

**FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2011**

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**WEDNESDAY, APRIL 28, 2010**

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

The subcommittee met at 2:36 p.m., in room SD-138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senator Durbin, Lautenberg, Collins, Bond, and Cochran.

**COMMODITY FUTURES TRADING COMMISSION**

**STATEMENT OF HON. GARY GENSLER, CHAIRMAN**

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good afternoon. I am pleased to convene this hearing and apologize for being a few minutes late.

This is a hearing to consider the fiscal year 2011 funding request of two of our most important Federal regulatory agencies, the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC).

I am happy to welcome my colleague, a little tired I am sure from yesterday, Senator Susan Collins of Maine, who is my ranking Republican on this subcommittee, my friend. We have worked together on many aspects of many different laws over the years, and this is a very important one.

We will have other colleagues who will join us during the course of the hearing.

I want to welcome Gary Gensler, Chairman of the Commodity Futures Trading Commission, and after his testimony, Mary Schapiro, Chairman of the Securities and Exchange Commission.

Both Chairmen have invested countless hours in helping to craft a more reliable regulatory foundation to guide us in the future. These two agencies occupy pivotal positions at the forefront of stimulating and sustaining economic growth.

When this subcommittee was created and started, I insisted that it bring these two agencies together into one Appropriations subcommittee because they parallel one another in their regulatory responsibilities and I felt that the ancient separations no longer applied, that they really should be considered as a tandem operation to bring confidence to important marketplaces in America. And I

think the President has chosen well in the two people who guide these agencies today.

The SEC, of course, is responsible for maintaining orderly and efficient stock and securities markets and conducting day-to-day oversight of major market participants.

The Commodity Futures Trading Commission, well known to me, is an agency that also carries out market surveillance, compliance, and enforcement programs in the futures arena, very important to our Nation and certainly to the city of Chicago and the State of Illinois.

This subcommittee has an oversight responsibility over both of these agencies. We are now debating whether or not any committee like the Appropriations Committee should have oversight over these two agencies. I believe sincerely that we should. We have dramatically increased the resources and personnel at both of these agencies, and I hope we will continue that trend because their responsibilities are growing and we have to provide them the people and the technology to meet that challenge. But as we provide these resources, we also need to provide oversight. No agency that comes before this Government should be above oversight and review. That is why this subcommittee will continue to work diligently to exercise its oversight responsibility. There are some who question that, but I feel very strongly that not only will these agencies receive resources but they will be held accountable for the way they use these resources and spend them.

I will not go into detail here about the money that has been allocated so far to both of these agencies. We will get into that in the course of questioning.

I would like to, at this point, give my colleague, Senator Collins, an opportunity to make an opening statement before Mr. Gensler testifies.

#### STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Chairman, let me begin by associating myself with your comments, in fact, with all of your comments. I know that both of us share such a commitment to providing these two important consumer agencies with the resources that they need, but like you, I also believe in effective congressional oversight. And if we essentially put the budgets of these two agencies off budget, if we allow them to avoid the annual appropriations process, I believe congressional oversight and accountability will suffer.

Therefore, I am going to try to ensure that the financial reform bill that passes—and eventually a financial reform bill will pass—does not take these agencies—and particularly it has been proposed for the SEC—outside of the annual appropriations process. I think it is so important.

And I would note to the two Chairmen that we have before us today that this subcommittee has been extremely responsive to concerns for more resources. We want to reverse the years when you had insufficient staff to do effective enforcement. Indeed, as we begin to review your budget requests for this year, we should take note of the significant funding increases that our subcommittee provided for your agencies last year. In the case of the SEC, we

went above the President's budget request. We gave an increase of nearly \$159 million over the previous fiscal year; in the case of the CFTC, an increase of \$23 million over the previous year.

I have been pushing very hard to make sure that you not only have the levels of staffing that you need, but you have the skilled staff that you need. In fact, I have a feeling that the two chairs are competing for skilled staff in many ways, for the attorneys, the experts, the accountants that you need.

The roles that you are playing are so important.

I will say that I am very disturbed by the recent press reports that senior SEC staff were looking at pornography at work instead of focusing on securities fraud. That behavior is despicable at any time, but it appears to have occurred during the height of the financial crisis and that makes it even more inexplicable.

I look forward to discussing a lot of the important issues in financial reform with our witnesses today.

Again, thank you, Mr. Chairman, for your leadership in this area.

Senator DURBIN. Thank you, Senator Collins.

Senator Bond, unless you have an opening statement, I am going to recognize Chairman Gensler, but you are going to be recognized if you do.

#### STATEMENT OF SENATOR CHRISTOPHER S. BOND

Senator BOND. Let me state very briefly because I do have a question or two for the Chairman. We welcome him here.

Everybody is talking about the financial regulatory system and the changes. In the heartland I am from, we hear and understand that Wall Street provides critical financial support. We also understand that the changes to the system are necessary on Wall Street, but if they alter significantly the way people do business back home, we want to make sure reform is done right.

The derivatives, yes. Some of the derivatives really need to be regulated. But a lot of the small businesses back home are in commodities hedging where the contracts pose no systemic risk, and lumping these into risky derivatives trading, as far as I am concerned, makes no sense. These are not speculative contracts. They are contracts between parties who operate normally. And to be blunt, if that goes through, I am afraid that this will entail higher costs for energy production, for transportation, particularly for farmers.

So I would like to ask you about that and appreciate the chance to raise that, Mr. Chairman.

Senator DURBIN. Thank you very much, Senator Bond.

Let us let Mr. Gensler give his opening statement, and then we will pose some questions. Please proceed.

#### SUMMARY STATEMENT OF HON. GARY GENSLER

Mr. GENSLER. Thank you, Chairman Durbin, Ranking Member Collins, and Senator Bond. I thank you for inviting me here to testify on behalf of the Commodity Futures Trading Commission. I am also honored to be here with Chairman Schapiro. Mary and I work very closely on many things. I remember last year we were at the

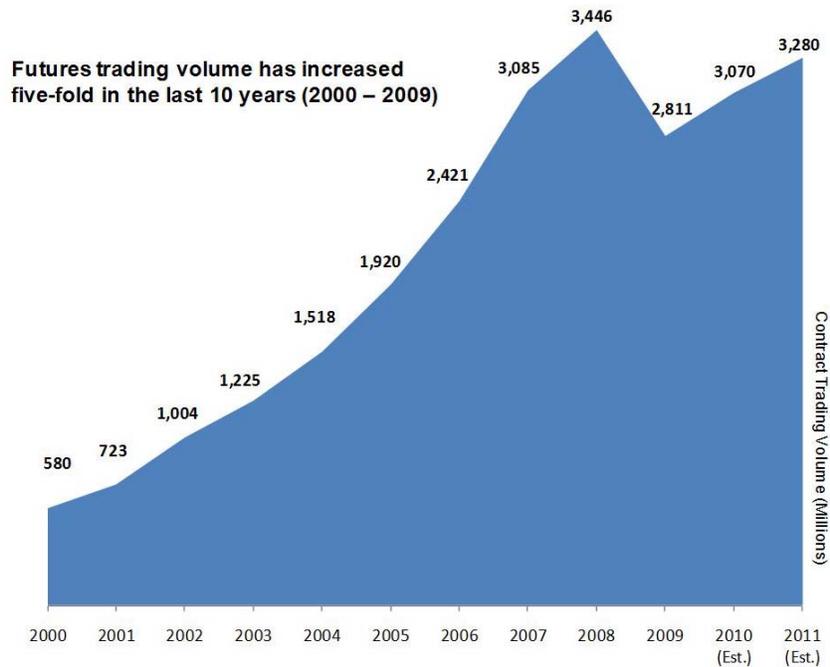
table together, and I appreciated that as well because she took more questions than me.

But I guess this year I'm at the table alone.

With the help of this subcommittee, the CFTC has risen to staffing levels of 600 people. This is roughly where we were in the 1990s, but it is with your help that we came back from about 440 people just 2½ or 3 years ago. We do believe, to fulfill our mission and protect the American public and promote transparency in markets, we need 745 people. We also need to get a bit more in our technology budget.

The CFTC, as you know, ensures that futures exchanges and the clearinghouses that we oversee work to lower risk to the public and increase transparency. We also oversee all of the intermediaries or the dealers in these markets as well.

Though our staffing level is only slightly higher than it was 10 years ago, futures trading volume—and I think I have a chart over here, if I might. The blue is the trading volume in this period of time in the 10 years since 1999. And as you can see, our staff actually shrunk and we are coming back.



Now, one might look at this and say that is productivity, but just imagine a city with police officers that has grown five-fold. You would not really want to have the police force shrink because you cannot investigate cases. You cannot protect the public. It is the same thing really in an agency like ours. We are like that police force that shrank while the city grew five-fold.

But with the help of this subcommittee, we have turned the corner. We have come back to, as I said, where we were in the 1990s.

And this increased funding, if I can just tell you what we have been able to do with it, but why we think we need some more.

First, we have been able to significantly increase our Enforcement Division. That Enforcement Division by the end of this year will be about 170 people. We think we need to get to 200 people however.

Second, we have embarked—we have just started—on a program to do automated surveillance. We have hundreds of thousands of trades that come in to us a day. We see all those trades. That is very good and the exchanges see them. But we want to automate the surveillance of those and bring 21st century computing power to the American public.

Third, we have also implemented the authorities that you and others in Congress granted us under the farm bill in 2008. That was to bring enhanced regulation to the markets and put out rules. We have proposed rules on position limits. We have proposed rules on foreign exchange. We are planning to put out rules on collocation in the near future.

But even with these recent increases, we need more. The market participants have technology now that we have to stay up with, and that is the thought.

So starting in 2010, we started a multiyear project to automate our surveillance. It is going to take us several years, and we have included that in the numbers.

Second, we do need staffing levels and resources to conduct annual reviews. When I got to the CFTC, I said are we like the bank examiners. Are we inside the banks every year? And I found out actually because we had shrunk, that we were not inside the exchanges and inside the clearinghouses every year just to do what is called a rule enforcement review. We think that we really need to be there every year and work with the exchanges, work with the clearinghouses to do that.

Third, our enforcement staff. We really do feel we need to get up to 200. Our financial crisis exposed more fraudulent schemes that require extensive staff resources. Manipulation cases particularly can take up to 2 to 3 years, and what Doug is putting up for me is just our overall funding request. And then I think my time will be up.

But our overall funding, which you helped us get to, is \$169 million, on the left. And what we are asking for in 2011 is \$216 million, or 745 full-time equivalents (FTEs). Much of that is to keep current services. We have taken out some more space because of the growth. Of course, there will be a cost-of-living increase and technology. But in addition to that, if Congress were to move forward, as I hope in the next few days that the Senate will—I was encouraged, Senator Collins, by what you said on that. But if the Senate takes up the full debate on derivatives reform, the SEC and CFTC will have a lot of additional responsibilities and authorities. The over-the-counter derivatives marketplace is 8 to 10 times the size of the on-exchange derivatives market measured in notional amount. I do not want to frighten you. It is a smaller number of transactions.

## PREPARED STATEMENT

The President was good enough to include a \$45 million request that will get us part-way there. We think in 2011, we will need somewhere on the order of 240 more people and \$18 million more in technology to get started on the derivatives oversight. And I know that Chair Schapiro will have some of those numbers as well, but the thought is for 2011, it may be a conditional appropriation or if the derivatives reform were to go through, maybe you would include it in the whole appropriations package.

With that, I would be glad to take any questions.

[The statement follows:]

## PREPARED STATEMENT OF GARY GENSLER

Good afternoon Chairman Durbin, Ranking Member Collins and members of the Subcommittee. I am pleased to testify on behalf of the Commodity Futures Trading Commission (CFTC), and I thank you for the opportunity to discuss issues related to the Commission's 2011 budget.

In the fall of 2008, the financial system and the financial regulatory system failed. While more than 1 year has passed and the system appears to have stabilized, we cannot relent in our mission to vigorously implement our mandate to protect the public from fraud, manipulation and other abuses in the commodity markets. I would like to express my gratitude to Congress for the recent increases in appropriations that now permit the Commission to address longstanding regulatory and oversight weaknesses. The CFTC, however, requires additional resources to hire staff with new competencies and skill sets and to ensure our technological infrastructure and systems keep pace with the industry we regulate. These improvements are essential to promoting transparency and integrity in the marketplace. Only through strong, intelligent regulation can we fully protect the American people and keep our economy strong.

## CFTC REGULATORY REGIME

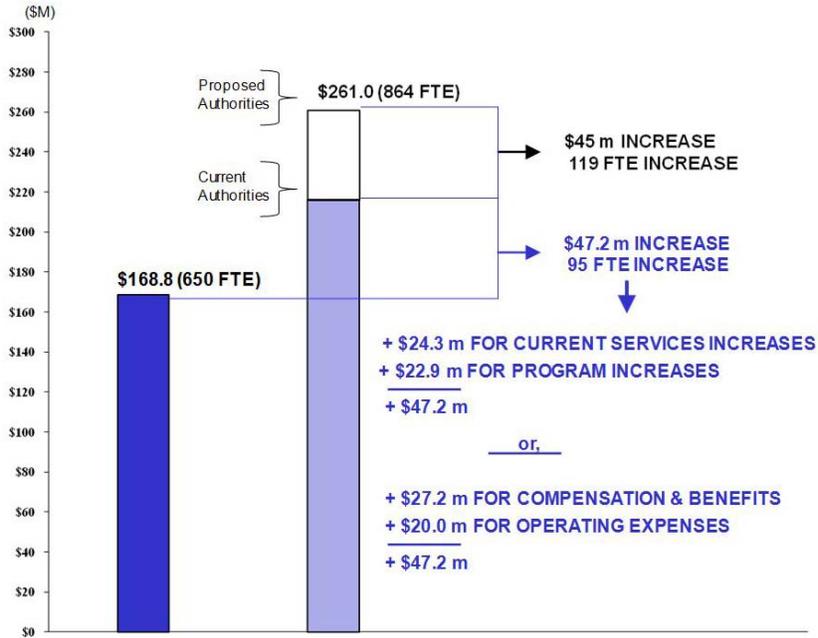
Before I discuss the President's budget request for the CFTC, I will take a moment to discuss the agency's oversight of the futures markets. Futures have traded since approximately the Civil War, when grain merchants came together and created the new marketplace. It took nearly 60 years and the Great Depression until President Franklin Roosevelt and the Congress regulated the futures markets.

The CFTC ensures that futures and commodity options exchanges have procedures to protect market participants and ensure fair and orderly trading, free from fraud, manipulation and other abuses. Exchanges are where buyers and sellers meet and enter into a transaction. The CFTC also oversees clearinghouses, which enter the picture only after two counterparties enter into the transaction. Clearinghouses act as middlemen between the two parties and take on the risk that one counterparty to the trade may fail to meet its obligations under the contract for the duration of the contract. Centralized clearing has helped lower risk to the markets for decades in both calm markets and in the stormiest of markets, such as during the 2008 financial crisis.

The CFTC has wide-ranging transparency efforts designed to provide as much information about commodity futures markets and trading to the American public as possible under current law. The agency also has broad surveillance powers to police the markets for fraud, manipulation and other abuses.

## THE BUDGET

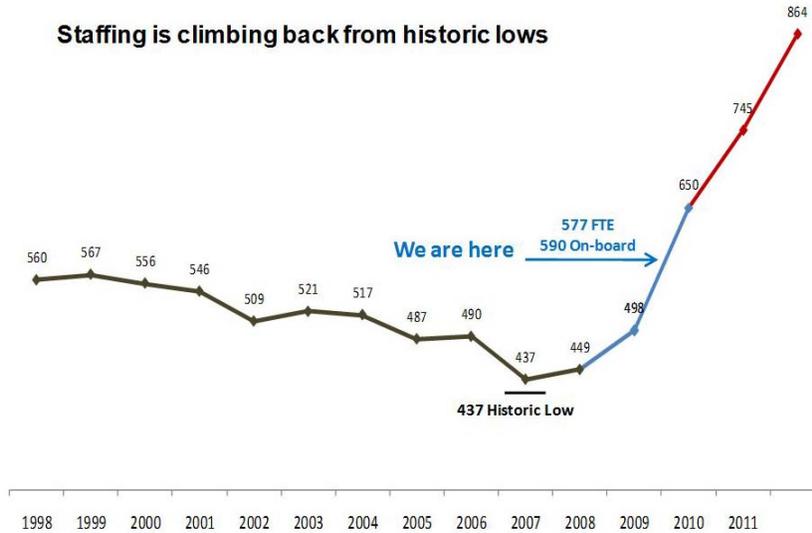
The President's budget proposes that \$216 million be appropriated for the Commission for fiscal year 2011 to remain available until expended through fiscal year 2012.



