lessons learned from the Stanford fraud. What changes did you make in this reorganization to ensure the problems identified by the OIG are being corrected?

Answer. While the Stanford IG Report did not include recommendations directed to the Office of Compliance Inspections and Examinations (OCIE), its findings show a clear need for improved coordination between enforcement and the OCIE on investigations of potential violations of the Federal securities laws, particularly those investigations initiated by a referral from the OCIE to the Enforcement Division. The OCIE has undertaken specific policy changes in its National Examination Program and instituted procedures to improve coordination and communication between the Enforcement Division and the OCIE.

Through a number of structural and process reforms, the OCIE and the Enforcement Division are working to identify misconduct earlier and to move to shut it down more rapidly. The OCIE and enforcement staff and leadership have been directed to evaluate potential referrals from the OCIE exam staff against enforcement's programmatic priorities regularly and determine the disposition of referrals. If there is disagreement on a case at the regional level, exam staff has been instructed to escalate the matter to the attention of senior leadership in Washington. These processes ensure that concerns can be escalated in a timely manner to senior leadership of both the exam and enforcement programs for appropriate review and resolution.

Exam and enforcement coordination with respect to particular matters is also the subject of periodic reviews. The OCIE policy now requires that the OCIE exam staff in each office hold quarterly Exam Reviews, in which the progress and status of every exam in the office is discussed and evaluated for several factors, including evaluating any significant issues with the firm that is the subject of the exam, determining whether more staff resources are needed on the exam and deciding if the exam is a potential referral to the Enforcement Division. These reviews are an opportunity to summarize and preview findings that appear likely to trigger possible Enforcement referrals, as well as to flag any potential differences in the assessment of urgency, potential harm to investors, or other issues that can then be raised at the joint regional meetings or to the OCIE senior management.

Finally, the OCIE exam staff is working closely with Enforcement's specialized units to identify key risks presented by entities registered with the SEC and key risks to the markets. As previously described, this partnership with the specialized units has already resulted in new approaches to joint efforts to identify risky firms that may warrant examination or an enforcement investigation. In addition, the OCIE recently announced the creation of several specialized working groups that will focus on areas where the OCIE plans to increase its specialization and market knowledge.

We have recently received encouraging news about these reforms. On March 30, 2011, the OIG issued the OCIE Regional Offices' Referrals to Enforcement, Report

No. 493 (Referral IG Report). This audit report suggests that our efforts at improved coordination are meeting with success. The report notes that a survey of all the OCIE examiners throughout the SEC's regional offices concerning their view of Enforcement responses to examination-related referrals found that "when combining the responses for 'completely satisfied' and 'somewhat satisfied' for respondents, the majority of SEC regional offices had a combined level of satisfaction ranging from 70 to 87 per cent." The IG Report further found that where there was dissatisfaction with the referral process, the level of concern dramatically dropped over time and particularly in fiscal year 2010, with some respondents identifying enforcement's newly created Asset Management Unit as having significantly assisted with the acceptance rate of the OCIE referrals.

An additional issue raised by the OIG's Stanford report, albeit one for which there were no specific recommendations, was a relative lack of coordination between the investment adviser exam team and the broker-dealer exam team in the Fort Worth Regional Office's examinations of Stanford. Senior leadership of the National Examination Program recognizes that the past structure within the examination program has resulted in certain silo effects in the examination process. After giving this issue careful consideration, changes have been made to the structure of several regional offices. For example, some of the regional offices have restructured their examination program so that each subgroup contains both adviser examiners and broker-dealer examiners. These examiners report to the same immediate supervisor, which has strengthened collaboration in examining entities that are dually registered with the SEC as both an investment adviser and a broker-dealer such as Stanford.

Question. I am very troubled by the OIG's report, released last year, on Stanford Financial. Many Mississippians and other Americans lost their life savings by investing in what were freely marketed as safe, Certificate-of-Deposit investments. Dating back to 1997, the SEC's Fort Worth Examination Group repeatedly requested that an enforcement action be brought against Stanford Financial. That was more than 12 years before the SEC actually brought an enforcement action. The OIG found serious managerial, cultural, and performance-based problems at the SEC, which led to this terrible failure. What are you doing to help compensate the victims of the Stanford Financial fraud?

