Testimony on "Continued Oversight of the Implementation of the Wall Street Reform Act"
by
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Chairman Johnson, Ranking Member Shelby, and members of the Committee:

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

The Dodd-Frank Act makes significant changes in the regulatory landscape for the SEC. Among other things, the Act brings hedge fund and other private fund advisers under the regulatory umbrella of the Investment Advisers Act of 1940 ("Advisers Act"), creates a new whistleblower program, establishes an entirely new regime for the over-the-counter ("OTC") derivatives market, enhances the SEC's authority over nationally recognized statistical rating organizations ("NRSROs") and clearing agencies, and heightens regulation of asset-backed securities ("ABS").

To implement the Act, the SEC was tasked with writing a large number of new rules and conducting over twenty studies and reports. Over the past 16 months, we have made great progress towards completing those tasks. Of the more than 90 provisions in the Act that require SEC rulemaking, the SEC already has proposed or adopted rules for over three-fourths of those that are required. Additionally, the SEC has finalized twelve of the more than twenty studies and reports that the Act directs us to complete. While we have had much success, we continue our work to implement all provisions of the Act for which we have responsibility – even as we also perform our longstanding core responsibilities of pursuing securities violations, reviewing public company disclosures and financial statements, inspecting the activities of investment advisers, investment companies, broker-dealers and other registered entities, and maintaining fair and efficient markets.

In my prior opportunities to testify before this Committee about Dodd-Frank Act implementation, I outlined our efforts to modernize our internal processes to enable us to better accomplish both our preexisting responsibilities and those added by the Act. Among others, these efforts include the creation of new cross-disciplinary working groups; our focus on increasing transparency, consultation and public input; and the forging and strengthening collaborative relationships with other federal regulators and our international counterparts. To date, we have participated in scores of interagency and working group meetings, conducted seven public roundtables, met with hundreds of interested groups and individuals including investors, academics and industry participants, and received, reviewed and considered thousands of public comments.

[1] 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 full Commission.

The considerable progress we have made so far is the result of the exceptional work of my fellow Commissioners and our staff, whose extraordinary efforts have enabled us to accomplish so much in a relatively short time. While the Dodd-Frank Act added significantly to their workload, they have been implementing the Act in a thoughtful, thorough, and professional manner.

My testimony today will provide an overview of these activities, emphasizing the Commission's efforts since I last testified before this Committee on Dodd-Frank Act implementation in July.

Hedge Fund and Other Private Fund Adviser Registration and Reporting

The Dodd-Frank Act mandated that the Commission require private fund advisers (including hedge and private equity fund advisers) to confidentially report information about the private funds they manage for the purpose of the assessment of systemic risk by the Financial Stability Oversight Council ("FSOC"). On October 31, 2011, in a joint release with the CFTC, based on staff consultation with staff representing members of FSOC, the Commission adopted a new rule that requires hedge fund advisers and other private fund advisers registered with the Commission to report systemic risk information on a new form ("Form PF").[2] Under the new rule, Commission registered investment advisers managing at least $150 million in private fund assets will periodically file Form PF. The data collection will dovetail with the enhanced private fund reporting discussed below.

The Form PF reporting requirements are scaled to the adviser. Advisers with less than a certain amount of hedge fund, liquidity fund or private equity fund assets under management will report only very basic information on an annual basis. Advisers with assets under management over specified thresholds will report more information, and large hedge fund and liquidity fund advisers also will report on a quarterly basis. This approach is intended to provide FSOC with a broad picture of the industry while relieving smaller advisers from much of the reporting requirements. In addition, the reporting requirements are tailored to the types of funds that an adviser manages and the potential risks those funds may present, meaning that an adviser will respond only to questions that are relevant to its business model. The Dodd-Frank Act provides special confidentiality protections for this data. The initial stages of this reporting will begin next year.

In addition to this important reporting rule, the Commission already has completed many of the rulemakings required by the Dodd-Frank Act amendments to the Advisers Act.

- In June, the Commission adopted rules that: require the registration of, and reporting by, advisers to hedge funds and other private funds and other advisers previously exempt from SEC registration; require reporting by investment advisers relying on certain new exemptions from SEC registration; and reallocate regulatory responsibility to the state

[2] *See* Release No. IA-3308, *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF* (October 31, 2011), http://www.sec.gov/rules/final/2011/ia-3308.pdf.

securities authorities for advisers that have between $25M and $100M in assets under management.[3]

- Concurrently, the Commission adopted rules to implement new adviser registration exemptions created by the Dodd-Frank Act. The new rules implement new exemptions for: (i) advisers solely to venture capital funds; (ii) advisers solely to private funds with less than $150 million in assets under management in the United States; and (iii) certain foreign advisers without a place of business in the U.S. and with only a de minimis amount of U.S. business.[4]

- The Commission also adopted a new rule defining "family offices" – a group that historically has not been required to register as advisers – that will be excluded from the definition of an investment adviser under the Advisers Act.[5]

- In May, the Commission proposed changes to the rule that permits investment advisers to charge certain clients performance fees.[6] The rule's conditions already include minimum standards, such as net worth, that clients must satisfy for the adviser to charge these fees. The proposed amendments would incorporate the revised dollar amount levels that the Commission adjusted by order this past July to account for the effects of inflation, as required by the Dodd-Frank Act. The amendments also would remove the value of a client's primary residence from the calculation of net worth.