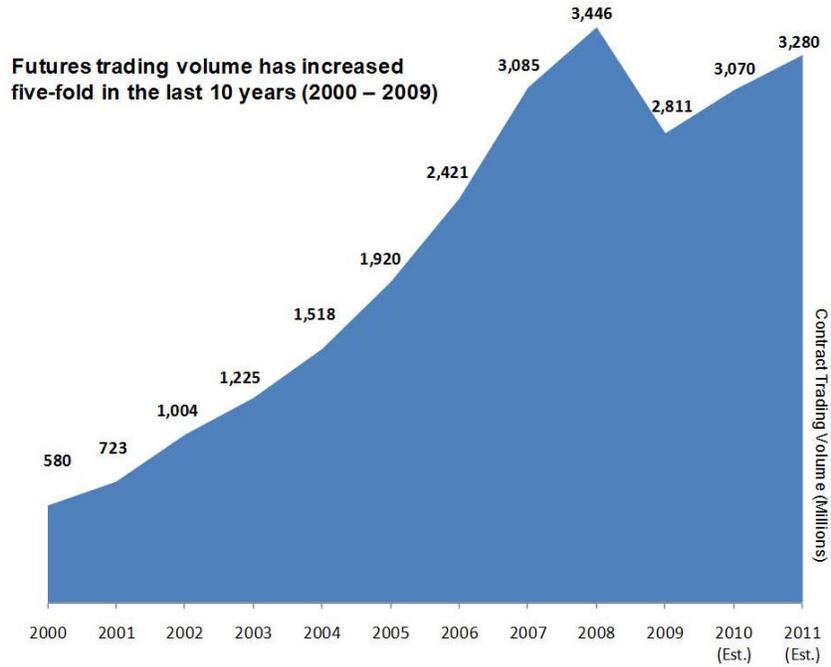
This amount would be for the agency to perform its duties under current statutory direction. In addition, the budget proposes that \$45 million be appropriated to be available through fiscal year 2012 contingent upon the enactment of authorizing legislation of new or enhanced financial regulation activities of the Commission.

Ten years ago, the CFTC was near its peak staffing level at 567 employees, but shrunk by 20 percent over the subsequent eight years before hitting a historic low of 437. Thanks to increased funding from Congress, the CFTC now has almost 600 staff on board, which is a net increase of 100 staff over were we stood a year ago.

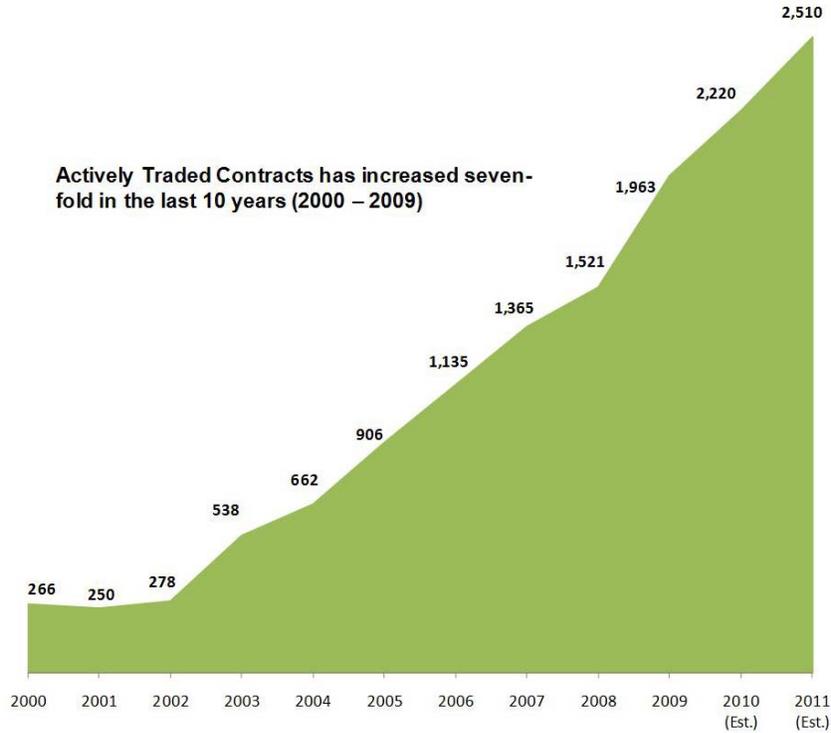
**Staffing is climbing back from historic lows**



All Commission programs: technology, market and intermediary oversight, enforcement, economic, legal and risk analysis have benefited from increased staff resources. Still, merely raising our staffing levels to the same as a decade ago will not be enough to adequately fulfill the agency's statutory mandate. In the last 10 years, futures trading volume increased almost five-fold.

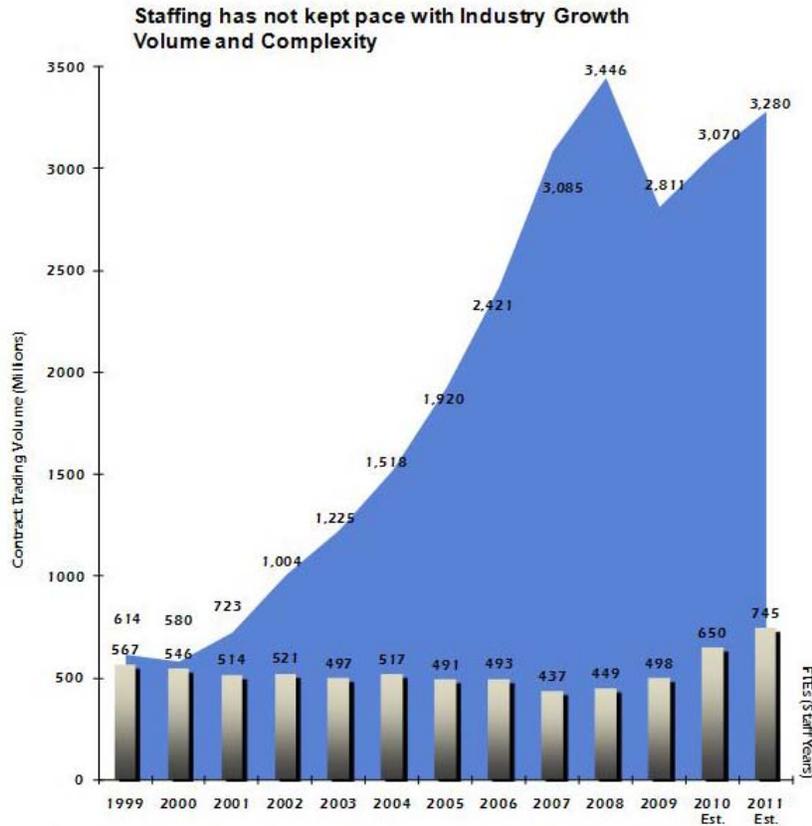


The number of actively traded futures and options contracts increased seven-fold, and many of these have become considerably more complex in nature.



We also moved from an environment with open-outcry pit trading to highly sophisticated electronic markets. What was once a group of regional domestic markets is now a global marketplace. What was once just a \$500 billion business has grown to a \$33 trillion industry. In short, the Commission requires funds to hire and retain highly trained professionals and equip them with information technologies that are as sophisticated as the expanding markets they we oversee.

Despite rapid advances in technology and the increased size and number of regulated futures 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. Further, the CFTC still does not have the staffing levels or the resources to conduct regular examinations of market intermediaries, exchanges and clearinghouses. Until additional staff resources are acquired we can conduct those examinations only periodically and have no choice but to leave routine examinations of intermediaries to self-regulatory organizations. The CFTC needs additional staff, with new expertise to conduct yearly examinations of the registrants we regulate.

For these reasons, it is appropriate for our staffing levels and our technology to be bolstered to meet the new financial realities of the day. As such, the CFTC's Budget and Performance Estimate for fiscal year 2011, for existing statutory authorities, would increase the agency's funding by \$47.2 million to \$216 million and would augment agency staff by 95 FTE to a total of 745 FTE.

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

*Updating the Commission's Surveillance and Technology Programs.*—The Commission requires additional resources to replace legacy surveillance technology with 21st Century computers and software. Significant changes in the markets demand new systems capable of efficiently receiving and managing massive amounts of raw data and converting it to useful information for analysis by skilled market experts, economists and technologists. For example, existing Commission surveillance systems annually process more than one billion transactions to capture mission-critical data. Recent Commission initiatives to promote transparency of market data reveal the need for a substantial investment in systems development.

The timely reporting of quality and meaningful market information is not possible with current legacy systems. Integration of two legacy systems, one with position data and one with trade data, is vital to building necessary functionality to capture

more detailed data by trader, account ownership, inter-day transactions and intraday transactions across all markets.

Upgraded systems and analytical tools, such as market compliance detection and alert software, together with new staff competencies and skill sets, will increase the staff's efficiency and ability to monitor the markets and provide better information about futures and options trading to the American public. Market transparency is crucial to public trust and confidence in the price discovery and risk management functions of the futures and option markets. In addition, increased transparency, sophisticated use of automation and a heightened level of oversight will foster market compliance and integrity and enable the CFTC to keep pace with a rapidly evolving industry.

*Strengthening the Commission's Enforcement Program.*—The CFTC should be adequately resourced to vigorously investigate and litigate complex market manipulation and trade-practice violations. Properly functioning markets must be free from fraud, manipulation and other abuses to ensure their integrity in setting prices and offsetting risk. A robust Enforcement program will foster regulatory compliance in the marketplace, protecting the American public and the marketplace. Adequate legal staff is necessary to act swiftly to investigate and prosecute fraudulent acts, such as the rash of Ponzi schemes uncovered during the recent market downturn.

*Rigorously Exercising Existing Authorities to Ensure Market Integrity.*—Additional economic and legal staff will enable the CFTC to conduct mandatory annual reviews of all contracts listed on exempt commercial markets (ECMs) to determine if they are significant price discovery contracts (SPDCs). Such contracts must be reviewed to determine whether the ECM should be subject to statutory Core Principles and Commission's regulations. These and other new and increasingly diverse products add to the scope and complexity of products staff must review and monitor to ensure the integrity of the marketplace.

*Initiating Major Reviews of Existing Programs.*—The Commission seeks additional resources to initiate major programmatic reviews of existing programs; expand development of the Commission's continuity of operations program (COOP); increase public and consumer education and outreach; implement the strategic plan; improve performance metrics; and enhance the Commission's equal employment opportunity program. The Commission is committed to creating a diverse pool of qualified candidates.

*Continuing Current Service Level.*—The CFTC requires additional resources to provide a continuation of the fiscal year 2010 current service level into fiscal year 2011. This includes annual merit based compensation adjustments for staff, lease of office space, utilities and communications, printing, supplies, capital equipment and fixed equipment.

Specifically, the funding will be allocated to increase staffing levels in the following divisions:

*Division of Enforcement.*—The Commission's Enforcement program is on track to reach a staff level of more than 170 by the end of this fiscal year. This is a significant program turnaround from an all-time low of 109 in fiscal year 2008. Nevertheless, a staff of 170 may be below what is needed to address the current challenges brought by the recent financial crisis. Our goal for fiscal year 2011 is to have an Enforcement staff of 200, including strategic plans to double the Enforcement staff in the Kansas City office. In addition, the Commission intends to augment the enforcement staff with improved litigation and forensics support technologies, such as the e-Law system. Use of the e-Law system improved productivity and has permitted the Commission to pursue resource-intensive investigations and litigation involving manipulation. It also has improved our ability to implement our new Farm Bill authorities in the over-the-counter forex futures market.

*Division of Market Oversight.*—The rapid changes occurring in the futures markets over the last decade have brought new challenges to the Commission's Division of Market Oversight (DMO). DMO now needs additional experienced professional staff to actively monitor exchanges to ensure compliance with CFTC regulations; keep a close eye for signs of manipulation or congestion in the marketplace and decide how to best address market threats; and ensure that traders do not exceed Federal position limits. Thus, the Commission seeks to increase DMO's staff from 139 in fiscal year 2010 to 168 in fiscal year 2011.

Specifically, DMO requires additional highly skilled economists, investigators, attorneys and statisticians so that: (1) position data may be analyzed quickly and thoroughly; (2) exchange applications and rule changes may be reviewed efficiently and comprehensively to ensure compliance with Core Principles and CFTC rules and policies; (3) exchange self-regulatory programs may be examined on an on-going annual basis with regard to trade practice oversight, market surveillance and compliance with disciplinary, audit trail and record-keeping regulations; (4) comments

related to a proposed energy position limits rulemaking, proposed significant price discovery contract determinations and other proposed rulemakings and industry filings can be comprehensively reviewed and summarized; and (5) proposed rulemakings and determinations can be effectively implemented should the Commission approve them.

*Division of Clearing and Intermediary Oversight.*—Additional resources would allow the Commission to perform regular and direct examinations of registrants and more frequently assess compliance with Commission regulations.

In the case of intermediaries, the Commission requires additional resources to directly assess compliance instead of relying on designated self-regulatory organizations (DSROs). The frequency of the reviews will increase to once a year from approximately once every 3 years. New staff will permit the review annually of all derivatives clearing organizations (DCOs) and the audit and financial surveillance programs of each DSRO ensuring ongoing rather than intermittent oversight. The Commission seeks to increase the Division of Clearing and Intermediary Oversight staff from 113 in fiscal year 2010 to 120 in fiscal year 2011.

*Offices of the Chairman and the Commissioners.*—The Offices of the Chairman and the Commissioners require professional, legal and economic expertise as they undertake a number of high priority programmatic initiatives, including: (1) subject to enactment of new authorities, regulation of derivatives markets and regulatory changes to protect the American public from systemic financial risks; (2) regulatory coordination with other agencies such as the Securities and Exchange Commission (SEC) and Federal Energy Regulatory Commission (FERC); (3) promoting market transparency; (4) promoting transparency on the Commission's website; (5) regulation of energy markets—especially with regard to position limits and the Commission's review of significant price discovery contracts; (6) increasing frequency of reviews and audits of Commission registrants; and (7) technology modernization, resource justification and program performance. The Commission proposes to bolster these offices from 35 staff in fiscal year 2010 to 47 staff in fiscal year 2011.

*Office of the Chief Economist.*—The CFTC's Office of the Chief Economist (OCE) conducts research on major economic issues related to the futures and options markets; participates in the development of Commission rulemakings; provides expert economic support and advice to other CFTC offices; conducts special studies and evaluations; and participates in the in-house training of staff on matters related to futures, options, swaps and risk management. OCE requires additional economists to review and analyze new market structures and off-exchange derivative instruments. OCE also needs additional resources to review and analyze risk management models supportive of the Commission's enforcement and surveillance programs. The Commission proposes to increase OCE staff from 13 in fiscal year 2010 to 17 in fiscal year 2011.

*Enterprise Risk Management Office.*—The budget proposes a new Enterprise Risk Management subprogram, consisting of three staff, to focus on proactively developing and employing methods and processes to manage risks that may be obstacles to the discharge of the Commission's responsibilities. The staff will identify plausible risks posed by current and future events or circumstances that may affect the Commission's ability to respond effectively. Risks will be assessed in terms of the likelihood and magnitude of impact. The program will determine an appropriate response strategy and monitor outcomes.

*Office of the Executive Director.*—The budget requests additional staff within the Office of the Executive Director to establish a Commission strategic and operational planning and evaluation function, the first such permanent resource. The additional two staff members will assist the Commission's programs in establishing metrics to track, monitor and evaluate program results, outcomes and goal achievement to ensure the effective and efficient allocation of resources. Adequate staff in the office is needed to ensure a sufficient level of human capital expertise focusing on employee development, recruitment and outreach, leadership, management training and employee relations. The Commission is mindful of the need to effectively manage staff resources to develop and sustain a professional workforce capable of keeping pace with our growing regulatory responsibilities.

*Office of International Affairs.*—The budget requests an additional staff member in the Office of International Affairs, which coordinates the Commission's non-enforcement related international activities, represents the Commission in international organizations such as the International Organization of Securities Commissions (IOSCO), coordinates Commission policy as it relates to U.S. Treasury global initiatives and provides technical assistance to foreign market authorities. The financial crisis has heightened the need for international cooperation among regulators, and an additional staff member is required to meet the mission critical responsibilities of the office.

*Office of Proceedings.*—The Office of Proceedings is responsible for providing an inexpensive, impartial and expeditious forum for handling customer complaints against persons or firms registered under the Commodity Exchange Act. The Commission requires one additional staff to ensure expeditious processing of complaints.

REGULATORY REFORM

In addition to implementing the authorities established in the Commodity Exchange Act, the CFTC also is working with Congress to bring comprehensive regulation to the over-the-counter derivatives marketplace. The Commission’s budget request includes an additional \$45,000,000 and 119 full-time equivalent employees for fiscal year 2011 to begin implementation of the Administration’s comprehensive proposal for financial regulatory reform. As proposed, the request is contingent on Congressional enactment of legislation giving the Commission new authorities. The Commission’s fiscal year 2012 total (current and proposed new authorities related to financial regulatory reform) staff requirement is estimated to be approximately 1,000 FTE. The requested funds will permit Commission implementation of new responsibilities under consideration by Congress, such as:

- Requiring swap dealers and major swap participants to register and come under comprehensive regulation, including capital standards, margin requirements, business conduct standards and recordkeeping and reporting requirements;
- Requiring dealers and major swap participants to use transparent trading venues for their standardized swaps;
- Ensuring that dealers and major swap participants bring their clearable swaps into central clearinghouses; and
- Providing the CFTC with authority to impose aggregate position limits including in the OTC derivatives markets.

Specifically, the Commission’s fiscal year 2011 budget request for regulatory reform would be allocated as follows: 41 additional staff for Market Oversight; 30 additional staff for Clearing and Intermediary Oversight and Risk Surveillance; 18 additional staff for Enforcement; 15 additional staff for Information Technology; eight additional staff for General Counsel; five additional staff for Human Resources and Management Operations; one additional staff for the Chief Economist; and one additional staff for International Affairs.

CLOSING

The staff of the CFTC is a talented and dedicated group of public servants. The financial crisis and the significant increase in trade volume, market complexity and globalization require that additional resources be committed to the protection of American taxpayers. For all of these reasons, it is necessary and appropriate that Commission staffing levels and technology be bolstered to address the new financial realities of the day.