Answer. We are proceeding on several fronts. Most recently, on June 15, 2011, the SEC asked the Securities Investor Protection Corporation (SIPC) to initiate a court proceeding under the Securities Investors Protection Act (SIPA) to liquidate the broker-dealer. This decision was based on the totality of facts and circumstances in the case. A SIPA liquidation proceeding would allow investors with accounts at Stanford Group Company to file claims with a trustee selected by the SIPC.

On the litigation front, the SEC's focus is to hold wrongdoers accountable while providing maximum recovery available under the law to investors harmed by this egregious fraud. First, after filing its civil action in February 2009, the SEC filed a motion requesting that the district court appoint a receiver over the defendants' assets to prevent waste and dissipation of those assets to the detriment of investors. Second, to complement the receiver's efforts, the SEC, in coordination with the Department of Justice (DOJ), moved to freeze Securities and Investment Board assets held in international financial institutions. Freezing assets in international jurisdictions poses complex litigation challenges, but this step was crucial to ensure the protection of investor funds. Third, the SEC is working with the receiver, DOJ, and securities regulators and law enforcement agencies in the United Kingdom, Switzerland, Canada, Mexico, and in several countries throughout Central and South America, to identify, secure, and repatriate for the benefit of investors more than $300 million in cash and securities held in non-U.S. bank accounts.

In a status report filed February 11, 2011, the receiver identified several categories of major assets for possible distribution to harmed investors:

—$94.7 million in cash on hand;
—$30.4 million in private equity investments already recovered and liquidated;
—$1 million in coins and bullion inventory;
—$6 million in real estate sale proceeds, with an additional $11.7 million expected from sales of other identified properties; and
—$594.9 million in pending fraudulent transfer and unjust enrichment claims.[1]

In conjunction with the SEC, the receiver is focused on identifying and liquidating the largest possible pool of obtainable assets for distribution to harmed investors.

The SEC is closely monitoring the receiver's costs to ensure optimal recovery for the victims of this massive fraud. We have strongly urged the receiver to stringently apply a cost-benefit analysis and pursue only those legal claims that could generate

[1] This figure includes amounts claimed in lawsuits filed or intended to be filed by the receiver; actual recovery may vary depending on litigation outcome.

maximum proceeds for the benefit of investors while minimizing the receiver's legal fees and expenses. We also have cautioned the receiver that we are carefully scrutinizing all bills requesting payment for fees and expenses. In fact, on at least three occasions, the SEC has formally challenged the receiver's bills. We will continue to do so where appropriate.

QUESTIONS SUBMITTED BY SENATOR KAY BAILEY HUTCHISON

Question. The Madoff and Stanford Ponzi schemes represent what many view as two of the largest failures of the Securities and Exchange Commission (SEC). Investigative reports published by your own Inspector General (OIG) highlighted several areas where the SEC failed in its mandate to protect investors. Can you please explain how the additional funds you are requesting for fiscal year 2012 would have helped the SEC to prevent or respond better to shut down the Madoff or Stanford Ponzi schemes before thousands of American investors saw their finances so devastated?

Answer. The SEC commends the work of the OIG investigating this matter and drafting the reports, Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme, OIG–526 (Stanford IG Report) and Investigation of the SEC's Failure to Uncover Bernie Madoff's Ponzi Scheme, OIG–509 (Madoff IG Report). In the Stanford IG Report, the OIG conducted an extensive investigation that clearly identifies missed opportunities for protecting investors, and no one should evade responsibility for the SEC's handling of the Stanford matter. We deeply regret that the SEC failed to act more quickly to limit the tragic investor losses suffered by Stanford's victims. In the Madoff IG Report, the OIG identified numerous red flags that the SEC missed in its examinations and investigation of Bernie Madoff's hedge fund and trading practices.

In particular, the Stanford IG Report, which was released last year, made important recommendations identifying areas for improvement throughout the SEC and both the Division of Enforcement and the Office of Compliance Inspections and Examinations (OCIE) have since instituted various measures to implement all of those recommendations.