Staff Studies Regarding Investment Advisers and Broker-Dealers

In January 2011, the Commission submitted to Congress two staff studies in the investment management area as required under the Dodd-Frank Act.

The first study, mandated by Section 914, analyzed the need for enhanced examination and enforcement resources for investment advisers that are registered with the Commission.[7] It

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

[4] *See* Release No. IA-3222 *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers* (June 22, 2011), http://www.sec.gov/rules/final/2011/IA-3222.pdf.

[5] *See* Release No. IA-3220, *Family Offices* (June 22, 2011), http://www.sec.gov/rules/final/ia-3220.pdf.

[6] *See* Release No. IA-3198, *Investment Adviser Performance Compensation* (May 10, 2011), http://www.sec.gov/rules/proposed/2011/ia-3198.pdf.

[7] *See Study on Enhancing Investor Adviser Examinations* (January 2011), http://www.sec.gov/news/studies/2011/914studyfinal.pdf; *see also* Commissioner Elisse B. Walter, Statement on Study Enhancing Investment Adviser Examinations (Required by Section 914 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act) (Jan. 2010), http://www.sec.gov/news/speech/2011/spch011911ebw.pdf.

found that the Commission likely will not have sufficient capacity in the near or long term to conduct effective examinations of registered investment advisers with adequate frequency. Therefore, the study stated that the Commission's examination program requires a source of funding that is adequate to permit the Commission to meet new examination challenges and sufficiently stable to prevent adviser examination resources from continuously being outstripped by growth in the number of registered investment advisers.

The study highlighted the following three options to strengthen the Commission's investment adviser examination program: (1) imposing user fees on Commission-registered investment advisers to fund their examinations; (2) authorizing one or more self-regulatory organizations that assess fees on their members to examine, subject to Commission oversight, all Commission-registered investment advisers; or (3) authorizing FINRA to examine a subset of advisers – i.e., dually registered investment advisers and broker-dealers – for compliance with the Advisers Act.

The second staff study, required by Section 913 of the Dodd-Frank Act (the "IA/BD Study"), addressed the obligations of investment advisers and broker-dealers.[8] This study reviewed the broker-dealer and investment adviser industries, the regulatory landscape surrounding each, issues raised by stakeholders who commented during the preparation of the report, and other considerations.

The IA/BD Study made two primary recommendations: that the Commission (1) exercise its discretionary rulemaking authority to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when they are providing personalized investment advice about securities to retail investors; and (2) consider harmonization of broker-dealer and investment adviser regulation when broker-dealers and investment advisers provide the same or substantially similar services to retail investors and when such harmonization adds meaningfully to investor protection.

Under Section 913, the uniform fiduciary standard to which broker-dealers and investment advisers would be subject would be "no less stringent" than the standard that applies to investment advisers today.

As the IA/BD Study notes, the distinction between an investment adviser and a broker-dealer is often lost on investors, and it remains difficult to justify why there should be different rules and standards of conduct for the two roles – especially when the same or substantially similar services are being provided. Investment professionals' first duty must be to their clients, and we are giving serious consideration to the study's recommendations.

The staff is currently considering the contours of rulemaking following on the study, including the costs and benefits of options for rulemaking. The staff also is continuing to meet with academics, and industry and investor representatives who have an interest in or insights into the

[8] *See Study on Investment Advisers and Broker-Dealers* (January 2011), http://www.sec.gov/news/studies/2011/913studyfinal.pdf; *see also* Statement by SEC Commissioners Kathleen L. Casey and Troy A. Paredes Regarding Study on Investment Advisers and Broker-Dealers (January 21, 2011), http://www.sec.gov/news/speech/2011/spch012211klctap.htm.

results and recommendations of the study. In addition, the Commission's economists are considering available data that would help inform any potential rule recommendation.

Whistleblower Program

Section 922 of the Dodd-Frank Act established a whistleblower program that requires the SEC to pay an award to eligible whistleblowers who voluntarily provide the agency with original information about a violation of the federal securities laws that leads to a successful SEC enforcement action. The Act also required the Commission to promulgate rules to implement the program.

Our final rules, adopted in May, became effective on August 12, 2011. Since then, the Commission has received hundreds of tips through the whistleblower program from individuals all over the country and in many parts of the world. That, of course, is in addition to the tens of thousands of tips, complaints, and referrals the agency receives every year. Our new Office of the Whistleblower is reviewing these submissions and working with whistleblowers. The office recently filed its Annual Report to Congress detailing its many activities since its creation. These include, among other things, the establishment of an outreach program, internal training programs, development of policies and procedures, meeting with whistleblowers and their counsel, and coordination on investigations with Commission staff.

We already are reaping the early benefits of the whistleblower program through active and promising investigations utilizing crucial whistleblower information, some of which we hope may lead to rewards in the near future. In addition, the quality of the information we are receiving has, in many instances, enabled our investigative staff to work more efficiently, thereby allowing us to better utilize our resources.

Additional Investor Protection Provisions

The Commission continues to exercise its expanded enforcement authority by utilizing many of the other investor protection provisions contained in the Dodd-Frank Act. For example, we use our new "collateral bar" authority to bar or suspend persons who have engaged in serious misconduct in one segment of the financial services industry that the Commission regulates from other segments that the Commission also regulates.