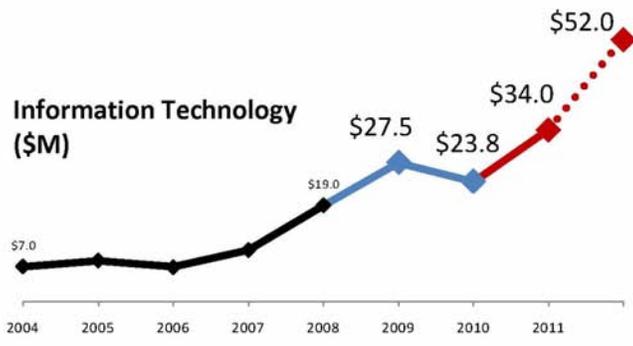
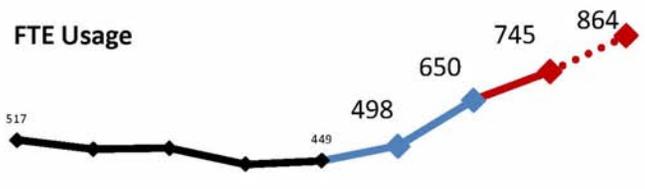
In short, despite the recent increase in funding, the Commission remains an underfunded agency. With additional resources, we will be more able to police the market, promote market integrity and protect the public from fraud, manipulation and other abuses.

I thank you for inviting me to testify today. I will be happy to answer any questions you may have.

Past 2004–2008	Present 2009–2010	Future
<b>AUTOMATING MARKET SURVEILLANCE</b>		
Critical IT systems for the surveillance of positions and trading practices were not robust. They have not been upgraded to reflect the vast increase in volume and complexity of the markets.	Development of new staff skill sets with access data query, analysis, algorithmic models and reporting tools that alert staff to the conditions for potential abusive trading or misconduct.	Robust, linked and fully integrated IT surveillance systems that produce the surveillance reports needed to meet the analytical needs of our professional staff and the transparency needs of the public.

Past 2004–2008	Present 2009–2010	Future
<p><b>IMPROVING MARKET TRANSPARENCY</b></p> <p>Lack of market transparency stemming from lack of reliable data about the size or effect of influential investor groups and potential harm posed by a commodity asset bubble.</p>	<p>New staff with new skill sets have improved data collection and reporting on the size of positions held by large traders.</p> <p>New public reports include:</p> <ul style="list-style-type: none"> <li>Disaggregated Commitment of Trader Reports.</li> <li>Supplemental Report on Commodity Index Traders.</li> <li>Swap Dealer Reports.</li> </ul>	<p>Collect and report data from swaps dealers and index investors. Release data on commodity index investment on a monthly basis rather than quarterly.</p>
<p><b>ENFORCEMENT</b></p> <p>The Commission's enforcement program reached an all-time low of 109 as recently as in fiscal year 2008. The financial crisis revealed fraudulent schemes that could only stay afloat during periods of rising asset values. The downturn exposed more leads than the Commission can thoroughly and effectively investigate. This is true both as it relates to fraud and Ponzi schemes as well as staff-intensive manipulation investigations.</p>	<p>Appropriations increases have permitted the Commission to enhance Enforcement staffing and resources committed.</p> <p>Staffing increased by more than 50 percent in 2 years.</p> <p>Leads and investigations increased by more than 100 percent over 2 years.</p> <p>New investigations will exceed 250, which is the highest level in 10 years.</p> <p>The Enforcement division filed 31 civil actions involving Ponzi type schemes in fiscal year 2009, which was more than twice the amount in fiscal year 2008.</p> <p>New tools and competencies are being developed to address and identify trends, analyze data and explore resources previously unavailable to the Commission.</p>	<p>Future initiatives include:</p> <ul style="list-style-type: none"> <li>Pursuing all potential fraud cases reported to the Commission;</li> <li>Keeping pace with the proliferation in trading and the emergence of new electronic trading facilities. Effective enforcement requires looking beyond the exchanges to multi-level platforms and bilateral trading, which is very resource intensive;</li> <li>Enhancing the Commission's ability to respond efficiently to major market movement or major collapse of an entity without adversely affecting other on-going investigations and litigation; and</li> <li>Rebuilding bench strength and succession planning.</li> </ul>
<p><b>INCREASED AUDIT OVERSIGHT</b></p> <p>The Commission does not conduct: annual compliance audits of every designated contract market (DCM). Audits occur every 3 years, on average; annual compliance audits of every derivatives clearing organization (DCO). Periodic reviews on selected core principles occur every 3 years; or routine examinations of CPOs, CTAs, &amp; FCMs, which are currently performed by self regulatory organizations.</p>	<p>The Commission currently assesses or conducts: financial surveillance programs of SROs; certain regulatory functions performed by the NFA; other self-regulatory organizations such as DCM SRO functions; and examinations of FCMs for compliance with the CEA and Commission regulations.</p>	<p>Future initiatives include:</p> <ul style="list-style-type: none"> <li>annual reviews of DCOs, which is critical as the volume of positions cleared by DCOs and the complexity of positions grow;</li> <li>annual compliance reviews of DCMs;</li> <li>examination of the books and records of additional FCMs on a "for-cause" basis and expand the reviews of certain compliance areas, such as sales practices and foreign currency trading; and</li> <li>additional examinations of CPOs and other registrants to ensure a better understanding of firms' operations, trading strategies, back office procedures and other factors integral to firms' compliance.</li> </ul>

## Commodity Futures Trading Commission Appropriation History and Budget Outlook



## TECHNOLOGY

Senator DURBIN. Thanks a lot, Mr. Chairman. And there are so many questions to ask, and I know we will not likely have time to ask all of them today.

But I do want to reiterate what was said by Senator Collins. There are substantially greater investments in the resources that your agency and the SEC have to work with. I think it calls for substantially more oversight from our side of the table because there is a certain level of absorption which you can add to your staff in a professional manner and increase the workload. And then I have found, in the time that I have been around Congress, there reaches a tipping point where perhaps they cannot be absorbed effectively. There should be a committee of Congress watching this, following this, making certain that we are moving toward the same goal and that you are achieving that goal.

Let me ask you in a specific way about technology. My impression, having worked with Senator Collins on this issue since 9/11 when we were both on the Homeland Security Committee, is that the Federal Government is like the last to pick up on new technology. We create rules and obstacles for purchasing and acquisition and all sorts of security questions, and we fall far behind the private sector. Do you feel that your technology improvements parallel or are consistent with the technology available in the private sector for similar functions?

Mr. GENSLER. Well, first, let me say I welcome the oversight of this subcommittee and our authorizing committee as well and working with Marianne and Dale and all the staffs that are with you.

In terms of technology, we have had, with your help, an ability to get the data resources. We can actually take in all the transactions on the next day. We can take in all the positions at the end of the day. That is very helpful. We also rely on the exchanges because they have a lot of the technology as well.

But what we are trying to build is 21st century software to actually do automated surveillance—consider it sort of flags and alerts so that our staff can then see whether it is a wash sale, whether it is a position limit concern, and then go back to the exchanges, work to see if there is a violation, work with the Division of Enforcement if something has to be followed up on. With hundreds of thousands of trades a day, we need to do that.

I think, Senator, we are probably not there yet. I mean, think of algorithmic trading experts—we need to get some of that expertise into Government.

Senator DURBIN. What I am asking you, is there any built-in obstacles to your acquiring the technology that you believe is available and that you need?

Mr. GENSLER. The good news is we have the legal abilities. We do it through procurement laws and so forth, but we do have the legal ability to acquire it. It is usually just resources. In the past, we actually did not even have the hardware to store all the data. We have taken care of the storage side, but now we have to build some of that software.

Senator DURBIN. Is the answer no? I am asking if there are obstacles to your—

Mr. GENSLER. I am not aware of obstacles other than dollars and then the human time to actually do this.

#### TRANSPARENCY

Senator DURBIN. One other aspect of this is how much of this is being made available to the public to review your work and the activities that are not proprietary, obviously, of the exchanges which you monitor.

Mr. GENSLER. Well, there is a great deal of information that we make available in the aggregate data, and then Senator Bond asked about derivatives reform. If derivatives reform were to move forward, there would be a lot of information about that market as well on real-time reporting. I think that answers your question.

Senator DURBIN. I am just wondering if there is more and more of this information that is being made available to the public.

Mr. GENSLER. Well, we have had success in the last year. We have actually made more information available about index investments in the market. For years, we have put out reports on every Friday about the markets, and we have broken that down between commercial and noncommercial traders. Now people can see what swap dealers and money managers or hedge funds are doing in the market in aggregate. Again, we do not break out the individuals.

Senator DURBIN. I see.

I am going to yield now to Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

#### ENERGY POSITION LIMITS

Chairman Gensler, as you know, I have had a great interest in seeing the Commission establish position limits to apply to the energy markets. Senator Lieberman and I held hearings looking at the price spikes in the energy markets a couple of years ago, and position limits can potentially help prevent those kinds of abrupt price movements or market disruptions. Could you update us on what is being done by the Commission to establish position limits for energy markets?

Mr. GENSLER. I thank you, Senator, for your leadership on this issue.

We published proposed rules in January and asked for public comment—that comment period actually closed yesterday—to reestablish position limits. There were position limits in the energy markets with the exchanges through 2001. So we were looking to possibly reestablish them. We have over 8,000 comments. So what we will do as an agency is review those—the staff is just embarking on that—and then bring those recommendations and review up to the five Commissioners and we will see how best to proceed based on those recommendations.

#### OVER THE COUNTER DERIVATIVES LEGISLATION

Senator COLLINS. The second issue that I want to talk to you about in this first round has to do with the regulation of derivatives. This is such a complex and important issue. We clearly need

more transparency. One of the debates, however, is the extent to which end-user manufacturers or grocery stores, like Hannaford's in my State, should face increased costs for investing in commodities essential to their products. And they will face increased costs if, in fact, they have to go through the clearinghouses.

Help us understand the debate on derivatives and whether there should be exemptions for end-users, whether you see the Agricultural Committee's bill providing exemptions. There is a dispute over whether or not they do. Educate us a bit on this issue.

Mr. GENSLER. Well, I thank you.

One of the key ways to lower risk in the derivatives marketplace is something called a clearinghouse. They have existed since the 1890s. They have been well regulated since the 1930s by us for exchange traded derivatives, and then there are other clearinghouses by the SEC. And they stand as middlemen or middlewomen, if I could say, between two parties. So if one of the parties fails, then they stand behind the contract. So that fundamentally lowers risk, and those clearinghouses have been very strong.

They, by the way, have not had access to the discount window. I think we probably should keep it that way. We should not expand the safety net to them. But they stand between the two parties.

So what we are recommending and what the bills do say is there would be clearing on those products that are standard enough to be brought into a clearinghouse. Some people think that may be three-quarters of the market.

But the Senate Agriculture bill, as merged into the Senate Banking bill, will have an exemption. The exemption would be for non-financial entities, if I might call them commercial entities, hedgers. It could be Hannaford Brothers in your State or it could be some of the commercial entities that Senator Bond referred to. They, if they are hedging whether it is for corn or wheat or it is an interest rate or a currency they are hedging, if they are not a financial entity—now, on the other hand, if it is an insurance company or a bank or a hedge fund, they would have to use the clearinghouse for their standard product. Their customized things they could still do.

Senator COLLINS. Thank you, Mr. Chairman.

Senator DURBIN. Senator Bond.

#### END USERS

Senator BOND. Thank you very much, Mr. Chairman.

Mr. Gensler, I am delighted you said they would not require an end-user to clear hedging.

If a community bank had a large portfolio of loans and wanted to offset part of that risk by going short or buying some form of put, who would be the appropriate person to regulate that? Would it be the bank regulator? Would it be the CFTC?

Mr. GENSLER. The bank regulator would regulate those banks.

Senator BOND. The CFTC would not be involved in it.

Mr. GENSLER. They would not regulate the bank. We would regulate the exchanges. If it was so standard that it was bought or sold on an exchange, we would regulate the exchange as we do now. That community bank might buy a future right now in the Chicago Mercantile Exchanges to hedge an interest rate. We do not regulate

the bank. We regulate just the exchanges in that example or the clearinghouse, of course.

Senator BOND. So they would not have to pay a separate fee if they were doing that. They would pay the fees that are already built in through the existing exchanges?

Mr. GENSLER. Well, I believe that is correct. That community bank could do a customized, tailored transaction. It might not even come to a clearinghouse. But if it is so standard that the clearinghouse is there, they would bring it there.

Senator BOND. Now, do I understand that you and the Secretary of the Treasury should say that where there are customized transactions, two parties that have worked together have adopted a customized derivative or hedging operation where it cannot be cleared—do you agree that there is no reason for two parties who have developed a complex contract be cleared or have margin?

Mr. GENSLER. Well, one, if it is customized, it would not be brought to a clearinghouse, and that is the recommendation. We are recommending that the swap dealers themselves, the dealers, the large banks be regulated, and that the banking regulators be able to lower risks to the American public by setting capital and margin requirements for those big financial houses that are the swap dealers themselves. But the customized transactions could occur and not be brought to the clearinghouses.

#### MARGIN

Senator BOND. Would they have to post margins on that?

Mr. GENSLER. What we have recommended is that the banking regulators, what is called prudential regulators, would have the authority to ask for those large swap dealers to either post or receive margin.

Margin also protects the other parties. What we need in our society, I believe, is that the large swap dealers should be able to fail. The terrible place that our Secretaries of the Treasury have been, Republicans and Democrats alike—they sit in the office, an ornate office. They get all the phone calls, and they say, can I let this company fail? And one of the problems is they are saying, well, if I let it fail, it is going to bring down the community banking system or it is going to bring down the farm credit system. So part is to have them post margin as well.

Senator BOND. But requiring margins, if a small bank hedges its risk, would it have to put up a margin or would that be up to the prudential regulator to determine whether it was appropriate to make that transaction?

Mr. GENSLER. If it is a custom-tailored product as you say, it would really be up to the banking regulators to say whether the big swap dealer—it is the regulator regulating the swap dealer would have that authority if the bill were to go through Congress.

#### SWAPS DEALERS

Senator BOND. If you are a major energy producer that has lots of contracts with a lot of—say, it is a coal or a natural gas company that has lots of contracts with lots of energy companies. Would these be major swap dealers who would be under the new regulations?

Mr. GENSLER. Senator, I think that the important thing is if they present themselves to the public dealing in swaps, they would be regulated.

Senator BOND. Not to the public but present themselves to their customers.

Mr. GENSLER. Well, what we want to guard against is the next AIG. We would not want to have an exemption or a loophole that the regulation is only regulating some swap dealers and not other swap dealers. Most energy companies are not swap dealers. Most energy companies are just hedging their own business.

Senator BOND. That was the question, whether by doing that, that would fall in a major swap dealer category.

Mr. GENSLER. I do not think most of them will. Some are swap dealers. Some do that. They actually have registered trading entities and so forth.

Senator BOND. Thank you, Mr. Chairman. Thank you, Mr. Gensler.

#### OTC MARKET SIZE

Senator DURBIN. Chairman Gensler, this whole conversation we are having about the future of derivatives, what will be regulated, what will not be regulated, what is standard, what will be custom—do you have any projection if we move into this new world of the volume that we would be talking about? You talked earlier about the number of contracts versus the size of the contracts. Could you give us some estimation of what we are looking at?

Mr. GENSLER. Mr. Chairman, I wish I had. This is such a dark market. It is hard to estimate. But the size of the market worldwide is about \$600 trillion, which is about 12 times the world economy. It is estimated about one-half of that is in the United States, which is about 20 times our economy. We Americans use them more than overseas.

But in terms of the numbers of transactions, we do not have an actual estimate. It is probably not a multiple. The market we oversee now is—I think the numbers were about \$34 trillion in futures. So you can see that is the 9 to 1 or something. But the numbers of transactions probably are less. The futures transactions are in the hundreds of thousands of trades a day. This new market is smaller than that in terms of numbers of trades a day, but we do not have an exact number. I wish I did.

Senator DURBIN. So if we embark on this brave new world, do you see a demand for more staffing and more activity at your agency?

#### ADDITIONAL RESOURCES NEEDED

Mr. GENSLER. I do. I mean, our best estimate—the Congressional Budget Office (CBO) asked us for 2011, and we forwarded these 238 people. What the President's budget did is said let us fund one-half of those people, or 119, in 2011 because we would be sort of growing during the course of the year. And I know the Securities and Exchange Commission has their numbers as well. We both do envision that this is a really important market to the American public, but it means little if Congress just authorizes it and we do not marry it with the appropriations.

Senator DURBIN. You talked about audits. What funding level would allow the CFTC to perform annual reviews of every DSRO and derivatives clearing organization, as well as annual examinations of commodity pool operators, trading advisors, and the futures commission merchants.

Mr. GENSLER. We believe, in the funding we have asked for this \$216 million, that we can do much of what you just said, the annual reviews of the clearing organizations, the trading organizations, and so forth. I may have not even listened closely. Some of those reviews that you mentioned are actually done by the self-regulatory organizations, but the ones we do we think that is the level.

#### STAFF EXPERTISE

Senator DURBIN. So my last question is kind of historic. When I first visited the Board of Trade and Mercantile Exchange over 25 years ago, they were still clinging to their early image as protectors of the agriculture sector in terms of the trading that was going on on the floor, and they were just starting to branch out into new worlds of futures.