In addition to the OIG's recommendations in the Stanford IG Report, under their new leadership both the Division of Enforcement and the OCIE have engaged in a top to bottom review within the last 2 years and have implemented measures to reform organizational processes and improve our effectiveness. We have streamlined management; put seasoned investigative attorneys back on the front lines; improved our examiners' risk-assessment techniques; revised our enforcement and examination procedures to improve coordination and information-sharing; leveraged the knowledge of third parties; instituted new initiatives to identify fraud; expanded our training programs; hired staff with new skill sets; and revamped the way that we handle the tremendous volume of tips, complaints, and referrals that we receive annually.

Although our reform efforts are ongoing, the OIG's recent report, the OCIE Regional Offices' Referrals to Enforcement, Report No. 493 (Referral IG Report), issued on March 30, 2011, indicates that enhanced coordination between Enforcement and the OCIE is proving effective, particularly in the area of handling referrals from the OCIE to Enforcement. In addition, strengthened collaboration between the OCIE and Enforcement has resulted in a number of notable enforcement actions in the past 2 years.

Despite the many changes, more work remains. This will require commitment and creativity. While we must always efficiently use existing resources, additional resources will help us continue to implement organizational reforms underway in the Division of Enforcement and the OCIE. For example, additional resources will allow us to enhance our IT capabilities to allow enhanced data analytics and data mining in our Enforcement investigations, enabling us to identify patterns across suspicious conduct and generate meaningful investigative leads. Although we deeply regret the losses suffered by Stanford and Madoff investors, we embrace the challenges that lie ahead and are confident that our ongoing efforts will enhance investor protection and the integrity of our financial markets.

Question. The Securities Investors Protection Act (SIPA) Trustee appointed to the Madoff case has reportedly recovered almost all the investors' original principal to be distributed among the victims, while the SEC-appointed receiver in the Stanford case has so far recovered an estimated 2 cents per $1. Unlike the Securities Investor Protection Corporation (SIPC) appointed trustee who draws his fees from the SIPC, the SEC-appointed receiver draws his fees from the funds he has been able to recover. Ultimately, this lessens funds able to be distributed to Stanford investors.

Does the SEC still maintain that receivership was the appropriate course of action for the Stanford case? If so, why?

Answer. Upon filing its civil action in February 2009, the SEC filed a motion requesting that the district court appoint a receiver over the defendants' assets (including more than 100 Stanford-related entities operating around the world) to prevent waste and dissipation of those assets to the detriment of investors. While a receiver was a necessary tool in this case, the SEC has closely monitored the receivership to help maximize investor recovery. To complement the receiver's efforts, the SEC, in coordination with the Justice Department, moved to secure assets held in international financial institutions.

Securing assets in international jurisdictions poses complex litigation challenges, and those challenges have been magnified in this case by, among other issues, the appointment in Antigua of a competing receiver that has not cooperated with the SEC and that, in fact, has challenged various steps taken by the receiver, the SEC and the Justice Department. But securing international assets was crucial to ensure the protection of investor funds and we continue to work closely with the receiver, Justice Department, and securities regulators and law enforcement agencies in the United Kingdom, Switzerland, Canada, Mexico, and in several countries throughout Central and South America, to identify, secure, and repatriate for the benefit of investors more than $300 million in cash and securities held in non-U.S. bank accounts.

In conjunction with the SEC, the receiver is focused on identifying and liquidating the largest possible pools of assets to prepare for a future distribution to harmed investors. In addition, the SEC has recently worked with other involved parties in the creation of an investor committee to provide an additional mechanism for investor input as to the receivership operations.

Throughout this case, the SEC has worked closely with a court-appointed examiner to monitor the receiver's costs and ensure maximum recovery to the victims of this massive fraud. These efforts have had tangible benefits. For example, the receiver and the professionals assisting him have reduced their customary fees by at least 20 percent and have capped the rates charged by senior lawyers. In addition, we carefully scrutinize the receiver's bills for fees and expenses. In fact, in response to our objections, the district court has held back, on an ongoing basis, an additional 20 percent from the receiver's fees and expenses. We have strongly urged the receiver to stringently apply a cost-benefit analysis and pursue only those legal claims that could generate maximum proceeds for the benefit of investors while minimizing the receiver's legal fees and expenses.

As with our monitoring of the receiver's fees and expenses, the SEC has intervened when it believed the receiver was pursuing inappropriate claims. For example, the SEC challenged the receiver's lawsuits seeking net profits from innocent investors. Conversely, when the receiver properly pursues assets, we intervene in support of that effort where appropriate. For example, the SEC recently submitted an amicus brief in the Fifth Circuit supporting the receiver's efforts to maintain a freeze more than approximately $24 million in accounts held by former Stanford financial advisers. We will continue to be closely involved with the receiver's activities.