In addition, the Commission has used its authority granted in Section 929P(a) to impose penalties in administrative cease and desist actions against non-regulated individuals and entities. Although the Commission could impose penalties against regulated persons administratively prior to Dodd-Frank, it could obtain penalties against non-regulated persons only in enforcement actions filed in district court. The Act now permits the Commission to obtain penalties against non-regulated violators of the federal securities laws in either forum. In one recent example of our exercise of this authority, the Commission imposed a $3 million administrative penalty against an alcoholic beverage producer for violations of the Foreign Corrupt Practices Act involving more than $2.7 million in illicit payments to government officials in India, Thailand and South Korea.[9] Prior to the Dodd-Frank Act, the Commission would not have been able to impose a penalty against the company in a cease-and-desist proceeding; that sanction would only have been available in a district court action. Accordingly, to obtain full relief, the Commission would have had to either file the entire action in district court or, alternatively, file two separate actions – one administrative and one civil. With the new authority granted in Section 929P(a), the Commission no longer has to file multiple actions or abandon what may be the more appropriate forum in order to obtain an appropriate penalty.

Section 929E of the Dodd-Frank Act allowed for nationwide service of process so that the SEC could compel a witness to appear at trial anywhere in the United States. This new tool has enhanced our enforcement efforts by providing our trial attorneys with greater access to key witnesses and documents at trial.

These are just a few examples of the many ways in which we are utilizing our expanded authority to more effectively protect investors. And, these new tools are augmenting our Enforcement Division's own, proactive initiatives to enhance its effectiveness by bringing more cases – and more significant cases – more swiftly and more efficiently. Indeed, in recently-ended fiscal year 2011, the SEC filed 735 enforcement actions – more enforcement actions than ever filed in a single year in SEC history. As a result of our aggressive enforcement activity, we obtained more than $2.8 billion in penalties and disgorgement ordered in fiscal year 2011.

OTC Derivatives

Among the key provisions of the Dodd-Frank Act are those that will establish a new oversight regime for the OTC derivatives marketplace. Title VII of the Dodd-Frank Act requires the Commission to work with other regulators – the CFTC in particular – to write rules that:

- Address, among other things, mandatory clearing, the operation of trade execution facilities and data repositories, business conduct standards for certain market intermediaries, capital and margin requirements, and public transparency for transactional information;
- Improve transparency and facilitate the centralized clearing of swaps, helping, among other things, to reduce counterparty risk and systemic risk that results from exposures by market participants to uncleared swaps;
- Enhance investor protection by increasing security-based swap transaction disclosure and helping to mitigate security-based swap conflicts of interest; and
- Allow the OTC derivatives market to continue to develop in a more transparent, efficient, and competitive manner.

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[9] *See In the Matter of Diageo Plc, Release No. 34-64978 (July 27, 2011)* http://www.sec.gov/litigation/admin/2011/34-64978.pdf

Title VII Implementation to Date

To date, the Commission has proposed rules in thirteen areas required by Title VII:

- Rules prohibiting fraud and manipulation in connection with security-based swaps;[10]
- Rules regarding trade reporting, data elements, and real-time public dissemination of trade information for security-based swaps that would lay out who must report security-based swaps, what information must be reported, and where and when it must be reported;[11]
- Rules regarding the obligations of security-based swap data repositories that would require them to register with the Commission and specify the extensive confidentiality and other requirements with which they must comply;[12]
- Joint rules with the CFTC regarding the definitions of swap and security-based swap dealers, and major swap and security-based swap participants;[13]
- Rules relating to mandatory clearing of security-based swaps that would establish a process for clearing agencies to provide information to the Commission about security-based swaps that the clearing agencies plan to accept for clearing;[14]
- Rules regarding the exception to the mandatory clearing requirement for hedging by end users that would specify the steps that end users must follow, as required under the Dodd Frank Act, to notify the Commission of how they generally meet their financial obligations when engaging in security-based swap transactions exempt from the mandatory clearing requirement;[15]
- Rules regarding the confirmation of security-based swap transactions that would govern the way in which certain of these transactions are acknowledged and verified by the parties who enter into them;[16]

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[10] *See* Release No. 34-63236, *Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps* (November 3, 2010), http://www.sec.gov/rules/proposed/2010/34-63236.pdf.

[11] *See* Release No. 34-63346, *Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information* (November 19, 2010), http://www.sec.gov/rules/proposed/2010/34-63346.pdf.

[12] *See* Release No. 34-63347, *Security-Based Swap Data Repository Registration, Duties, and Core Principles* (November 19, 2010), http://www.sec.gov/rules/proposed/2010/34-63347.pdf.

[13] *See* Release No. 34-63452, *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant,""Major Security-Based Swap participant" and "Eligible Contract Participant"* (December 7, 2010), http://www.sec.gov/rules/proposed/2010/34-63452.pdf.

[14] *See* Release No. 63557, *Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations* (December 15, 2010), http://www.sec.gov/rules/proposed/2010/34-63557.pdf.

[15] *See* Release No. 34-63556, *End-User Exception of Mandatory Clearing of Security-Based Swaps* (December 15, 2010), http://www.sec.gov/rules/proposed/2010/34-63556.pdf.

[16] *See* Release No. 34-63727, *Trade Acknowledgment and Verification on Security-Based Swap Transactions* (January 14, 2011), http://www.sec.gov/rules/proposed/2011/34-63727.pdf.