And now I see, when I take a look at the activities that you are watching closely, that the financial commodity futures and option contracts make up approximately 79 percent of the trades that you regulate and other contracts like metals and energy products, about 13 percent. Only 8 percent can really be characterized as agricultural in nature.

What kind of challenges does this present to your agency to have this kind of mix which is moving toward much different objects that are at the soul and heart of the futures trading markets?

Mr. GENSLER. Well, I think you are right. It is actually a development that has happened over those 25 years. I think there is a uniformity and consistency of derivatives. They are all based upon some underlying commodity. We call a Euro dollar actually a commodity in the law.

But what we have to do as an agency is we have experts who have expertise in corn and wheat. We have some other experts in our Division of Market Oversight that have expertise in the financial products. So as these products continue, we try to build separate expertises that have a uniform expertise around derivatives but then have some product expertise. This is a little bit different. We have problems in the wheat market still about wheat convergence. That is very different than what goes on in the Euro dollar market, but we build the expertise across the product sets, as we will have to in the future as we take on more responsibilities possibly in what is now called the swaps market.

Senator DURBIN. Let me ask you about that. Are those going to be so unique by contract that they are going to put a special burden on your regulators to try to understand the real heart and nature of the transaction?

Mr. GENSLER. Well, I think humility suggests that there is going to be a lot we are going to learn along the way because we have not as a Nation regulated these products in the past. We do not have the authority. But I do think, for instance, interest rate derivatives where the CFTC will take the lead—we will share a lot

with the SEC—that that has a lot of similarities to what we do overseeing the Euro dollar contracts for now. Of course, the commodity derivatives have a lot of similarities, but there will be things that we are going to be learning along the way. We will be, hopefully, sharing that with you.

Senator DURBIN. Thank you.

Senator COLLINS.

Senator COLLINS. Thank you.

#### PROPOSED COUNCIL OF REGULATORS

Chairman Gensler, I think you said in response to Chairman Durbin's question that the futures market was something like \$34 trillion. That raises the question in my mind. Under Senator Dodd's bill, is the CFTC a member of the Systemic Risk Council of Regulators?

Mr. GENSLER. I believe the answer is yes.

Senator COLLINS. Let me ask the next question. Should you be a member?

Mr. GENSLER. I think so. I think so. Thank you.

Senator COLLINS. And if you are not a member of the council, I am going to offer an amendment to put the Commodity Futures Trading Commission Chairman on that council. I think it is really important that we try to be as inclusive—

Mr. GENSLER. The only reason I hesitated, I could not remember what it was called. I know there is a council. It may have different names in different bills.

Senator COLLINS. It does.

But they are in. Okay. The Chairman confirms it.

#### TOO INTERCONNECTED TO FAIL

Let me ask you a question then. How do you plan to help monitor and mitigate the potential for systemic risk arising from the concentrations or interconnectedness of risks that are related to derivative products?

Mr. GENSLER. Well, derivatives do weave sort of a spider's web between the financial system, and one of the reasons that we have been fighting to lower risk for the American public is to bring the derivatives into clearinghouses. Clearinghouses, again, stand between buyers and sellers, and that is one of the ways that we lower interconnectedness. Our system today does not just have "too big to fail." When Continental Illinois Bank—because I know it is in your State—that was thought years ago to be too big to fail in a sense, but now we have banks that are too interconnected to fail. If we let it go, it is going to pull down everything else. That was the central lesson of AIG. And tens of billions of dollars of our money, taxpayer—all of it went through AIG to other financial institutions.

So I believe we really need to, hopefully, stand—there will be some stress and pressures. There will be amendments probably offered to have another exemption here, another exemption there. And I hope—I would advocate we not have those exemptions for financial entities. We have an exemption for the commercial entities, but hopefully, we do not for the financial entities.

## TRANSPARENCY

Senator COLLINS. Could you give us an example of the kind of transparency that would be helpful to you that would come about because of moving derivative trades to a clearinghouse? Let me ask this in a better way.

What would you know that you do not know now if more of the trades go through a clearinghouse?

Mr. GENSLER. There are two types of transparency, one to the regulators and one to the public. Clearinghouses and something called trade repositories will give transparency to the regulators and we will know a lot. We will be able to—and I know the SEC will be able to—better enforce and police the markets for manipulation and fraud because so much can be now just transferred. We can currently look at wheat futures. We can look at Euro dollar futures. Somebody can just move the same trade over into an over-the-counter interest rate or a complex credit default swap. So as enforcement agencies, we get to follow it across to those other markets.

But there is also public market transparency, and public market transparency only comes really from reporting the transactions on a real-time basis. And for that, every end-user, Hannaford Brothers and others alike, will actually benefit because transparency leads to lower cost, lower bid spreads. It does shift the information advantage away from Wall Street. Wall Street is not happy with the proposals the administration has made, but public market transparency does that.

It also lowers risk. Remember we were all debating about toxic assets. The more transparency we bring, it lowers risk as well to the public.

Senator COLLINS. That is very helpful.

## END USER EXEMPTION

My final question to you is one that I raised with you in my office but I want to raise for the record as well, and that is, I have been hearing from some home heating oil companies in Maine that are worried that if they have to go through clearinghouses, that they will jeopardize their ability to enter into contracts with their customers that would be fixed price contracts for the upcoming winter. Do you see any problems created for them in this area?

Mr. GENSLER. I think you have heard from them because there have been a variety of bills, and even I as an advocate—I have advocated for no exceptions. But I think where Senator Lincoln and Senator Dodd and all the people that have worked on those two committee bills have come out, there would be an exception for commercial parties hedging as long as they were not financial. So the home heating oil companies would be exempted from having their transactions coming to a clearinghouse, as long as they were not speculating, which I do not think that is what they are doing.

Senator COLLINS. No, they are not.

Mr. GENSLER. So I think the bill accommodates that interest.

Commercial entities make up maybe, on worldwide statistics, about 9 or 10 percent of the market. We do not know precisely what it is in each and every market, but the exemption that is in

the Senate Agriculture and the Senate Banking bill is a balancing of interests, and it has exempted that 9 or 10 percent. But it is the commercial enterprises like the home heating oil companies in Maine.

Senator COLLINS. Thank you.

Senator DURBIN. Senator Cochran.

Senator COCHRAN. Mr. Chairman, thank you.

#### BUDGET IMPACT OF PENDING LEGISLATION

Chairman Gensler, I am curious to know about the new authorities which you are suggesting the CFTC should have. What is the status of the legislative authority that you are talking about? Has that been enacted into law, or is it just a proposal at this point?

Mr. GENSLER. It is a proposal. And the reason it came up here is, in terms of if it went through, the funding levels would be different. But right now the House of Representatives has passed a strong bill, but then the Senate hopefully in the next few days, you would tell me better.

Senator COCHRAN. I am not the chairman anymore. You forgot they had an election.

Mr. GENSLER. But I think that the Agricultural Committee and the Banking Committee have merged their product. They have a very strong derivatives portion that I believe is getting merged into the overall financial reform bill. I am hopeful, with Congress' deliberations, that we will get something to the President's desk.

Senator COCHRAN. This has a budgetary impact, does it not? Because it is going to cost more to enforce the new authorities. I assume there will be new hires required.

What are the other funds that you expect to be needed to be used for?

Mr. GENSLER. We have estimated to the Congressional Budget Office that in 2011 that we would need about 240 more people and about \$18 million more in technology budget. There is an awful lot of information that will be stored and will have to be assessed and so forth. That is included in the President's budget request in sort of a conditional way if Congress were to adopt financial reform.

Senator COCHRAN. Okay. Thank you very much.

Mr. GENSLER. Thank you.

Senator DURBIN. Chairman Gensler, thank you. There are plenty of other questions which we would like to share with you in writing and hope that you might be able to respond in a timely way. Other members of the subcommittee may have some questions. But we thank you for being here today and we will continue to work with your agency.

Mr. GENSLER. I thank the chairman and Senator Collins. Thank you.

Now you get Chairman Schapiro. Do I stay or do I leave? All right. Good luck, Mary.

## SECURITIES AND EXCHANGE COMMISSION

### STATEMENT OF HON. MARY SCHAPIRO, CHAIRMAN

Senator DURBIN. We now will hear from the Securities and Exchange Commission Chairman, Mary Schapiro, and following her presentation, we will proceed with question rounds of 5 minutes.

Chairman Schapiro, thank you for joining us today. We welcome your staff as well. Please proceed.

Ms. SCHAPIRO. Thank you very much, Mr. Chairman.

Chairman Durbin, Ranking Member Collins, Senator Cochran, thank you for the opportunity to describe how the President's fiscal year 2011 budget request would allow the SEC to better pursue our mission of protecting investors, regulating markets, and facilitating capital formation.

When I joined the Commission only last year, we were just emerging from an extraordinary economic crisis. The markets were still trying to regain a firm footing and confidence in the institutions of Government generally—and the SEC specifically—was badly shaken.

Thanks to the strong support that this subcommittee has provided, the SEC has begun to rebuild that confidence by making needed and significant changes to virtually every aspect of our operations. We brought in new leadership throughout the agency, streamlined procedures, and reformed operations. We began putting new technology in place, and we initiated one of the most significant investor-focused rulemaking agendas in decades. Our Enforcement Division undertook a top-to-bottom review, leading to a complete restructuring. Silos inhibiting internal communications were torn down. A layer of management was eliminated, freeing up professionals for front-line duty. And we created specialized units that will bring a deeper focus to critical areas such as market abuse and structured products.

These efforts are already paying dividends. Thanks to the support of this subcommittee, among the highlights of my first year we sought more than twice as many temporary restraining orders and asset freezes in 2009 as in 2008. We issued well over twice as many formal orders of investigation. We won \$540 million more in disgorgement orders. Penalty orders more than doubled. And we filed nearly 10 percent more actions overall, including nearly twice as many involving Ponzi schemes.

Our Office of Compliance, Inspections, and Examinations is undergoing a similar review which we expect to yield significant restructuring and improvements.

And to get ahead of the next financial challenge we may face, we created a new Division of Risk, Strategy, and Financial Innovation and are staffing it with people who bring us new and different perspectives and expertise.

We have made real progress, but restoring investor confidence and rebuilding the trustworthiness of financial institutions and markets will require a sustained regulatory commitment. Fiscal year 2011 will be a critical year in continuing our efforts to reinvigorate the Commission and its programs. The challenge we face grows every day. Since 2003, the number of registered investment advisors has increased by nearly 50 percent and their assets under management have grown by \$12 trillion. Today we rely on fewer than 4,000 individuals to monitor more than 35,000 regulated entities. And yet, it was only this year that the SEC staff members returned to the level last seen in 2005, and in the intervening years tight budgets forced us to cut investments in new information technology by more than one-half. This subcommittee's support has allowed us to reverse those harmful trends, and I thank you deeply for that.

And the President's fiscal year 2011 budget will allow us to continue on this new path. More staff will mean a deeper pool of institutional expertise, as we hire specialists with deep experience with today's markets and products. More staff will also mean more investigations and trials and a smaller gap between the number of examiners and the firms they examine and greater capacity to respond to emerging trends.

The President's budget will also provide a much-needed \$12 million increase in information technology (IT). Our top IT priority is completion of a new system for reviewing complaints, tips, and investigative leads provided by whistleblowers or other sources. The initial phase is done, creation of a single searchable database for existing tips and complaints. To this we will add risk analytics that help us quickly and efficiently identify high-value tips and search for trends and patterns across the data.

We are also enhancing collection, analysis, and distribution of the disclosure documents filed with the Commission. This will allow us to monitor macro trends, search for hidden risks, and track systemic changes.

We also plan to complete improvements to the case and exam management tools available to our enforcement and examination programs. While we will never match the technology available to the financial institutions we regulate and the big law firms we face, the ability to search and use the vast mountains of data we collect will make our team much more competitive. New technology will be accompanied by comprehensive training, allowing staff to navigate the constantly evolving financial environment they monitor.

And in the year ahead, we will also continue our pursuit of rule-making that looks after the interests of investors and responds to changes in the American financial marketplace. Key goals include a thorough review, already underway, of the rapidly evolving equity market structure, helping shareholders more effectively exercise their rights, and giving investors better information to make sound decisions regarding investments in municipal and other securities.

## PREPARED STATEMENT

I am pleased with the progress we have made, but we recognize that much work remains to be done to continue to restore investor confidence in our markets. The funding level of the President's budget request is critical for us if we are to continue to improve our performance in an increasingly complex financial world.

Thank you and I would be happy to answer your questions.  
[The statement follows:]

## PREPARED STATEMENT OF MARY SCHAPIRO

Chairman Durbin, Ranking Member Collins, Members of the Subcommittee: Thank you for the opportunity to testify today in support of the President's fiscal year 2011 budget request for the Securities and Exchange Commission.<sup>1</sup> I am grateful for the support that you and this Subcommittee have provided to the Commission. I welcome this opportunity to answer your questions and provide you with additional information on how the SEC would make effective use of the \$1.258 billion that the President has requested for the coming fiscal year.

When I joined the Commission early last year, we were just emerging from an economic crisis that threatened our financial system and the entire American economy. The markets were still trying to regain a firm footing, and confidence in the institutions of government generally—and the SEC specifically—was badly shaken.

Since then, we have taken significant steps to make the SEC more vigilant, sharp, and responsive—and focus the agency squarely on its mission to protect investors, maintain orderly markets, and facilitate capital formation. We brought in new leaders across the agency. We streamlined our procedures. We worked to reform the ways we operate. We began modernizing our systems. We set out to regulate more effectively. We fully engaged in the debate on regulatory reform, and we initiated one of the most significant investor-focused rulemaking agendas in decades.

While we made real progress over the past year, restoring investor confidence and rebuilding the trustworthiness of financial institutions and markets will require a sustained regulatory commitment. Fiscal year 2011 will be a critical year in our continuing efforts to reinvigorate the Commission and its programs.

My testimony will provide an overview of the actions and initiatives that we began over the past year thanks to the support that this Subcommittee has provided. I will then discuss the President's fiscal year 2011 request and the important work which these resources would make possible.

## NEW LEADERSHIP, ORGANIZATIONAL STRUCTURES, AND EXPERTISE

Without a doubt, the most critical element to success in improving the Commission's operations is the agency's talented and capable staff. During the past year, I am pleased to have been able to bring on board new senior managers who are playing a vital role in our efforts to transform the agency.

We brought in new leadership to run the agency's four largest operating units—the Division of Enforcement, the Office of Compliance Inspections and Examinations, the Division of Corporation Finance, and the Division of Trading and Markets. We also selected a new General Counsel, Chief Accountant, head of the Office of Investor Education and Advocacy, and directors for the New York, Miami, and Atlanta regional offices. The efforts of these new senior managers, together with the efforts of other leaders who are continuing their service, are already making the SEC a more agile, responsive and intelligent agency.

This new leadership team is committed to a culture of collaboration—sharing information and sharing ideas. To encourage that culture, I established several cross-functional teams to focus on issues such as life settlements and the development of a consolidated audit trail. We have begun integrating our broker-dealer and investment adviser examinations and are moving to consolidate our multi-office oversight of clearing agencies.

Significantly, we've created and staffed a new division—the Division of Risk, Strategy, and Financial Innovation—to bore through the silos that for too long have compartmentalized and limited the impact of our institutional expertise. A principal lesson learned from the financial crisis is that, because today's financial markets and their participants are dynamic, fast-moving, and innovative, the regulators who

<sup>1</sup>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.

oversee them must continue to improve their knowledge and skills in order to regulate effectively. The Division of Risk, Strategy, and Financial Innovation will help to re-focus the agency's attention on and response to new products, trading practices, and risks. Already, this new Division has attracted renowned experts in the financial, economic, and legal implications of the financial innovations being crafted on Wall Street.

In addition, we are working to establish a deeper reservoir of experts throughout the agency to conduct risk analysis, spot emerging trends and practices, and reduce the likelihood that a problem might grow into a more potent risk.

We also are committed to improved training and education of agency staff in order to close competency gaps and expand knowledge of industry activities and trends. Training needs to be current, continuous, and mandatory—and it needs to equip the SEC's workforce with the tools they need to enforce the Federal securities laws and protect investors.

Last year, we launched an effort to ensure that employees throughout the agency receive timely and relevant training which will allow them to fulfill the agency's mission. This agency-wide initiative includes a new integrated structure to identify training needs and to approve professional education and leadership development programs. The new training initiative also seeks to improve collaboration with other regulators and has enabled hundreds of employees to take advantage of external professional certification programs. While it will take time to fully implement all the components of our new training initiative, we are already seeing good results from this increased focus on staff development.

#### REINVIGORATING THE ENFORCEMENT PROGRAM

Enforcement of the securities laws is the foundation of the SEC's mission. Swift and vigorous prosecution of those who have broken the law is at the heart of the agency's efforts to restore investor confidence. But in recent years, the SEC's enforcement program had suffered under a variety of procedural, structural, and budgetary constraints.

Over the past year, we have improved our law enforcement capabilities and sent a clear signal to our staff that we value toughness and speed by removing procedural roadblocks impeding their investigations. For example, we delegated to senior staff the authority to issue subpoenas, so investigations can be launched without the prior—and time-consuming—approval of the Commission. We also abolished the requirement that staff obtain Commission approval before entering into settlement talks involving civil monetary penalties against public issuers.

We added a host of 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, and they provide new tools to help investigators develop first-hand evidence to build the strongest possible cases as quickly as possible.