Question. Currently, the Supreme Court forbids investors from going to court to compel SIPC to order a brokerage liquidation as it believes there are adequate safeguards in place to prevent a miscarriage of justice for investors. What options do investors have when they do not agree with the SEC's or the SIPC's interpretation of the SIPA?

Answer. The SEC staff monitor situations in which SIPC member broker-dealers are in (or may be approaching) financial distress to determine whether a SIPA liquidation proceeding is appropriate for the protection of the firm's customers. In addition, customers of SIPC member firms and their representatives can and do communicate with SEC staff and Commissioners when they believe that a member firm should be liquidated under the SIPA. In the Stanford case, for example, investors asked the SEC to direct SIPC to begin a liquidation under the SIPA of Stanford Group Company, a registered broker-dealer and member of SIPC. On June 15, 2011, the SEC asked SIPC to initiate a court proceeding under the SIPA to liquidate Stanford Group Company. In every case in which the SEC has concluded that a SIPC member firm should be liquidated under the SIPA, SIPC has agreed to do so. If SIPC were not to agree, section 11(b) of SIPA gives the SEC the right to file an action to compel SIPC to begin a liquidation proceeding to ensure that the protections provided by SIPA are available to the customers of the SIPC member firm. The SEC has authorized its Division of Enforcement to bring an action to compel SIPC to begin a SIPA liquidation of Stanford Group Company if SIPC refuses to do so.

In *Securities Investor Protection Corporation* v. *Barbour*, 421 U.S. 412 (1975), the Supreme Court held that customers of a SIPC member firm do not have an implied private right under SIPA to ask a court to require SIPC to begin a liquidation proceeding. Without deciding whether customers may challenge the SEC's decision not to seek an order (under SIPA section 11(b)) compelling SIPC to begin a liquidation proceeding, the Court in *Barbour* noted that the SEC's brief in that case indicated that such a decision "might be reviewable under the Administrative Procedure Act for an abuse of discretion." Id. at 425 n.7. No customer has sought judicial review of an SEC decision not to request a court to order SIPC to begin a SIPA liquidation.

QUESTION SUBMITTED BY SENATOR MARK KIRK

Question. Last year, the Congress passed significant new sanctions on Iran and others, including the United Nations and the European Union, also imposed sanctions. The result is that companies continuing to do business in Iran now face significantly more risk—the risk of direct sanctions; the risk that sanctions will make any business in Iran more difficult and more expensive; and the representational risk that comes with doing business with a regime that brutally suppresses its own people. Why has the Securities and Exchange Commission (SEC) failed to issue a specific regulation requiring companies, which face potential sanction under U.S. law for their activity in Iran, to disclose that information?

Answer. Currently, our rules do not include a line-item requirement to disclose a company's business activities in Iran. Instead, with regard to whether companies will be required to disclose information relating to activities in Iran, the general materiality analysis that governs disclosure obligations applies. Under our rules, a company would be required to provide some disclosure of its business activities in Iran if the company faces material risks, including material risks from possible sanctions violations, as a result of those activities. Generally speaking, information is considered material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or, put another way, if the information would alter the total mix of available information. I recognize that this is a difficult judgment call, and may not result in disclosure in every case that some may think is appropriate.

I note, however, that I have asked the Division of Corporation Finance to prepare a rule proposal for the SEC's consideration on disclosure of activities that may subject a company to sanctions under the Iran Sanctions Act. In addition, based on a study of divestment activities, the Government Accountability Office has recommended that the SEC consider issuing a rule requiring companies that trade on U.S. exchanges to disclose their business operations tied to Sudan, as well as possibly other state sponsors of terrorism. The division has outlined the terms for a possible rule proposal for specific disclosure requirements regarding business and investment activities in Iran and Sudan, and has circulated this outline for the SEC's consideration.

SUBCOMMITTEE RECESS

Senator LAUTENBERG. The subcommittee hearing is hereby recessed.

[Whereupon, at 11:22 a.m., Wednesday, May 4, the subcommittee was recessed, to reconvene subject to the call of the Chair.]