- Rules defining and regulating security-based swap execution facilities, which specify their registration requirements, and establish the duties and implement the core principles for security-based swap execution facilities specified in the Dodd-Frank Act;[17]
- Rules regarding certain standards that clearing agencies would be required to maintain with respect to, among other things, their risk management and operations;[18]
- Joint rules with the CFTC regarding further definitions of the terms "swap," "security-based swap," and "security-based swap agreement;" the regulation of mixed swaps; and security-based swap agreement recordkeeping;[19]
- Rules regarding business conduct that would establish certain minimum standards of conduct for security-based swap dealers and major security-based swap participants, including in connection with their dealings with "special entities," which include municipalities, pension plans, endowments and similar entities;[20]
- Rules regarding the registration process for security-based swap dealers and major security-based swap participants;[21] and
- Rules intended to address conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.[22]

The Commission adopted an interim final rule regarding the reporting of outstanding security-based swaps entered into prior to the date of enactment of the Dodd-Frank Act.[23] This interim final rule notifies certain security-based swap dealers and other parties of the need to preserve and report to the Commission or a registered security-based swap data repository certain information pertaining to any security-based swap that was entered into prior to the July 21, 2010 passage of the Dodd-Frank Act and whose terms had not expired as of that date.

[17] *See* Release No. 34-63825, *Registration and Regulation of Security-Based Swap Execution Facilities* (February 2, 2011), http://www.sec.gov/rules/proposed/2011/34-63825.pdf.

[18] *See* Release No. 34-64017, *Clearing Agency Standards for Operation and Governance* (March 2, 2011), http://www.sec.gov/rules/proposed/2011/34-64017.pdf.

[19] *See* Release No. 33-9204, *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping* (April 27, 2011), http://www.sec.gov/rules/proposed/2011/33-9204.pdf.

[20] *See* Release No. 34-64766, *Business Conduct Standards for Security-Based Swaps Dealer and Major Security-Based Swap Participants* (June 29, 2011), http://www.sec.gov/rules/proposed/2011/34-64766.pdf.

[21] *See* Release No. 34-65543, *Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants* (October 12, 2011), http://www.sec.gov/rules/proposed/2011/34-65543.pdf.

[22] *See* Release No. 34-63107, *Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC* (October 14, 2010), http://www.sec.gov/rules/proposed/2010/34-63107.pdf.

[23] *See* Release No. 34-63094, *Reporting of Security-Based Swap Transaction Data* (October 13, 2010), http://www.sec.gov/rules/interim/2011/34-63094.pdf.

In addition, to facilitate clearing of security-based swaps, the Commission has proposed rules providing exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for security-based swaps transactions involving certain clearing agencies satisfying certain conditions.[24] We also readopted certain of our beneficial ownership rules to preserve their application to persons who purchase or sell security-based swaps.[25]

Moreover, the Commission has taken a number of steps to provide legal certainty and avoid unnecessary market disruption that might otherwise have arisen as a result of final rules not having been enacted by the July 16 effective date of Title VII. Specifically, we have:

- Provided guidance regarding which provisions in Title VII governing security-based swaps became operable as of the effective date and provided temporary relief from several of these provisions;[26]
- Provided guidance regarding – and where appropriate, interim exemptions from – the various pre-Dodd-Frank provisions that would otherwise have applied to security-based swaps on July 16;[27] and
- Taken other actions to address the effective date, including extending certain existing temporary rules and relief to continue to facilitate the clearing of certain credit default swaps by clearing agencies functioning as central counterparties.[28]

Next Steps for Implementation of Title VII

While the Commission has made significant progress to date, much remains to be done to fully implement Title VII. First, we need to complete the core elements of our proposal phase, in

[24] *See* Release No. 33-9222, *Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies* (June 9, 2011), http://www.sec.gov/rules/proposed/2011/33-9222.pdf.

[25] *See* Release No. 34-64628, *Beneficial Ownership Reporting Requirements and Security-Based Swaps* (June 8, 2011), http://www.sec.gov/rules/final/2011/34-64628.pdf.

[26] *See* Release No. 34-64678, *Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps* (June 15, 2011), http://www.sec.gov/rules/exorders/2011/34-64678.pdf.

[27] *See* Release No. 34-64795, *Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment* (July 1, 2011), http://sec.gov/rules/exorders/2011/34-64795.pdf; and Release No. 33-9231, *Exemptions for Security-Based Swaps* (July 1, 2011), http://www.sec.gov/rules/interim/2011/33-9231.pdf.

[28] *See* Release No. 34-64796, *Order Pursuant to Section 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions from Clearing Agency Registration Requirements under Section 17A(b) of the Exchange Act for Entities Providing Certain Clearing Services for Security-Based Swaps* (July 1, 2011), http://sec.gov/rules/exorders/2011/34-64796.pdf; and Release No. 33-9232 *Extension of Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps* (July 1, 2011), http://www.sec.gov/rules/interim/2011/33-9232.pdf.

particular, rules related to the financial responsibility of security-based swap dealers and major security-based swap participants.

In addition, because the OTC derivatives market has grown to become a truly global market in the last three decades, we must continue to evaluate carefully the international implications of Title VII. Rather than deal with these implications piecemeal, we intend to address the relevant international issues holistically in a single proposal. The publication of such a proposal would give investors, market participants, foreign regulators, and other interested parties an opportunity to consider as an integrated whole our proposed approach to the registration and regulation of foreign entities engaged in cross-border transactions involving U.S. parties.