Last year, I hired as the Director of the Enforcement Division, Robert Khuzami, a longtime Federal prosecutor who had served as Chief of the Securities and Commodities Fraud Task Force of the U.S. Attorney's Office for the Southern District of New York. Under his leadership, we are undertaking the most significant structural reforms of the enforcement program since 1972—reforms designed to maximize resources and enable us to move swiftly and vigorously against securities fraud. Highlights of the initiatives currently being implemented include:

—*Specialization.*—The Division has created five new national specialized investigative groups dedicated to high-priority areas of enforcement, including Asset Management (hedge funds and investment advisers), Market Abuse (large-scale insider trading and market manipulation), Structured and New Products (various derivative products), Foreign Corrupt Practices Act violations, and Municipal Securities and Public Pensions. The specialized units will utilize enhanced training, specialized industry experience and skills, and targeted investigative approaches to better detect links and patterns suggesting wrongdoing—and ultimately to conduct more efficient and effective investigations.

—*Management Restructuring.*—The Division has adopted a flatter, more streamlined organizational structure under which it has reallocated a number of staff who were first line managers to the mission-critical work of conducting front-line investigations. While a layer of management has been eliminated, the Division is maintaining staff-to-manager ratios that will allow for close substantive consultation and collaboration, resulting in a management structure that facilitates timeliness, quality, and staff development. The Division also has hired its first-ever Managing Executive, who is focusing on the Division's administrative,

operational, and infrastructure functions, thus freeing up valuable investigative resources for mission-critical work.

—*Office of Market Intelligence.*—The Enforcement Division has established an Office of Market Intelligence, which will serve as a central office for the handling of complaints, tips, and referrals that come to the attention of the Division; coordinate the Division’s risk assessment activities; and support the Division’s strategic planning activities. In short, this office will allow the Division to have a unified, coherent, coordinated response to the huge volume of complaints, tips, and referrals we receive every day, thereby enhancing the Division’s ability to open the right investigations, bring solid cases, and effectively protect investors.

In my first year, compared to the previous year, the SEC’s enforcement activity increased significantly. We sought more than twice as many temporary restraining orders and asset freezes; we issued well over twice as many formal orders of investigation; we won \$540 million more in disgorgement orders while penalty orders more than doubled; and we filed nearly 10 percent more actions overall, including nearly twice as many involving Ponzi schemes.

Of course, numbers alone don’t capture the complexity and range—or the importance—of the actions we brought. For example, we have brought a number of cases involving issues surrounding the financial crisis, including cases alleging accounting fraud at subprime lenders, misrepresentation of complex investments as appropriate for retail investors seeking safe financial products, fraud in connection with CDO marketing materials, and misleading investors about exposure to subprime investments. Our cases have included actions against Goldman Sachs and Co., American Home, Countrywide, New Century, Brookstreet Securities, and Morgan Keegan.

Examples of where the SEC’s actions have benefitted investors include:

—Charging Boston-based State Street Bank and Trust Company with misleading investors about their exposure to subprime investments while selectively disclosing more complete information only to certain favored investors. As a result of this one action, more than \$300 million will be distributed to investors who lost money during the subprime market meltdown.

—Charging the investment adviser for the Reserve Primary Fund with failing to properly disclose to investors and trustees material facts relating to the value of the fund’s investments in Lehman-backed paper. We also charged the adviser with misrepresenting that it would provide the credit support necessary to protect the \$1 net asset value of the Primary Fund when, according to our complaint, the adviser had no such intention. In bringing the enforcement action, the SEC also sought to expedite the distribution of the fund’s remaining assets to investors by proposing a pro-rata distribution plan, which the Court has approved. To date, investors have been provided with recovery of more than 98 cents on the dollar, with a Court-ordered distribution to be effected in the coming days that will bring their recovery to over 99 cents on the dollar.

In addition to the significant cases we have brought arising out of the financial crisis, we have continued to bring cases in many other important areas.

—In a pension fund pay-to-play case, we filed a settled action against a private investment firm, Quadrangle Group LLC, and one of its affiliated entities, charging them with participating in a widespread kickback scheme to obtain investments from New York’s largest pension fund.

—In the municipal securities arena, we settled fraud charges with J.P. Morgan Securities for its alleged role in an unlawful pay-to-play scheme in Jefferson County, Alabama. J.P. Morgan paid \$50 million directly to Jefferson County, forfeited more than \$647 million in claimed termination fees, and paid a penalty of \$25 million. At the same time, the SEC also charged two of J.P. Morgan’s former managing directors with fraud arising out of this scheme and had previously charged others, including the former Birmingham mayor—who last month was sentenced to 15 years in prison and fined \$360,000—a JP Morgan banker, and the local operative who served as go-between.

—In the area of accounting and financial fraud, auditor Ernst & Young LLP paid an \$8.5 million settlement—one of the largest ever paid by an accounting firm—and six current and former partners were sanctioned for their conduct in the audit of Bally Total Fitness Holding Corporation. We charged that they abdicated their responsibility to function as gatekeepers while their audit client engaged in fraudulent accounting.

—Finally, in the *Galleon* and *Cutillo* cases, we charged more than a dozen hedge fund managers, lawyers and investment professionals in two overlapping serial insider trading rings that collectively constitute one of the largest insider trading prosecutions in Commission history. In the parallel criminal prosecutions, ten individuals have already pled guilty and nine additional individuals have been indicted.

## STRENGTHENING EXAMINATIONS AND OVERSIGHT

Strong regulation is essential to the fair, orderly, and efficient operation of markets. A vigorous examination program cannot only reduce the opportunities for wrongdoing and fraud, but also provide early warning about emerging trends and potential weaknesses in compliance programs. Over the past year, we have begun reforming the Office of Compliance Inspections and Examinations in response to ever-changing Wall Street practices and lessons learned from the Madoff fraud. Reforms include:

- Placing greater reliance on risk assessment procedures and techniques to better identify areas of risk to investors.
- Requiring examiners to routinely verify the existence of client assets with third party custodians, counterparties, and customers, and have developed procedures to ensure compliance with the Commission's new rules to strengthen custody controls of an investment adviser's client assets.
- More rigorously reviewing information about firms before sending examiners out to the field, so that we can use our limited resources more effectively and to target those firms with the greatest risks.
- Enhancing the training of examiners and re-focusing on basics such as exam planning, tracking, and accountability.

We also plan to make significantly greater progress during the current year under the leadership of our new OCIE director, Carlo di Florio, who came to the SEC from PricewaterhouseCoopers, where he was a national leader in corporate governance, enterprise risk management and regulatory compliance and ethics. He also has extensive experience investigating corporate fraud, corruption, conflicts of interest and money laundering. At my request, he is undertaking a top-to-bottom assessment of the Office's operations to determine where additional opportunities exist to strengthen our exam program. As I will discuss later, there is such a huge disparity between the number of examiners and the number of entities that we must examine that we must ensure that we are using our limited resources wisely.

## IMPROVING AGENCY SYSTEMS AND MANAGEMENT

A key priority for me as Chairman is to ensure that our staff has the tools they need to conduct oversight of vast financial markets. Between fiscal year 2005 and fiscal year 2009, investments in new information technology systems dropped by more than half, resulting in a growing gap between our mission and the ability of our systems to help us accomplish it. Thanks to the resources provided by this Subcommittee, this fiscal year we have been able to begin investing in several new or improved IT projects and systems.

One of the first initiatives I launched was a strategic review of the agency's systems for reviewing complaints, tips, and investigative leads provided by whistleblowers or other sources. Having an effective process to identify the most important tips can give the agency an early jump on frauds and other violations of securities laws, help guide compliance exams, and provide important information across the agency to aid staff working to protect investors and maintain market integrity. The absence of such a system directly contributed to past failures by the agency.

We have completed the first phase of this effort, which was to centralize into a single, searchable database all our existing tips and complaints that were previously in multiple databases. This means that complaints we receive in Chicago are now downloaded into the same database as complaints received in Miami or any of our other offices, and the information investors share with our investor assistance hotline can be searched alongside complaints received by our markets hotline in our Division of Trading and Markets. Additionally, we released for the first time a set of agency-wide policies and procedures to govern how employees should handle the tips they receive.

Simultaneously, we have been working on a new intake system that will allow us to capture more information about tips and complaints. The new system will provide more robust search capabilities so that tips can be better assessed or triaged. In addition, this new system will add enhanced workflow abilities so we can track how tips and complaints are being used throughout the agency. We expect to deploy this system later this year. Meanwhile, we also are in the early stages of designing the third phase of this system, which will add risk analytics tools to help us quickly and efficiently identify high value tips and search for trends and patterns across the data.

In addition, we are enhancing the collection, internal analysis, and subsequent distribution of disclosures filed with the SEC, so that this unique set of data can be aggregated both across firms and over time—allowing us to monitor macro trends, search for hidden risks, and track systemic changes in filings.

During my first year, I also focused much attention on improving the agency's basic internal operations—the processes that guide our work, support the agency's infrastructure, and determine how we are organized. The public appropriately holds the SEC to a very high standard for integrity and professionalism, and we must hold ourselves to that very high standard as well. In the past year, we took major steps to implement a compliance program to guard against inappropriate securities trading by SEC staff. We have acquired and deployed a computer compliance system to track, audit, and oversee employee securities trading and financial disclosures in real time, and have hired a new Chief Compliance Officer to oversee these efforts. We also are strengthening internal rules governing employee securities trading and, in May 2009, we submitted proposed rules to the Office of Government Ethics ("OGE") that would prohibit staff from trading in the securities of companies under SEC investigation—regardless of whether an employee has personal knowledge of the investigation—and require the preclearance of all trades.

Also during the past year we hired a new Chief Freedom of Information Act (FOIA) Officer and have undertaken a comprehensive overhaul aimed at strengthening our FOIA program and our commitment to open government.

Within the next few weeks, we will also have on board a Chief Operating Officer. As I mentioned to the subcommittee last year, this is a new position that we are creating to help us manage our significant rebuilding projects. Our COO will provide executive leadership in the areas of information technology, financial management, and records management (including FOIA).

I have approved a new internal audit follow-up rule that sets forth roles, responsibilities, and procedures to ensure that SEC staff take timely and appropriate corrective action to address recommendations by the Government Accountability Office or the SEC's Office of Inspector General.

In addition, we are undertaking significant efforts to eliminate the material weakness in our internal controls over financial reporting, including automating the numerous processes that have been performed manually and strengthening our core financial system.

#### ENGAGING IN A SIGNIFICANT INVESTOR-FOCUSED RULEMAKING AGENDA

Of course, the changes we have initiated have not just been internal. The past year has witnessed one of the Commission's most significant rulemaking agendas in years. Here are some highlights:

Adopted:

- Custody controls*.—We adopted a rule in the wake of the Madoff fraud designed to provide greater protections to investors who entrust their assets to investment advisers. The rule leverages our own resources by relying on independent, third-party accountants serving as a "second set of eyes" to confirm client assets and review custody controls in situations where the possibility for misappropriation of client assets is most acute because of the adviser's possession of, or control over, client assets.
- Proxy enhancements*.—We adopted rules that require companies to provide investors with more meaningful information about the leadership structure of boards, the qualifications of board nominees and the relationship between a company's overall compensation policies and risk taking.
- Discretionary voting by brokers for directors*.—We approved a New York Stock Exchange rule to eliminate broker discretionary voting for all elections of directors, whether contested or not. This helps to ensure that director elections are determined by investors with an economic interest in the company.
- Short selling/Fails-to-deliver*.—We adopted a rule that will restrict short selling when a stock is experiencing significant downward price pressure. This rule will also enable long sellers to stand in the front of the line and sell their shares before any short sellers once a circuit breaker is triggered. In addition, we addressed the potentially harmful effects of abusive "naked" short selling, adopting rules that require that fails-to-deliver resulting from short sales be closed out immediately after they occur. Since this rule was adopted, the number of failures to deliver securities has dropped significantly.
- Money market funds*.—We adopted new rules that will help avoid a recurrence of the serious problems exposed in 2008, when the Reserve Primary Fund "broke the buck." The rules will strengthen the oversight and resiliency of these funds by, among other things, increasing credit quality, improving liquidity, shortening maturity limits, and requiring stress testing of money market fund portfolios and the disclosure of the funds' actual "mark-to-market" net asset value.

—*Central Clearing of Credit Default Swaps.*—We took action to address counterparty risk and improve transparency in the multi-trillion dollar credit default swap market by approving conditional exemptions that allowed certain clearinghouses to operate as a central counterparty for clearing credit default swaps.

—*Credit Rating Agencies.*—We adopted rules, and proposed others, to create a stronger, more robust regulatory framework for credit rating agencies—including measures designed to improve the quality of ratings by requiring greater disclosure, fostering competition, addressing conflicts of interest, shedding light on the practice of rating “shopping,” and promoting accountability.

Proposed:

—*Asset-backed securities.*—We proposed rules to fundamentally revise the regulatory regime for asset-backed securities. This comprehensive proposal would revise the disclosure, reporting, and offering process for asset-backed securities to better protect investors in the securitization market and promote efficient capital formation.

—*Proxy access.*—We proposed rules to facilitate the effective exercise of the rights of shareholders to nominate directors to the boards of the companies they own. If adopted, this rule would increase shareholders’ ability to hold boards accountable.

—*Large Trader Reporting.*—We proposed rules to create a large trader reporting system that, if adopted, would strengthen our oversight of the markets by enhancing our ability to identify large market participants and collect information on their trades so we can better analyze the data and investigate potentially illegal trading activity.

—*Flash orders.*—We proposed rules that would effectively prohibit all markets from displaying marketable flash orders.

—*Sponsored Access.*—We proposed a new rule that would effectively prohibit broker-dealers from providing customers with “unfiltered” or “naked” access to an exchange or ATS.

—*Dark pools.*—We proposed rules to generally require that information about an investor’s interest in buying or selling a stock be made publicly available, instead of available only to a select group operating within a dark pool.

—*Pay-to-Play.*—We proposed rules to address pay-to-play practices where investment advisers are managing or seeking to manage public monies that fund state and local pension plans and other important public programs.

—*Municipal Securities Disclosure.*—We proposed rules to improve the quality and timeliness of disclosure of material events related to municipal securities, such as payment defaults, rating changes and tender offers.

Our rulemaking agenda makes it clear that the Commission is now willing to address challenging issues and make tough choices.

#### SEC RESOURCES

The financial crisis reminded us just how large, complex, and critical to our economy the securities markets have become. Over the last 20 years, the dollar value of the average daily trading volume in stocks, exchange-traded options, and security futures has grown by over 25 times, reaching approximately \$245 billion a day. The number and size of market participants have grown as well. For example, since 2003, the number of registered investment advisers has increased by 49 percent, and their assets under management have jumped by over 57 percent, to \$33 trillion.

Yet, while the markets were growing exponentially in size and complexity, the SEC’s workforce was getting smaller and its technology was falling further behind. We are only just now returning to the staffing levels of 5 years ago. As you know, between fiscal year 2005 and fiscal year 2007, the agency experienced 3 years of flat or declining budgets, losing 10 percent of its employees, which severely hampered our enforcement and examination programs. In the context of rapidly expanding markets, limited SEC staffing levels hindered the agency’s ability to effectively oversee the markets and pursue violations of the securities laws.

Fortunately, thanks to support from the members of this Subcommittee, we have begun to rebuild our workforce and to invest in needed new technologies. Yet, the SEC is still responsible for overseeing more than 35,000 entities with just over 3,800 staff. Additional resources are essential if we hope to make the SEC a dynamic and effective regulator of our financial markets.

The President is requesting a total of \$1.258 billion for the agency in fiscal year 2011, a 12 percent increase over the fiscal year 2010 funding level. If enacted, this request would permit us to hire an additional 374 professionals, a 10 percent increase over fiscal year 2010. That would bring the total number of staff to about

4,200. The request also will permit us to continue expanding our investments in surveillance, risk analysis, and other technology, as well as in better training for SEC staff.

Of this total request, \$24 million would be contingent upon the enactment of financial reform—so that if reform is passed, we would have the resources to begin implementing our enhanced authorities.

It is important to note that the proposed increase in spending would be fully offset by the fees we collect on transactions and registrations. In fiscal year 2011, we estimate that we will collect \$1.7 billion—an increase of \$220 million over fiscal year 2010.

If we were to receive the proposed increase in spending, we anticipate it would be broken out as described below.

In the Enforcement Division, the budget request would enable us to add about 130 new full time employees so we can reinforce our investigations process, support more cases, and strengthen the intelligence analysis function. With these new staff resources—along with the Division restructuring and initiatives outlined above that will make the Division more efficient and effective—the Division projects that we will be able to open 75 more inquiries than the previous year, open 130 more formal investigations, and file charges in 70 more civil or administrative cases.

In addition to fully staffing the new Office of Market Intelligence and its critical risk assessment and strategic planning functions, we plan to use additional Enforcement Division resources in the following ways:

—*Hire Individuals with Specialized Industry Experience.*—One of the SEC's priorities is to seek persons with specialized financial industry experience. We intend to hire enforcement staff with specialized expertise in financial products, including structured products and hedge funds, trading strategies, risk, and financial analysis. Building upon the existing strengths of the Division, specialists will increase the Division's depth of understanding of the patterns, links, trends, and motives of wrongdoers. Moreover, the specialists can utilize their unique experience to more quickly target, analyze, and bring to light unlawful activities.