After proposing all of the key rules under Title VII, we intend to seek public comment on an implementation plan that will facilitate a roll-out of the new securities-based swap requirements in a logical, progressive, and efficient manner that minimizes unnecessary disruption and costs to the markets. Many market participants have advocated that the Commission adopt a phased-in approach, whereby compliance with Title VII's requirements would be sequenced. Commission staff is actively engaged in developing an implementation proposal that takes into consideration market participants' recommendations with regard to such sequencing.

Clearing Agencies

Title VIII of the Dodd-Frank Act provides for increased regulation of financial market utilities and financial institutions that engage in payment, clearing and settlement activities that are designated as systemically important. Clearing agencies play a critical role in the financial markets by ensuring that transactions settle on time and on agreed-upon terms. The purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability.

To promote the integrity of clearing agency operations and governance, the Commission proposed certain enhanced requirements for clearing agencies.[29] Specifically, the proposed rules would require clearing agencies to maintain certain standards with respect to risk management and operations, have adequate safeguards and procedures to protect the confidentiality of trading information, have procedures that identify and address conflicts of interest, require minimum governance standards for boards of directors, designate a chief compliance officer, and disseminate pricing and valuation information if the clearing agency performs central counterparty services for security-based swaps. Many of the proposed requirements would apply to all clearing agencies, while others would focus more specifically on clearing agencies that clear security-based swaps.

The proposal was the result of close work between the Commission staff and staffs of the CFTC and the Federal Reserve Board ("Board"). The proposed requirements are consistent with – and build on – current international standards, and they are designed to further strengthen the Commission's oversight of securities clearing agencies, promote consistency in the regulation of clearing organizations generally, and thereby help to ensure that clearing agency regulation

[29] *See* Release No. 34-64017, *Clearing Agency Standards for Operation and Governance* (March 3, 2011), http://www.sec.gov/rules/proposed/2011/34-64017.pdf.

reduces systemic risk in the financial markets. The comment period for the proposal ended on April 29, 2011 and we received approximately twenty-five comments. We expect to consider final rules and revisions in light of comments received in the near future.[30]

In addition, as directed by Title VIII, the SEC staff worked jointly with the staffs of the CFTC and the Board over the past year to develop a report to Congress reflecting recommendations regarding risk management supervision of clearing entities designated as systemically important by the FSOC – each called a "designated clearing entity" or "DCE". The staffs of the agencies met regularly and engaged in constructive dialogue to develop a framework for improving consistency in the DCE oversight programs of the SEC and CFTC, promoting robust risk management by DCEs, promoting robust risk management oversight by DCE regulators, and improving regulators' ability to monitor the potential effects of DCE risk management on the stability of the financial system of the United States. The joint report was submitted to Congress in July and recommended finalizing rulemakings to establish enhanced risk management for DCEs, formalizing the process for consultations and information sharing regarding DCEs, enhancing DCE examinations, and developing ongoing consultative mechanisms to promote understanding of systemic risk. The report should establish a strong framework for ongoing consultation and cooperation in clearing agency oversight among the Commission, the CFTC, and the Board, which in turn should help to mitigate systemic risk and promote financial stability.

Credit Rating Agencies

Under the Dodd-Frank Act, the Commission is required to undertake approximately a dozen rulemakings related to nationally recognized statistical rating organizations ("NRSROs"). The Commission adopted the first of these required rulemakings in January 2011,[31] and in May, the Commission published for public comment a series of proposed rules that would further implement this requirement.[32] The proposed rules are intended to strengthen the integrity of credit ratings by, among other things, improving their transparency. Under the Commission's proposals, NRSROs would, among other things, be required to:

- Report on their internal controls;
- Better protect against conflicts of interest;
- Establish professional standards for their credit analysts;

[30] The CFTC adopted final rules regarding standards for derivatives clearing organizations based on the applicable core principles on October 18, 2011. *See Derivatives Clearing Organization General Provisions and Core Principles*, 76 FR 69334 (November 8, 2011), http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-27536a.pdf.

[31] *See* Release No. 33-9175, *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (January 20, 2011), http://www.sec.gov/rules/final/2011/33-9175.pdf.

[32] *See* Release No. 34-64514, *Proposed Rules for Nationally Recognized Statistical Rating Organizations* (May 18, 2011), http://www.sec.gov/rules/proposed/2011/34-64514.pdf.

- Publicly provide – along with the publication of any credit rating – disclosure about the credit rating and the methodology used to determine it; and
- Provide enhanced public disclosures about the performance of their credit ratings.

In addition, the proposals would require disclosure concerning third-party due diligence reports for asset-backed securities.

The Dodd-Frank Act requires the SEC to conduct three studies relating to credit rating agencies. In December 2010, the Commission requested public comment on the feasibility and desirability of standardizing credit rating terminology.[33] The Commission received sixteen comment letters in response to this request, and Commission staff has reviewed the comments received and is working towards producing a final product. The Dodd-Frank Act also requires (1) a study, due in July 2012, about alternative compensation models for rating structured finance products and (2) a study, due in 2013, about NRSRO independence.