—*Hire Additional Trial Attorneys.*—It is essential that the SEC be able to act decisively on its growing caseload and that the Division has the resources to present effective cases at trial and to negotiate potential settlements from a position of strength. We intend to hire additional experienced trial counsel, not only to enable the Division to carry a caseload that includes increasingly complex cases, but also to allow the SEC and the Division to demand tough but appropriate sanctions with the confidence that we have the resources to litigate if necessary. It is critical that the Division convey to defendants that we are prepared to go to trial and to win. With our increased case load, our trial unit needs to expand to ensure that we are able to maintain a program of rigorous enforcement for the protection of investors.

—*Increase Administrative Staff.*—Division lawyers spend too much time on tasks more efficiently handled by support and paraprofessional staff. We can leverage our resources by transferring document management, case filings, and other administrative tasks to support staff with the appropriate expertise, thereby freeing up our attorneys to tackle critical front-line work of investigating cases, bringing enforcement actions and allowing all levels of the staff to leverage their specialized knowledge.

—*Train Strategically.*—It is critical that the Division invest in employee development to prepare its staff to respond to continuing changes in the securities industry, sophisticated new products and novel trading strategies. In addition, the Division needs to ensure that all staff has access to training to improve on the competencies and skills required for their jobs and to maximize individual potential.

—*Information Technology.*—Information technology is also a priority for the Division. We are spending significant resources on a number of ongoing projects—improving the Division's case management system, managing ever-increasing amounts of electronic evidence with sophisticated new tools, and establishing a more centralized system for reviewing and analyzing tips, complaints, and referrals. We intend to commit whatever resources are necessary and available to ensure a timely conclusion to these upgrades. We also anticipate major future projects, including a new IT Forensics Lab, enhanced data and trading analytics, and improved document and knowledge management to further enhance efficiency and consistency across the Division.

In our Examinations unit, the budget request would allow us to add about 70 staff to help us begin closing the gap between the number of examiners and the growing number of registered firms we oversee. With these new resources, OCIE expects to be able to expand the scope and coverage of adviser and fund examinations and to

staff fully the oversight function for credit rating agencies, allowing us to examine half of the rating agencies in fiscal year 2011. If the financial regulatory reform legislation now under consideration requires hedge fund advisers to register, we will expand our inspection program to include these new registrants.

It is important to note, however, that even with an increase in the number of exams these additional resources will enable us to conduct, we anticipate examining only nine percent of SEC registered investment advisers and 17 percent of investment company complexes in fiscal year 2011.

In the newly created Division of Risk, Strategy, and Financial Innovation, the budget request would enable us to add about 20 new professionals. The new staff would allow the Division to establish a deeper reservoir of experts who can conduct risk and economic analysis and spot emerging trends and practices in support of rulemaking and enforcement activities. We anticipate hiring professionals with significant knowledge and expertise in financial markets and products, including economists, academics, lawyers, and financial market professionals.

Among the other divisions, the budget request would permit us to add almost 50 staff to the Divisions of Investment Management and Trading and Markets. These personnel will help us enhance oversight of money market funds, clearing agencies, broker-dealers, credit rating agencies, and, if brought under the agency's jurisdiction, hedge fund advisers and OTC derivatives. The Division of Corporation Finance would add about 25 professionals to allow it to focus more, and with greater frequency, on the financial statements and other disclosures of large and financially significant companies.

Finally, the fiscal year 2011 budget request proposes to spend an additional \$12 million on information technology investments, focused on several key projects. Our top priority, as I described earlier, will be the third phase of our new system for analyzing tips, complaints, and referrals.

We also intend to continue our efforts to build a suite of surveillance and risk analysis tools that will substantially improve the agency's ability to find connections, patterns, or trends in the data we collect. The agency has numerous internal information repositories which result from disclosure filings, examinations, investigations, economic research, and other ongoing activities. With better tools, we will be able to mine this data, link it together, and combine it with data sources from outside the Commission. This will enable staff to more effectively identify risks to investors, trends in the markets, and to identify patterns of activities meriting further examination or investigation.

We also plan to complete improvements to the case and exam management tools available to our enforcement and examination programs. We intend to modernize our financial systems and implement a new system to handle the significant increase in the volume and complexity of evidentiary material obtained during the course of investigations. We also need tools to significantly improve the efficiency of loading, storing, and archiving the roughly three terabytes of data received per month during the course of investigations in order to improve turnaround time to staff and to contain costs.

#### MANAGING AGENCY GROWTH

While the budget request anticipates significant growth in the size of the SEC, the agency is properly positioned to implement this spending plan. To accomplish the hiring of hundreds of new staff during the course of fiscal year 2011, the SEC is enhancing its human resources staff and, consistent with its current authorities, streamlining its hiring process. Improvements include simplifying the application process and maintaining a searchable database of applicants, so that it is possible to interview for a vacancy as soon as it appears rather than having to go through the lengthy posting process each time. Being able to better tailor, target and speed recruiting will enhance the quality of applicants and help the agency acquire the necessary talent to perform effectively in an increasingly complex financial environment.

#### CONCLUSION

Thank you, again, for your past support, and for allowing me to be here today to present the President's budget request.

While the SEC is a relatively small agency, we are charged with protecting millions of investors every day, including the nearly one-half of all households that own securities. I am pleased with the progress that we have made to date, but recognize that much work remains to be done to continue to reinvigorate the SEC and restore investor confidence in our securities markets. The funding level in the President's

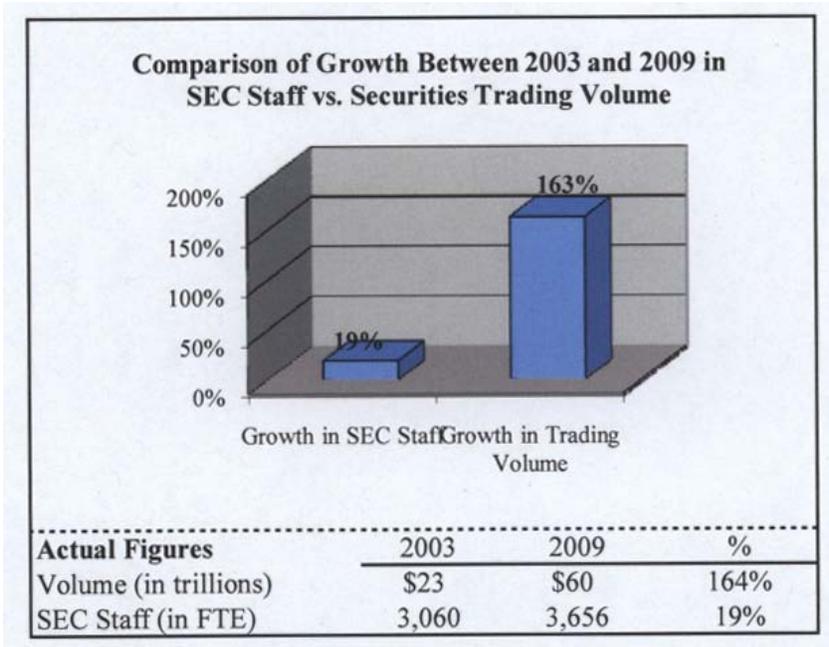
budget request is critical for us if we are to succeed in these efforts, and continue to improve our performance in an increasingly complex financial world.

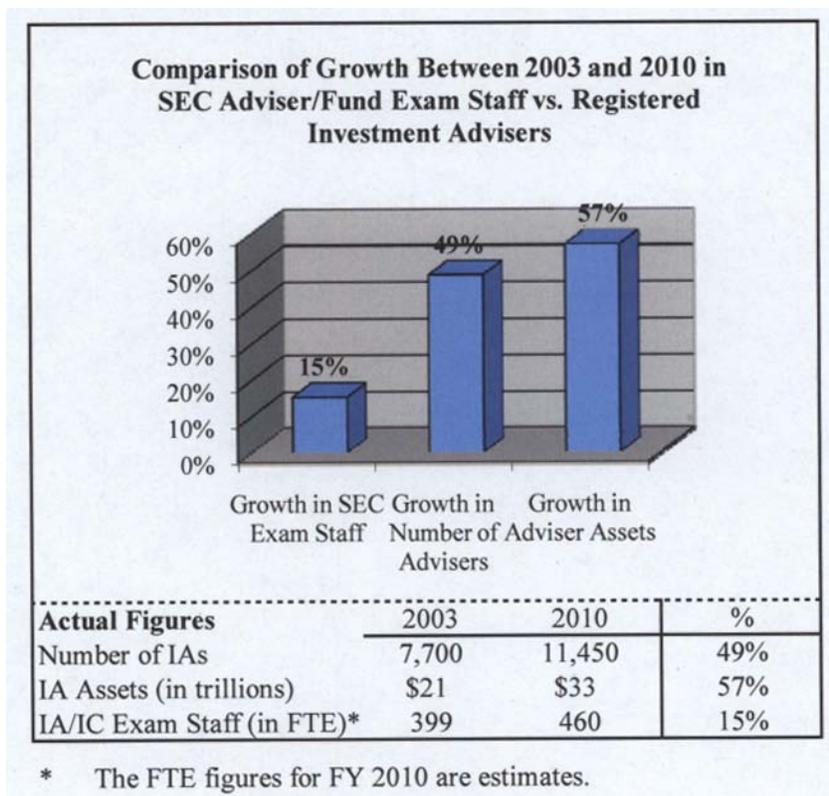
I am happy to answer any questions that you might have.

**SEC STAFF LEVELS HAVE NOT KEPT PACE WITH INDUSTRY GROWTH**

The SEC's staff of 3,816 FTE (estimate for fiscal year 2010) oversees more than 35,000 entities. These include: 11,500 investment advisers; 5,400 broker-dealers; 7,800 mutual funds; about 600 transfer agents; clearance and settlement systems; 12 securities exchanges; 10,000 public companies; 10 credit rating agencies; and FINRA, MSRB, & PCAOB.

The following charts provide examples of how various aspects of the markets have grown since 2003, relative to the SEC's staff:





#### OVERSIGHT OF CREDIT RATING AGENCIES

Senator DURBIN. Thank you, Chairman Schapiro.

I have joined a lot of other people in just finishing Michael Lewis' book, "The Big Short", and it is really an eye-opener of what was going on at the time that this real estate bubble was created. One of the areas that I had heard about many times that he made reference to was the work of credit rating agencies and the fact that some of the credit ratings that were given were misleading, to say the least.

Now, since the beginning of the credit crunch in early 2007, these agencies have come under fire for inflated ratings of mortgage-backed securities that did not reflect the financial stability of the borrowers. At our hearing last June, I asked you some questions about what the SEC was doing to restore confidence in these credit rating agencies, what improvements were needed.

In your budget justification materials submitted to the subcommittee in February, you indicate on page 4 that the fiscal year 2011 budget will enable the SEC to carry out a more robust oversight function for credit rating agencies and conduct examinations at one-half of the registered, nationally recognized statistical rating organizations next year. Underlined, "next year." You explained that in 2006, the SEC took on a major new responsibility with the

Credit Rating Agency Reform Act, which gave the agency authority to regulate internal processes of nationally recognized statistical rating organizations, such as recordkeeping and policies to guard against conflicts of interest. You contend “The SEC never received any increased or dedicated funding to carry out these new responsibilities, and it has been forced to divert positions from other programs in order to staff this vital function.”

I am puzzled by that statement. In fiscal year 2009, Congress provided the SEC with \$970 million in budget authority, \$57 million above the President’s request of \$913 million. And in fiscal year 2010, this current year, Congress provided \$1.1 billion, \$85 billion above the President’s request.

If the SEC regards its obligation to oversee credit rating agencies as a high priority, why were you not able to devote some of the increased funds we provided for this function in fiscal year 2009 and 2010?

Ms. SCHAPIRO. Senator, we have. I do not have the statement right in front of me. But let me assure you we are very committed to aggressive oversight of credit rating agencies. We have, in fact, created a new examination branch for credit rating agencies, and our goal would be to try to examine all the credit rating agencies on a regular basis. So we are quite committed to solving the problems that we have seen with respect to credit rating agencies.

In addition—

Senator DURBIN. Is this a typo where it says that you are going to start this work next year?

Ms. SCHAPIRO. We have already begun this work, and I will—

Senator DURBIN. This was in the budget justification materials given to this oversight committee.

Ms. SCHAPIRO. I can assure you this work has begun. We have a new head of our Office of Compliance, Inspections, and Examinations. Credit rating agencies are a focus of that office.

Senator DURBIN. We have the justification materials, and I would like to share them with you because what you have just said is not consistent with what was given to the subcommittee.

[The information follows:]

As a follow up to your question during the hearing, I wanted to offer clarification regarding the SEC’s examinations of credit rating agencies. As we discussed, page 4 of the SEC’s fiscal year 2011 Congressional Justification says: “. . . the SEC never received any increased or dedicated funding to carry out these new responsibilities, and it has been forced to divert positions from other programs in order to staff this vital function.” I understand that, in the months immediately following the passage of the Credit Rating Agency Reform Act of 2006, the SEC did not receive additional funds to handle these responsibilities, and the SEC during this period was in the middle of a 10 percent cutback in its overall staffing levels. However, this statement leaves the incorrect impression that the SEC has not received budget increases since that time. Accordingly, I have asked that this sentence be stricken from the version of the document that appears on the SEC website. As I mentioned in my testimony, your subcommittee’s support has in fact resulted in significant budget increases since I became Chairman and is allowing us to rebuild the agency’s workforce. In fiscal year 2009 the SEC was able to create a team of staff dedicated to examining credit rating agencies, and the fiscal year 2011 budget request asks for additional staff resources to expand the program.

I hope this information helps clarify the state of the SEC’s program to examine credit rating agencies.

## WHISTLEBLOWER BOUNTY PROGRAM

Senator DURBIN. Let me ask about another issue. In the wake of the massive Ponzi scheme perpetrated by Bernie Madoff, the SEC has undertaken an array of reforms to reduce similar frauds and the fact that they would go undetected. Among the actions cited in SEC materials is, "advocating for a whistleblower program," as part of the financial reform legislation. The SEC has requested expanded authority from Congress to reward whistleblowers who bring forward substantial evidence about Federal securities violations. Current law permits the SEC to award a bounty to a person who provides such information, leading to the recovery of a civil penalty from an inside trader, from a person who tipped information to an inside trader, or from a person who directly or indirectly controlled an inside trader.

Now, a few weeks ago on March 29, the SEC's inspector general issued a report on how the bounty program is working at your agency. The SEC inspector general noted that while the SEC has had a bounty program in place for more than 20 years for rewarding whistleblowers for insider trading tips, there have been very few payments under the program. Likewise, the SEC has not received a large number of applications from individuals seeking a bounty over this 20-year period. The inspector general also found the program is not widely recognized either inside or outside your agency.

The inspector general indicated that although the SEC is seeking expanded authority to reward whistleblowers who bring forward substantial evidence about other significant Federal security law violation, the current SEC bounty program is not fundamentally well-designed to be successful.

They called for a long list of improvements by your inspector general. Make the application more user-friendly. Establish internal policies and procedures to assist staff in assessing contributions made by whistleblowers in making bounty award determinations. Routinely provide status reports to whistleblowers regarding their bounty applications. Track the applications to ensure timely and adequate review.

The inspector general acknowledged that the SEC has begun to take steps to correct the deficiencies identified in this whistleblower bounty program, including consultation with the Department of Justice, the Internal Revenue Service, and other agencies.

After the embarrassment of Bernie Madoff, this inspector general report about your whistleblower program is troubling to me. It indicates that the level of energy which we expected in response to Madoff and the embarrassment he brought to your agency and to our Government would create a whistleblower program to try to save some of those investors and savers who could be exploited by people like him.

Ms. SCHAPIRO. Senator, I would very much like to address that.

First of all, when I arrived, I asked that we build a more robust, effective whistleblower program simply because the insider trading program has not been effective. And that is in part because insider trading rarely is brought to the attention of the SEC by tips. It is generally discovered as a result of surveillance done by the ex-

changes or surveillance that is done by the SEC itself. So we needed a program that was far more effective and covered much more than insider trading, which is a small proportion of the cases that we bring every year.

So the SEC staff, in fact, crafted the whistleblower legislation that we believe would be far more effective, addresses the issues that are raised in the inspector general's report, and we think will allow us to really leverage the information that whistleblowers bring to the SEC on a broad range of potential violations.

Senator DURBIN. But you are asking for expanded authority to reward whistleblowers. If you were discounting what they could do, why would you ask for expanded authority in that program?

Ms. SCHAPIRO. But I am not discounting what they do. I believe we can make tremendous use of tips and complaints from whistleblowers.

In the narrow context of insider trading, which is the only place the existing program can be applied, it has not been an effective program. So we need legislative authority to craft a program that will allow us to give whistleblowers more meaningful recovery on their claims and that will cover more than simply insider trading which, as I said, frequently is not the result of a whistleblower coming to us because insider trading tends to be detected from abnormal trading activity in a stock prior to the announcement of a merger or an acquisition that is detected by exchange surveillance systems referred to the SEC and then prosecuted by us. So the program was flawed in many ways, which is why we asked to expand the program, make it more robust, and have the legislative authority to do that.

Senator DURBIN. So is the inspector general's report on the right track of what you need to do within your own agency about this program?

Ms. SCHAPIRO. I think the inspector general's report is on the right track, and in fact, many of the recommendations he made are really a result of talking extensively with our staff about how to make this program better.

Senator DURBIN. Senator Collins.

#### ENFORCEMENT ACTIONS

Senator COLLINS. Chairman Schapiro, there have been three issues in the press lately that affect the SEC that I particularly want to ask you about today to get your answers on the record and perhaps put an end to some of the speculation about one of these issues and that is the first one that I am going to begin with.