With respect to alternative compensation models, the Dodd-Frank Act directs the Commission to study the credit rating process for structured finance products and the conflicts associated with the "issuer-pay" and the "subscriber-pay" models. The Commission also must study the feasibility of establishing a system in which a public or private utility or a self-regulatory organization would assign NRSROs to determine the credit ratings for structured finance products. Accordingly, in May 2011 the Commission published a request for public comment on the feasibility of such a system, asking interested parties to provide comments, proposals, data and analysis.[34] The comment period ended on September 13, 2011. The Commission received twenty-nine comment letters in response to its request for comments, which Commission staff is currently reviewing.

The Dodd-Frank Act also requires every federal agency to review its regulations that require use of credit ratings as an assessment of the credit-worthiness of a security and undertake rulemakings to remove these references and replace them with other standards of credit worthiness that the agency determines are appropriate. The Commission has taken the following steps to fulfill this requirement:

- In July 2011, the Commission adopted rule amendments removing credit ratings as conditions for companies seeking to use short-form registration when registering non-convertible securities for public sale. Under the new rules, the test for eligibility to use Form S-3 or Form F-3 short-form registration is tied to the amount of debt and other non-convertible securities (other than equity) a particular company has sold in registered primary offerings within the previous three years, or that the company has outstanding that were issued in registered primary offerings.[35] In addition, prior to adoption of the

[33] *See* Release No. 34-63573, *Credit Rating Standardization Study* (December 17, 2010), http://sec.gov/rules/other/2010/34-63573.pdf.

[34] *See* Release No. 34-64456, *Solicitation of Comment to Assist in Study on Assigned Credit Ratings* (May 10, 2011), http://www.sec.gov/rules/other/2011/34-64456.pdf.

[35] *See* Release No. 33-9245, *Security Ratings* (July 27, 2011), http://www.sec.gov/rules/final/2011/33-9245.pdf

Act, in April 2010 the Commission proposed new requirements to replace the current credit rating references in shelf eligibility criteria for asset-backed security issuers with new shelf eligibility criteria.[36]

- In April 2011, the Commission proposed to remove references to credit ratings in rules concerning broker-dealer financial responsibility, distributions of securities, and confirmations of transactions.[37]

- In March 2011, the Commission proposed to remove credit ratings from rules relating to the types of securities in which a money market fund can invest.[38] This proposal includes amendments to Rule 2a-7, which governs the operation of money market funds and requires these funds to invest only in highly liquid, short-term investments of the highest quality. These proposed amendments would replace the current requirement that rated portfolio securities have received a first or second tier rating. They are designed to offer protections comparable to those provided by NRSRO ratings and to retain a degree of risk limitation similar to the current rule.

In September 2010, the Commission also adopted a rule amendment to remove communications with credit rating agencies from the list of excepted communications in Regulation FD, as required by Section 939B of the Dodd-Frank Act.[39]

Finally, the Dodd-Frank Act requires the SEC to conduct staff examinations of each NRSRO at least annually and to issue an annual report summarizing the exam findings. Our staff recently successfully completed the first cycle of these exams, and the Commission approved the publication of the staff's summary report of the examinations.[40] The staff will continue to focus on completing the statutorily mandated annual examinations of each NRSRO, including follow-up from prior examinations, and making public the summary report of those examinations.

[36] *See* Release No. 33-9117, *Asset-Backed Securities* (April 7, 2010), http://www.sec.gov/rules/proposed/2010/33-9117.pdf.

[37] *See* Release No. 34-64352, *Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934* (April 27, 2011), http://www.sec.gov/rules/proposed/2011/34-64352.pdf.

[38] *See* Release Nos. 33-9193; IC-29592, *References to Credit Ratings in Certain Investment Company Act Rules and Forms* (March 3, 2011), http://www.sec.gov/rules/proposed/2011/33-9193.pdf.

[39] *See* Release No. 33-9146, *Removal from Regulation FD of the Exemption for Credit Rating Agencies* (September 29, 2010), http://www.sec.gov/rules/final/2010/33-9146.pdf.

[40] *See 2011 Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization* (September 2011), http://www.sec.gov/news/studies/2011/2011_nrsro_section15e_examinations_summary_report.pdf.

Volcker Rule

In October 2011, the Commission proposed a rule jointly with the Federal banking agencies to implement Section 619 of the Dodd-Frank Act, commonly referred to as the "Volcker Rule."[41] This proposal reflects an extensive, collaborative effort by the Federal banking agencies, the SEC, the CFTC, and their respective staffs to design a rule to implement the Volcker Rule's prohibitions and restrictions in a manner that is consistent with the language and purpose of this complex statute. In developing this proposal, interagency staffs gave close and thoughtful consideration to the FSOC's January 2011 study and its recommendations for implementing Section 619.[42] As a result, the joint proposal builds upon many of the recommendations set forth in the FSOC study, including the use of quantitative measurements to distinguish prohibited proprietary trading from permitted market making-related activity and the requirement that banking entities develop robust programmatic compliance regimes.

As required by the statute, the joint proposal generally prohibits banking entities from engaging in proprietary trading and having certain interests in, and relationships with, hedge funds and private equity funds. The proposed rule also provides certain exceptions to these general prohibitions, consistent with the statute. For example, the proposal permits a banking entity to engage in underwriting, market making-related activity, risk-mitigating hedging, and organizing and offering a private equity fund or hedge fund, among other permitted activities, provided that specific requirements set forth in the proposed rule are met. Further, as established by Section 619, an otherwise-permitted activity would be prohibited under the proposed rule if it involved a material conflict of interest, high-risk assets or trading strategies, or a threat to the safety and soundness of the banking entity or to the financial stability of the United States. The proposal defines "material conflict of interest," "high-risk asset," and "high-risk trading strategy" for these purposes. As set forth in the Dodd-Frank Act, the Commission's rule would apply to banking entities for which the Commission is the primary financial regulatory agency. These banking entities include, among others, certain registered broker-dealers, investment advisers, and security-based swap dealers.