There has been speculation reported in the financial press that the SEC's case against Goldman Sachs was somehow motivated by the timing of the financial reform bill that the Senate will shortly consider. For the record, was the timing of the SEC's enforcement action against Goldman in any way connected to the Senate's actions on financial reform?

Ms. SCHAPIRO. Absolutely not, and I put out a statement to try and make that quite clear that we do not time our enforcement actions by the legislative calendar or by anybody else's wishes. We bring our cases when we have the law and the facts that we believe support bringing our cases, and that is exactly what happened

here, as has happened in the more than a dozen other financial crisis cases that we have brought in the past year.

Senator COLLINS. I share your view on that issue, but I think it is important for me to ask you for the record.

Ms. SCHAPIRO. I appreciate the opportunity to answer it.

#### EMPLOYEE MISUSE OF COMPUTERS

Senator COLLINS. The second question I want to ask you has to do with the disciplining of SEC employees who were involved in the porn case.

I really am so appalled at those findings by the inspector general because it was not just one or two people. According to the inspector general's report, 33 staffers at the agency were found to have looked at porn on their computers at work over the past 5 years, and 17 of them were highly paid employees that were earning between \$99,000 and \$222,000 a year.

An unrelated issue but another issue that causes me to ask what your process is and what are you doing to discipline employees has to do with the inspector general's criticisms of the SEC's failure to uncover the Madoff Ponzi scheme. Has the SEC taken any disciplinary actions against employees as a result of the inspector general's findings in the Madoff case?

Ms. SCHAPIRO. Senator, I am happy to respond to both of those.

In the first instance, let me say that it was the agency's own filters that detected the activity that was reported by us to the inspector general, and there were 33 persons, as you point out, cited in the inspector general's report over a 5-year period. And a number of those, in fact, were outside consultants.

That said, I completely share your disgust with this conduct. It is unacceptable at the Securities and Exchange Commission or anywhere else. We will deal very swiftly and very severely within the limits of the Federal employment rules and laws with anybody who abuses SEC resources. In fact, last week, I put out a message to all employees making it clear that anyone who abuses SEC resources in this manner or misuses them will be subject to termination. So we will deal with this very swiftly and severely, and all employees are clearly on notice with respect to that.

Many of these actions were a number of years ago, and disciplinary actions have already been taken at one level or another. We have significantly ramped up the potential penalties.

With respect to your last question regarding Madoff, as a result of the inspector general's investigation of the agency's failure to detect the Madoff fraud, there was a recommendation that we consider whether discipline is appropriate with respect to employees. I should say that, for example, in the Enforcement Division, of the 20 employees who were involved with Madoff investigations or examinations, 15 have already left the agency. With respect to those who are left, we have put in place a disciplinary process in accordance with the Federal rules that apply to all Federal workers in all situations like this. That process is intended to be fair and deliberative but appropriate, and we are going through that right now. It is well underway, and I cannot really comment on any specific actions, but I can assure you that a disciplinary process is underway.

Senator COLLINS. Thank you.  
 Senator DURBIN. Senator Cochran.  
 Senator COCHRAN. Mr. Chairman, thank you.

#### CORRECTIVE AND DISCIPLINARY ACTIONS

May I ask whether or not any of the findings and recommendations of the inspector general in the case that Senator Collins raised have been implemented, or have those who were found to have violated regulations or laws in this connection been punished? You mentioned that five are still working there, and there were others who resigned, as I understand it.

Ms. SCHAPIRO. The inspector general, Senator, issued his reports in August and October, and between them, they included about 69 different recommendations for the staff. As a result of that, very promptly, the offices that were involved, primarily our inspections group and our enforcement group, issued corrective action plans, which under Federal law generally require that corrective actions in response to an inspector general report be taken within 1 year. As of March 31—so between 4½ and 6 months after those reports were issued—the offices have completed corrective actions on 35 of the 69 recommendations. We are awaiting the inspector general's concurrence on 19 of those. The rest are substantially well underway and I think we are making very significant progress.

With respect to the employees, as I mentioned, a number of them have already left. We are looking at whether personnel action should be taken. There is, as I said, an established process that we are legally required to follow, as we would in any employment issue involving a Federal worker. And that process is well underway, and we will be happy, upon its completion, to report back to the subcommittee.

#### STANFORD PONZI SCHEME

Senator COCHRAN. I have several constituents from Mississippi who called and came up to Washington to visit with me and other Members of Congress and the Senate to tell us about their experiences in the really serious financial dislocations that have been caused by this scheme. It is really heartbreaking to realize that these people were really innocent victims of somebody's greed and corruption, and I want to be sure that whatever can be put in place to prevent this kind of thing from happening in the future is acted on and done quickly.

Can you assure the subcommittee that that is the step and that is the intent of the SEC in this case?

Ms. SCHAPIRO. Senator, absolutely. As soon as I arrived last January, I put into motion a number of things that we hope will reduce the chances of a tragedy like this ever happening again. So we changed leadership across the agency. We restructured our Enforcement Division. We are in the process of restructuring our examinations group. We are bringing in people who have new skills that are better able to understand some of the information that Mr. Madoff managed to so expertly fool the staff with. We are doing much better training. We have over 500 employees who have gone through either certified fraud examiner training or chartered financial analyst training.

We have put in place new rules that will allow us to leverage the work of accounting firms when an investment adviser custodies assets with an affiliate, which is what happened in this situation. They are now required to have a surprise audit by a PCAOB registered accounting firm and allow us to have access to that information immediately so we can look for suspicious activity.

And as I mentioned in my statement, we have put in place a system to try to better track tips and complaints and referrals so that the kind of information that the staff had about Madoff will have far less chance of slipping through the cracks.

We have worked day and night to do everything we can think of to try to minimize the chances of a horrific event like this ever happening again. I share your deep concern about it.

Senator COCHRAN. I appreciate your response and the obvious interest you have in helping to change things so that it will be less likely, we hope not likely at all, for something like this to happen in the future.

I wish there was some way that we could provide some kind of restitution, or through a request from the administration, Congress could provide you with some authorities to help do something to compensate these victims for this terrible scheme.

Ms. SCHAPIRO. Through the SIPC program, Madoff victims are entitled to recovery. It will not come anywhere close to replenishing the funds that many of them have lost or thought they had earned over many years of this Ponzi scheme. But I believe at this point, the SIPC trustee has paid out somewhere around \$680 million, and the trustee has gathered about \$1.5 billion for distribution to victims. It is a long and difficult process, but it is well underway.

Senator COCHRAN. Well, thank you very much.

Senator DURBIN. Senator Lautenberg.

Senator LAUTENBERG. Welcome, Ms. Schapiro.

Ms. SCHAPIRO. Nice to see you again.

Senator LAUTENBERG. Congratulations on the earnestness with which you have taken over this assignment. That was desperately needed because not only did people lose lots of money, but they lost faith in Government at the same time.

Ms. SCHAPIRO. Absolutely.

#### TIPS AND COMPLAINTS

Senator LAUTENBERG. It is a subject of interest of mine over some years. I still sit on the board of the Columbia Business School, my alma mater, and in 2001 I was able to establish a chair at Columbia that called for better business ethics in corporate governance in 2001. And while I claim some clairvoyance, the fact of the matter is that to me, having come from the corporate world, I saw a situation developing that I found very discouraging. And we have seen it in the last years when looking back at the testimony given the people who served earlier, without direct criticism, that there were responses to questions that said, well, we just did not know. We were not aware with whistleblowers presenting fairly significant evidence of failures on the part of the SEC.

Is that still a source of information? Do we still get that kind of information? What happens when you get something?

Ms. SCHAPIRO. Senator, we do in fact. We get hundreds of thousands of tips and complaints a year. One of the problems I discovered when I arrived last year was that they came in from many different sources, investors, other regulators, companies, other regulated entities, and they came in all over the SEC. And there was no mechanism to centralize this information, connect the dots that might provide useful information about a trend or a growing problem with a particular product or a trading strategy or a particular firm.

So we spent the money that this subcommittee very generously gave this agency last year in technology dollars to begin to build a centralized repository for all the tips and complaints and referrals that come into the agency. That phase one is completed. The next phase is to add risk analytics to that, and we have created an Office of Market Intelligence in our Enforcement Division that is charged with the responsibility for knowing the data that is in there, understanding what creates the highest level of risk for the investing public, following up on those leads, triaging them, following up on them, tracking them, and making sure that we act on them as responsibly as we can.

There are hundreds of thousands, and I would not sit here and tell you we will never miss another one. But we have done everything we can think to do.

Senator LAUTENBERG. That is important. Could it be considered a fairly reliable source of inquiry that the SEC will look to these things? Because there was a pathetic response to why action was not taken in one case.

Ms. SCHAPIRO. Absolutely.

Senator LAUTENBERG. I see that your budget request clearly identifies enforcement as SEC's top priority, and obviously, it is brought about by the years of neglect that preceded this.

How do you stimulate your people to go after these things when the culture before was so neglectful? Are you able to keep track of what is going on there?

#### IMPROVING SEC ENFORCEMENT

Ms. SCHAPIRO. It is a great question. And I will tell you that I think—and I do not mean to sound Pollyannaish about this, but that the culture of the agency was maybe submerged a little bit over the last several years, but there is tremendous enthusiasm again for our enforcement role. We took the handcuffs off our Enforcement Division within 1 week after I arrived at the end of January last year. We told the enforcement staff that they could issue subpoenas without waiting for the five Commissioners to sit in a meeting and vote on it. It took months off the investigative process.

We enabled our staff to go ahead and negotiate corporate penalties with public companies in enforcement cases instead of getting permission in advance from the Commission, again speeding up the process, empowering them to do their jobs.

We created five specialized units of people with deep expertise and we are having tremendous success in recruiting people that will focus on specific areas and get deep and knowledgeable about structured products, asset management, insider trading, and market abuse, Foreign Corrupt Practices Act, and so forth. So we have

these specialized units that are going to be far more efficient, I believe, in bringing cases.

We took a layer of management out of the Enforcement Division and put hundreds of really talented people back on the front lines of doing the investigations and bringing cases.

We have done the most significant restructuring of the enforcement program in 30 years, and I think we are already seeing it pay dividends in the level of complexity of cases that we are bringing. If you look at the major cases over the last year, they are quite extraordinary. And, also the number of cases. For example, in 2009 over 2008, we shut down twice as many Ponzi schemes far earlier than the Madoff scheme would ever have been shut down.

#### CORPORATE COMPENSATION PROGRAMS

Senator LAUTENBERG. I would just ask the chairman, if I might take a moment from using and say that as you look at executive compensation, which I know is one of the things that you see—I ran a pretty good-sized company before coming here and was very conscious of things that we did to stimulate attitudes within the working population of the company, and when we put any money into the outside world to try and help us, we have effectively.

To me, a year-end—a termination bonus, what not to be the mark—a mark based on the stock price, but based on what good the individual did for the company, and instead of paying a bonus immediately, trail it out over maybe a 5-year period and say if the company achieved certain marks after you have been here, that is when the big bonuses ought to come. And I do not know what right you have at the SEC to make the recommendations on that basis or even to think about it.

Ms. SCHAPIRO. Senator, while I do not think we can dictate the terms of compensation arrangements, we did approve new rules in January that are in effect for this current proxy season that require the board of directors to explain to shareholders how they compensate risk-taking within the corporation and whether their compensation programs broadly, for all employees, not just the top five, might incentivize short-term risk-taking, how the board handles risk within the organization more broadly, as well as some others that we call proxy enhancements.

It is disclosure based, as much of our rules are, but I think it is forcing boards to really think about what do they want to say about their compensation programs and how do they want to explain the linkage between compensation and risk which we have seen over the financial crisis to be a strong link and one that had very deleterious effects at the end of the day.

Senator LAUTENBERG. I am glad to see that there is some fire in the belly over there.

Ms. SCHAPIRO. There is much fire.

#### CHIEF COMPLIANCE OFFICER WITHIN SEC ORGANIZATION

Senator DURBIN. Chairman Schapiro, you announced the appointment of a new chief compliance officer to serve as the internal watch dog to monitor security holdings and transactions by your own employees and, in your own words, said that this had to be

a world-class compliance program just as we expect from those we regulate.

There was an article that followed that decision, once they found out where this compliance officer would be standing on the pecking order or the administrative stair steps of your agency. There was a concern that this person really did not report—was in a post buried within the Office of Ethics Council, did not have an independent status, and did not report to you or another high-ranking official. The question was raised as to whether or not this really was a world-class attempt to deal with a serious problem that might involve some conflict of interest within your own agency.

Ms. SCHAPIRO. Senator, let me address this because I think the article was actually quite off the mark.

When I arrived at the SEC, I was surprised, I will say, to learn that there was not a system for monitoring employees' stock transactions, and I had come from an organization where we had quite a rigorous one. So I immediately brought in a contractor to help us develop a system that requires every employee to enter all of their stock holdings and all of their securities accounts into a centralized system. It enables employees to pre-clear any trades and ultimately will receive directly from brokerage firms duplicate copies of employees' statements.

At the same time, we are working with the Office of Government Ethics to bolster the existing rules that apply across the Government and no employee will be permitted to trade in the stock of any company under investigation by the SEC, whether or not they have any knowledge of it at all. That will also require preclearance and certification that they have access to no nonpublic material information about those companies. We are negotiating those rules out with the Office of Government Ethics right now.

The person we hired is responsible for that system. We have an entire Office of Ethics within the SEC. I meet with them regularly. In fact, I met with the new compliance officer this morning. But her responsibility is with respect to that system. It is not a chief compliance officer in the sense of one in a brokerage firm, which I think that article was trying to equate.

Senator DURBIN. So can this person report directly to you?

Ms. SCHAPIRO. She could. In fact, I met with her yesterday, and she knows my door is open to her at any time.

Because she is responsible for managing the system within the context of the many other ethical reviews that go on within the agency, it made sense to put her in the Office of the General Counsel. I would have no problem changing the reporting line. I think she will actually get more attention, though, and more focus there, and she knows she can come to me anytime, frankly, as every employee does on any issue that is of concern to them.

#### STANFORD PONZI SCHEME

Senator DURBIN. Let me ask you about the report that was released on April 16 from the Inspector General's Office about the *Stanford* case and the fact that this case was—Allen Stanford was indicted last year by the SEC in a \$7 billion fraud case, accused of fleecing more than 21,000 people, primarily through the sale of

a prized investment, certification of deposits issued by his bank headquarters in Antigua, and then sold at a brokerage.

The SEC's Fort Worth office was aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme. But as the inspector general report states, no meaningful effort was made by enforcement to investigate. SEC agents began looking at Stanford's companies in 1998, 2002, and 2004, but dropped their efforts. The inspector general report also said SEC supervisors were more interested in quicker turnaround cases at the time, not the kind of examinations needed to look into a complex entity like Stanford. And to make it worse, the former chief of enforcement at SEC's Fort Worth office who helped quash the inquiries later went to work for Stanford in 2006 before he was told by the SEC to stop because it "was improper to do so."

Like the case of Madoff, the scathing report offers another reminder of potential breakdowns in regulatory oversight. I recognize that these circumstances like the Madoff situation preceded your arrival. Yet, cases like this can fester and then bubble up to surface years later.

What controls does the SEC have in place now that would ensure that a disturbing mess like the *Madoff* and *Stanford* cases do not reoccur? What else should be done to make sure that they do not?

Ms. SCHAPIRO. Senator, let me speak specifically to Stanford because I have talked quite a bit about all the changes that we have put in place with respect to Madoff, although I am happy to discuss those in much more detail.

With respect to the conduct that was discussed by the inspector general in the *Stanford* case, there were many missed opportunities, without a doubt, in that 1997 to 2005 period before the agency took Stanford up seriously and earnestly to have done something. I was not there, so I do not truly understand what happened.

I will tell you that we have new leadership across the board in this agency, in the inspections program, as well as in the enforcement program. We have created escalation committees so that if an examiner believes that they have found something that is a real problem and they are not getting the response when they refer it over to the Enforcement Division that they want, they take it to an escalation committee and that will go all the way up into the senior ranks of the organization.

We have new management reporting metrics that have been put in place in the Enforcement Division and regular review of open matters in both the examinations group and the enforcement group so that we can be sure things are not sitting for a long time.

Decisions will be made sometimes to shut down a matter because there is not sufficient evidence, and we could miss something by doing that. But it has to be a conscious decision based on the evidence that is in front of people at the time. It cannot be because of neglect that something has not been pursued.

So I think between the leadership changes, the structural changes within enforcement, the structural changes that I anticipate we will be announcing in the inspections group before very long, the creation of the escalation committees, and the new reporting mechanisms within the divisions, I am hopeful that we will never have a repeat of that incident.

## OVERSIGHT BY APPROPRIATIONS COMMITTEE

Senator DURBIN. Let me say in closing, before turning it over to Senator Collins, the questions I have asked you today have been pointed. They have involved issues that are important and controversial. It is part of our responsibility on this side of the table with the oversight of your agency to ask those questions. There are some in the Senate now who want us to be taken out of this process. They do not want these questions to be asked, and I think that is wrong. We have a responsibility to make sure that you do your job and do it well and provide you with the resources to accomplish your goals, and the notion that the oversight of the Appropriations Committee is unnecessary for an agency as important as the Securities and Exchange Commission is just plain wrong. And I hope that we can continue a positive, constructive relationship providing you the resources and support you need, but you can count on this. As long as this Appropriations Committee is involved, each year you will face questions that get to the heart of your activities and be held accountable as we are held accountable.

Ms. SCHAPIRO. Senator, I appreciate that. I always endeavor to be completely transparent about what is happening at the SEC, what I see that is wrong, and how I am trying to fix it. This is an institution that must always learn from its mistakes, and that is my commitment to you. I will answer your questions.

Senator DURBIN. Make no mistake. I still have confidence in your leadership, but we have a responsibility on our side of the table as well.

Ms. SCHAPIRO. I understand.

Senator DURBIN. Senator Collins.

Senator COLLINS. Mr. Chairman, let me first wholeheartedly agree with the statements that you just made. I am going to bring up one of those kinds of questions right now too.

## GLOBAL SECURITY RISK MANAGEMENT

In 2004, at the direction of Congress, the SEC established the Office of Global Security Risk Management, and this was created—and probably the chairman was involved because I know this is an issue that has mattered to him for a long time. It was created to protect investors from the risk associated with investing in companies doing business in nations that are designated as state sponsors of terrorism by the Department of State.

But the office within the SEC has failed to vigorously carry out its mandate. Its most important mandate is to ensure that all companies that are sold on American exchanges that operate in those countries are disclosing their activities to investors. I know the chairman and I have supported legislation that has allowed State pension funds to divest their holdings in such cases.

Why has the SEC not been more aggressive in following through by issuing regulations to ensure that corporations do disclose the information about their activities in such countries to their investors?

Ms. SCHAPIRO. Senator, the Office of Global Security Risk, as you point out, was created in 2004. In that period between then and now, that office has reviewed about 800 corporate filings that dis-

close doing business on some level with Iran, Syria, Sudan, or Cuba that are on the State Department list.

The disclosure requirements are based on materiality, and that is something we could change. But there is not a separate line item disclosure for any level of business with one of those countries. So we look at materiality both quantitatively and qualitatively—the amount of the business that is done with one of those countries relative to the size of the company. Is it humanitarian or is it potentially business that could have a military application, for example? Is the business continuous or isolated? Is there just one instance and so forth? So we do this materiality analysis, and if the staff determines that the contact with one of these countries is material, then disclosure is required.

We could look at—in fact, I will tell you we are looking at whether this should be line item disclosure without regard to the materiality of the business conduct between the public company and one of these four nations that are currently on the list.

#### DISCLOSURE AND MATERIALITY TEST

Senator COLLINS. Well, let me follow up on that because I am told that in November 2007, the SEC issued a concept release seeking comment on whether to develop a better mechanism to allow investors to have better disclosures in this area and that the comment period ended in January 2008 and that the SEC has taken no action since that time.

Ms. SCHAPIRO. I have asked the staff to—

Senator COLLINS. Is that incorrect?

Ms. SCHAPIRO [continuing]. Go back to that. Again, as I said, we are looking at whether line item disclosure here as opposed to our normal you must disclose material risks to the business or material levels of business in this regard.

Senator COLLINS. But why has there been no action for 2 years since the comment period—more than 2 years?

Ms. SCHAPIRO. I think there has been a general view that our disclosure system is about disclosure that helps people make investment decisions and make the right decision about purchasing or selling a financial asset, and that if it is a de minimis amount of business that is being done with respect to one of these countries, does it meet either the qualitative materiality or the quantitative materiality standards, that it will not be useful disclosure. As I said, we are revisiting that issue now.

Senator COLLINS. Well, what I would say is I think you have a good point about de minimis business, but you ought to complete the work on it so that investors do have access to that information because there are many investors who will not want to do business with a company or will not want to buy shares in a company that is doing business with one of these countries.

Ms. SCHAPIRO. And if I could just add one thing because you mentioned the law with respect to divestiture. Our very recent filing reviews show that two mutual funds, CREF and Old Mutual, have actually relied on that safe harbor to divest themselves of stocks of companies doing business in the Sudan. So I think that is very good news.

Senator COLLINS. I do too.

## FIDUCIARY DUTIES OF BROKER-DEALER

Yesterday, as you know, at the hearings on Goldman Sachs, I asked what I thought was a pretty straightforward question to several of the bankers. I asked them whether they considered themselves to have a duty to act in the best interests of their clients, the kind of fiduciary obligation that investment advisors have. And to say that they danced around and evaded answering my question would be an understatement. But the fact is that the law currently does not impose that kind of fiduciary obligation on broker-dealers.

In your judgment, should the law impose a fiduciary obligation on broker-dealers?

Ms. SCHAPIRO. It absolutely should, and we have been strongly advocating for the regulatory reform bill to require that both investment advisors—and we have discussed this in a retail context, I will say, not with respect to the discussions this week about large institutional investors. But at a minimum, when you are dealing with the retail public, they are entitled to know that the financial services professional sitting across the table from them puts their, the customer's, interest first ahead of their own in all circumstances. There are some conflicts that perhaps can be disclosed. There are some conflicts that cannot be disclosed away in my view.

The duty that exists on the investment advisory side does not exist clearly on the broker-dealer side, and we need the law to make this a uniform fiduciary duty, and I am very hopeful that the Senate bill which does not have that provision right now will emerge with that provision in place. Right now we are required under the Senate bill to do a study. We are happy to study the issue, although I will say the SEC contracted with the RAND Corporation several years ago to do a study of this issue. So there is lots of work out there.

We will look at it again, but we would hope that when a study is done, it would trigger our ability to write the rules that would create a fiduciary duty if the study suggested that that is what is necessary. My personal bias, I will tell you out of the box, is that that is necessary.

Senator COLLINS. In writing this new rule, if we did, should we distinguish between individual retail investors for whom having that obligation is perhaps even more important because they are less sophisticated arguably than most institutional investors, or should it apply across the board?

Ms. SCHAPIRO. I think in the first instance, we have got to take care of retail investors. This is really a disgraceful situation in many ways.

But I would also note that in the Senate Agriculture Committee bill, there is a fiduciary duty that swap dealers owe to pension plans and municipalities, and that seems to me to be a very good idea.

So I think we could step this up over time to be broader, but I would start very clearly with retail.

Senator COLLINS. Thank you.

If you would provide me with a copy or provide the subcommittee with a copy of the RAND study, that would be helpful to us.

Ms. SCHAPIRO. I would be happy to do that.

[The information follows:]

The Rand Report on Investor and Industry Perspectives on Investment Advisers and Broker-Dealers can be found at the following website address: [http://www.rand.org/pubs/technical\\_reports/TR556.html](http://www.rand.org/pubs/technical_reports/TR556.html).

Senator COLLINS. Mr. Chairman, I apologize for exceeding my time.

I am going to submit a question on Allied Capital, that case which was also criticized by the inspector general, for the record and some other questions as well.

But thank you for the additional time.

Senator DURBIN. Senator Collins, thank you very much.

And let me just also say that I applaud your last line of questioning and believe that you have really touched on something that is absolutely essential. Maybe we can find some bipartisan ground to share here on this. I think I could support your effort, and I am glad to hear that the chairman believes it is a wise undertaking. So maybe we can build on that.

#### ADDITIONAL COMMITTEE QUESTIONS

The record of this subcommittee is going to be open until next Wednesday, so we may submit some written questions, and other members may join us.

In the meantime, thank you so much for being with us today.

Ms. SCHAPIRO. Thank you.

Senator DURBIN. Keep up your good work.

Ms. SCHAPIRO. Thank you.

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

#### QUESTIONS SUBMITTED BY SENATOR THAD COCHRAN

*Question.* There is a proposal in the financial reform bill that would make the SEC self-funded through the fees that it recovers. This effectively would exempt the SEC from Congressional appropriations and budgetary oversight. Before Congress decides to give up its constitutional responsibilities for directing Federal spending and providing necessary oversight over the Executive branch, we ought to know exactly what circumstances justify such an exemption for the SEC. What do you think those circumstances are?

It seems to me that, now more than ever, Congressional oversight is needed to “regulate the regulators” and to hold accountable those regulators who fail to do their jobs correctly. The SEC made many mistakes during the financial crisis. Recent reports by the Inspector General and others show that these problems were caused by mismanagement at the SEC, and not by any funding shortages. Shouldn’t Congress demand even more accountability of the SEC, rather than allowing the SEC to freely spend a greatly expanded budget?

*Answer.* As you know, the final Dodd-Frank Act that became law on July 21, 2010 did not include the self funding provision. That said, the Dodd-Frank Act does contain several funding reforms that I believe are very positive for the SEC. These improvements to the funding process should ensure appropriate Congressional oversight while addressing important issues regarding the agency’s funding. In particular, I am pleased that the Act will permit the SEC to provide information directly to the Committee regarding our funding requirements. I believe this enhanced communication will complement the ongoing Congressional oversight. I fully support these funding reforms and ensuring full transparency by the agency.

*Question.* The Office of the Inspector General identified several problems at the SEC, following its investigation of Stanford Financial. None of these involved inadequate funding or inadequate staffing at the SEC. Other recent reports identified senior-level employees using SEC computers to view pornography for hours a day when they should be protecting investors, and enforcement officials refusing to pur-

sue novel or more complicated cases. None of this suggests that if we give the SEC more funding, or the ability to fund itself, that the SEC's competence would improve as a result. Can you explain why Congress should give so much deference to the SEC, when it is plagued by these failures and mismanagement?

I am very troubled by the Inspector General's report 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 over 12 years before the SEC actually brought an enforcement action. The Inspector General found serious managerial, cultural, and performance-based problems at the SEC, which led to this terrible failure. First, what are you doing to help compensate the victims of the Stanford Financial fraud? And second, what steps are you taking to ensure that the performance problems identified in the Inspector General's report are corrected at the SEC?

Answer. The SEC is taking the situation of Stanford victims very seriously. In addition to working aggressively to maximize recovery to investors harmed by the Stanford fraud, Commission staff is studying all the facts relating to the *Stanford* case with respect to whether a legal basis exists for a SIPA liquidation of the registered broker-dealer, the Stanford Group Company. As part of this review, I have met with representatives of the Stanford Victims Coalition, and Commission staff also has met with a number of Stanford victims to discuss this matter. We continue to review the facts of the case to determine whether there is a statutory basis for providing SIPC coverage to the victims, and will continue to work with Congress in this regard.

With respect to the conduct that was discussed by the inspector general in the *Stanford* case, there were clearly many missed opportunities in the 1997 to 2005 period covered by the report. Since that time, much has changed regarding the agency's leadership, its internal procedures and its culture of collaboration. Even before the IG's report, the agency had taken a number of steps which address the concerns raised in the report. These steps include:

- Establishing escalation procedures and revamping the process for handling tips, complaints and referrals.
- Changing performance metrics so that quantity does not trump quality.
- Streamlining approval procedures in enforcement investigations.
- Establishing and consistently applying factors for referring matters to others agencies.
- Making effective use of other resources within the agency, such as economic and international experts.
- Training Enforcement Division staff on potential remedies available under the laws applicable to both investment advisers and broker-dealers.
- Sensitizing employees who leave the organization to their ongoing restrictions.

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#### QUESTIONS SUBMITTED BY SENATOR SUSAN COLLINS

*Question.* An Inspector General report found that the SEC did not properly pursue allegations made against Allied Capital, but instead went after the hedge fund manager who challenged the value of Allied Capital's investments. This allegedly occurred after heavy lobbying by Allied, who was represented by a former SEC official. These actions raise concerns about how decisions are made at the agency about bringing and conducting investigations.

What procedures and criteria does the Enforcement Division use to review and approve new investigations?

Answer. The Division pursues all information it receives concerning potential violations of the Federal securities laws and Commission rules. We generate and receive leads for new investigations through a variety of efforts, including research, market surveillance, examination referrals, and observation by Division staff. We also receive tips and other information from outside the Division and outside the agency.

Upon receipt of a Tip, Complaint or Referral ("TCR"), the Division's Office of Market Intelligence analyzes TCRs and triages the information provided, sometimes in consultation with other Divisions and Offices, to determine whether the information provided (along with any other similar information already available to the Commission) alleges a potential violation of the Federal securities laws or Commission Rules such that further review by an investigative group is warranted. If the information warrants further review, the Office of Market Intelligence assigns the TCR

to an investigative group that, among other things, analyzes the information to determine programmatic significance and resource availability.

When the investigative staff generates information or receives a TCR concerning potential violative conduct, the investigative staff determines whether to open a Matter Under Inquiry ("MUI") based on whether a sufficiently credible source or set of facts suggests that a MUI could lead to an enforcement action that would address a violation of the Federal securities laws. Basic considerations used when making this determination may include, but are not limited to:

- The statutes or rules potentially violated;
- The egregiousness of the potential violation;
- The potential magnitude of the violation;
- The potential losses involved or harm to an investor or investors;
- Whether the potentially harmed group is particularly vulnerable or at risk;
- Whether the conduct is ongoing;
- Whether the conduct can be investigated efficiently and within the statute of limitations period; and
- Whether other authorities, including Federal or State agencies or regulators, might be better suited to investigate the conduct.

While the threshold analysis for opening a MUI is relatively low, determining whether the MUI should be converted to an investigation or whether to open an investigation, is typically a more detailed evaluation that is based on additional information. The evaluation for whether to convert a MUI to an investigation (or open an investigation) turns on whether, and to what extent, the investigation has the potential to address violative conduct. Threshold issues for the investigative staff to consider when evaluating the facts include: (1) Do the facts suggest a possible violation of the Federal securities laws involving fraud or other serious misconduct? (2) If yes, is an investment of resources by the staff merited by: (a) the magnitude or nature of the violation, (b) the size of the victim group, (c) the amount of potential or actual losses to investors, (d) for potential insider trading, the amount of profits or losses avoided, or (e) for potential financial reporting violations, materiality? (3) If yes, is the conduct: (a) ongoing, or (b) within the statute of limitations period?

In addition to the threshold issues above, one way to determine whether the conduct is serious is to consider the following supplemental factors:

- Is there a need for immediate action to protect investors?
- Does the conduct undermine the fairness or liquidity? of the U.S. securities markets?
- Does the case involve a recidivist?
- Has the SEC or Division designated the subject matter to be a priority?
- Does the case fulfill a programmatic goal of the SEC and the Division?
- Does the case involve a possibly widespread industry practice that should be addressed?
- Does the matter give the SEC an opportunity to be visible in a community that might not otherwise be familiar with the SEC or the protections afforded by the securities laws?
- Does the case present a good opportunity to cooperate with other civil and criminal agencies?

Both senior management and frontline staff participate in the analysis to determine whether to open a MUI, to convert a MUI into an investigation, or to open an investigation. Leveraging the skill sets and experience of staff and management ensures that Division resources are efficiently utilized in the investigation of enforcement matters. This process gives the Division the ability to have a unified, coherent, coordinated response to the huge volume of information we generate or receive every day, thereby enhancing the Division's ability to open the right investigations, bring solid cases, and more effectively protect investors.

*Question.* How does the Commission evaluate the implementation of these procedures to ensure that the division is managing its operations efficiently?

*Answer.* Managing the flow of information into and throughout the Division is critical to effective operations within the Division. We have established systems and procedures that enable senior management to track a host of critical elements including the flow of information and the progress of investigations. For example, TCRs are now logged into a single, searchable database system. This allows management to track TCRs to ensure that each TCR is appropriately referred to the investigative staff, or otherwise resolved. The staff has been instructed as to procedures for memorializing their resolution decisions, which ensures that there is a record that can be audited.

Simultaneously, we have been working on a new intake and resolution system that will allow us to capture even more information about TCRs. The new system will provide more robust search capabilities so that TCRs can be better assessed or

triaged. In addition, this new system will add enhanced workflow abilities so we can track how TCRs are being used throughout the agency. We expect to deploy this system later this year. Meanwhile, we also are in the early stages of designing the third phase of this system, which will add risk analytics tools to help us quickly and efficiently identify high value tips and search for trends and patterns across the data.

We have also enhanced our ability to manage workflow to improve the oversight of our investigations. Senior management tracks all MUIs and investigations within the Division to ensure that resources are allocated appropriately, MUIs and investigations are conducted efficiently, and enforcement recommendations, or other resolutions, are completed timely. A bi-weekly report on MUI openings allows senior management to closely track new matters. Investigations are reviewed on a quarterly basis by senior management and the investigative staff. This review process ensures that robust investigative theories are developed, potential obstacles are identified early, and investigations advance appropriately. The quarterly review process also increases the Division's opportunities to coordinate enforcement efforts with other agencies.

Additionally, senior management designates certain investigations as National Priority investigations; these include, among others, cases of potential programmatic significance, where the alleged misconduct occurred in connection with products, markets, transactions or practices that pose particularly significant risks for investors or a systemically important sector of the market. The Office of the Director tracks National Priority investigations on a monthly basis to ensure swift and efficient resolution of these matters. The Director routinely meets with investigative staff and management assigned to each matter designated as a National Priority investigation.

In addition to the systems and procedures to manage TCRs and the progression of MUIs and investigations, the Division has implemented several methods to track routine investigative benchmarks such as issuing subpoenas, taking testimony, and making recommendations to the Commission. We implemented a practice whereby the staff must obtain the Director's approval before requesting an extension of a tolling agreement. Division management uses a Dashboard metric to continually measure the progress of the Division and we compare our progress to both our internal goals and past results.

#### SUBCOMMITTEE RECESS

Senator DURBIN. The subcommittee stands in recess.

[Whereupon, at 4:08 p.m., Wednesday, April 28, the subcommittee was recessed, to reconvene subject to the call of the Chair.]