The joint proposal requests comment on a wide range of issues due, in part, to the complexity of the issues presented by the statute and the proposal. The comment period for this proposal ends on January 13, 2012. We look forward to receiving and considering public comment on this proposal and continuing to work with the other regulators to further refine the rule prior to adoption.

Municipal Advisors

Section 975 of the Dodd-Frank Act creates a new class of regulated persons, "municipal advisors," and requires these advisors to register with the Commission. This new registration

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[41] *See* Release No. 34-65545, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds* (October 12, 2011), http://www.sec.gov/rules/proposed/2011/34-65545.pdf.

[42] The FSOC Volcker Rule study and recommendations can be found at http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf.

requirement, which became effective on October 1, 2010, makes it unlawful for any municipal advisor, among other things, to provide advice to a municipal entity unless the advisor is registered with the Commission. In September 2010, the Commission adopted an interim final rule establishing a temporary means for municipal advisors to satisfy the registration requirement.[43] In December 2010, the Commission proposed a permanent rule that would create a new process by which municipal advisors must register with the SEC.[44] We have received over 1,000 comment letters on the proposal, including many that express concerns regarding the treatment of appointed officials and traditional banking products and services. We are giving these comments careful consideration before adopting a final rule. In addition, we are continuing to discuss many interpretive issues with other regulators and interested market participants so that the final rule will strike an appropriate balance by ensuring that parties engaging in municipal advisory activities are appropriately registered, without unnecessarily imposing additional regulation.

Asset-Backed Securities

The Commission has been active in implementing Subtitle D of Title IX of the Dodd-Frank Act, entitled "Improvements to the Asset-Backed Securitization Process." In August 2011**,** the Commission adopted rules in connection with Section 942(a) of the Dodd-Frank Act, which eliminated the automatic suspension of the duty to file reports under Section 15(d) of the 1934 Act for ABS issuers and granted the Commission authority to issue rules providing for the suspension or termination of this duty to file reports. The new rules permit suspension of the reporting obligations for ABS issuers when there are no longer asset-backed securities of the class sold in a registered transaction held by non-affiliates of the depositor.[45]

On March 30, 2011, the Commission joined its fellow regulators in issuing for public comment proposed risk retention rules to implement Section 941 of the Act.[46] Section 941, which is codified as new Section 15G of the Securities Exchange Act of 1934, generally requires the Commission, the Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and, in the case of the securitization of any "residential mortgage asset," the Federal Housing Finance Agency and Department of Housing and Urban Development, to jointly prescribe regulations that require a securitizer to retain not less than five percent of the credit risk of any asset that the securitizer – through the issuance of an asset-backed security – transfers, sells, or conveys to a third party. Section 15G also provides that the jointly prescribed

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[43] *See* Release No. 34-62824, *Temporary Registration of Municipal Advisors* (September 1, 2010), http://www.sec.gov/rules/interim/2010/34-62824.pdf.

[44] *See* Release No. 34-63576, *Registration of Municipal Advisors* (December 20, 2010), http://sec.gov/rules/proposed/2010/34-63576.pdf.

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

[46] *See* Release No. 34-64148, *Credit Risk Retention* (March 30, 2011), http://www.sec.gov/rules/proposed/2011/34-64148.pdf.

regulations must prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain.[47]

Under the proposed rules, a sponsor generally would be permitted to choose from a menu of four risk retention options to satisfy its minimum five percent risk retention requirement. These options were designed to provide sponsors with flexibility while also ensuring that they actually retain credit risk to align incentives. The proposed rules also include three transaction-specific options related to securitizations involving revolving asset master trusts, asset-backed commercial paper conduits, and commercial mortgage-backed securities. Also, as required by Section 941, the proposal provides a complete exemption from the risk retention requirements for ABS collateralized solely by "qualified residential mortgages" (or QRMs) and establishes the terms and conditions under which a residential mortgage would qualify as a QRM. We have received a number of comments regarding the QRM exemption, which we will carefully consider as we move forward with the interagency rulemaking process. Although the original comment period was scheduled to close on June 10, 2011, in light of requests from various sources for an extension to allow sufficient time for data gathering and impact analyses related to the provisions of the proposed rule, we extended the comment period to August 1, 2011.

The Commission also adopted rules in January 2011 implementing Section 943, on the use of representations and warranties in the market for ABS,[48] and Section 945, which requires an asset-backed issuer in a Securities Act registered transaction to perform a review of the assets underlying the ABS and disclose the nature of such review.[49]

We also are working on rules requiring the disclosure of asset-level information regarding the assets backing each tranche or class of security.[50]

Prohibition against Conflicts of Interest in Certain Securitizations

In September 2011, the Commission proposed a rule to implement the prohibition under Section 621 of the Dodd-Frank Act, which prohibits entities that create and distribute asset-backed

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[47] *See* § 78o-11(c)(1)(A).

[48] *See* Release No. 33-9175, *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (January 20, 2011), http://www.sec.gov/rules/final/2011/33-9175.pdf.

[49] *See* Release No. 33-9176, *Issuer Review of Assets in Offerings of Asset-Backed Securities* (January 20, 2011), http://www.sec.gov/rules/final/2011/33-9176.pdf.

[50] *See* Section 942(b) of the Dodd-Frank Act. In April 2010, the Commission proposed, among other things, to require that, with some exceptions, prospectuses for public offerings of ABS and ongoing Exchange Act reports contain specified asset-level information about each of the assets in the pool. *See* Release No. 33-9117, *Asset-Backed Securities* (April 7, 2010), http://www.sec.gov/rules/proposed/2010/33-9117.pdf. In July 2011, the Commission requested additional comment on the 2010 proposals relating to asset-level data in light of Section 942(b) and comments received on the 2010 proposals. *See* Release No. 33-9244, *Re-proposal of Shelf Eligibility Conditions for Asset-Backed Securities and Other Additional Requests for Comment* (July 26, 2011), http://www.sec.gov/rules/proposed/2011/33-9244.pdf. The proposals, if adopted, would implement the requirements for registered offerings of Section 942(b).

securities from engaging in transactions that involve or result in material conflicts of interest with respect to the investors in such asset-backed securities.[51] The proposed rule would implement this provision by prohibiting underwriters, placement agents, initial purchasers, sponsors of an asset-backed security, or any affiliate or subsidiary of such entity from engaging in any transaction that would involve or result in any material conflicts of interest with respect to any investor in the relevant asset-backed security. These entities, referred to as "securitization participants," assemble, package and distribute asset-backed securities, and so may benefit from the activity that Section 621 is designed to prohibit. The prohibition would apply to both non-synthetic and synthetic asset-backed securities and would apply to both registered and unregistered offerings of asset-backed securities.

Under the proposal, a conflict of interest would arise if a securitization participant would benefit directly or indirectly from either the actual, anticipated, or potential (a) adverse performance of the asset pool supporting or referenced by the relevant asset-backed security, (b) loss of principal, monetary default or early amortization event on the asset-backed security, or (c) decline in the market value of the asset-backed security; ***or*** as a result of allowing a third party, directly or indirectly, to structure the relevant asset-backed security or select assets underlying the asset-backed security in a way that facilitates or creates an opportunity for that third party to benefit from a short transaction. The conflict would be material if there is a substantial likelihood that a reasonable investor would consider the conflict important to his or her investment decision.

The proposed rule contains three exceptions mandated by the statute for bona fide market-making, liquidity commitments and risk-mitigating hedging activities. In developing the proposal, we considered comments received in response to the Commission's general solicitation of comments on the implementation of the Dodd-Frank Act. Commenters suggested that applying the statutory prohibition in a broad manner might impair the asset-backed securities market. The proposal is not intended to prohibit legitimate securitization activities, but rather, to prohibit the type of conduct at which Section 621 is aimed. We asked many questions in the release to ensure that we strike the right balance of prohibiting the type of conduct at which the statute is targeted without restricting other securitization activities.

The Commission looks forward to public comment regarding this proposal, including comment on the potential interplay between this proposal and Section 619 of the Dodd-Frank Act. The 90-day comment period for this rule ends on December 19, 2011.

Corporate Governance and Executive Compensation

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

- **Say on Pay.** The Commission adopted rules in January 2011 that require, in accordance with Section 951 of the Act, public companies subject to the federal proxy rules to provide a shareholder advisory "say-on-pay" vote on executive compensation, a separate

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

shareholder advisory vote on the frequency of the say-on-pay vote, and disclosure about, and a shareholder advisory vote to approve, compensation related to merger or similar transactions, known as "golden parachute" arrangements.[52] The Commission also proposed rules to implement the Section 951 requirement that institutional investment managers report their votes on these matters at least annually.[53]

- **Compensation Committee and Adviser Requirements.** Section 952 requires the Commission to, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer that does not comply with new compensation committee and compensation adviser requirements. In March 2011, the Commission issued a proposal to implement Section 952 that would require the exchanges to establish listing standards that require each member of a listed issuer's compensation committee to be a member of the board of directors and to be "independent."[54]

  The proposed rules also would direct the exchanges to prohibit the listing of any equity security of any issuer that is not in compliance with certain requirements relating to compensation committees and compensation advisers. The proposal also would amend the Commission's existing compensation consultant disclosure rules to require disclosure about whether the issuer's compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflicts of interest; and, if so, the nature of any such conflict and how it is being addressed. The comment period for the proposal ended on May 19, 2011, and the staff is currently developing recommendations for final rules.

- **Incentive-Based Compensation Arrangements**. Section 956 of the Dodd-Frank Act requires the Commission along with six other financial regulators to jointly adopt regulations or guidelines governing the incentive-based compensation arrangements of certain financial institutions, including broker-dealers and investment advisers with $1 billion or more of assets. Working with the other regulators, in March the Commission published for public comment a proposed rule that would address such arrangements. The Commission has received voluminous comment letters on the proposed rule, and the Commission staff, together with staff from the other regulators, is carefully considering the issues and concerns raised in those comments before adopting final rules.

- **Prohibition on Broker Voting of Uninstructed Shares**. Section 957 of the Act requires the rules of each national securities exchange to be amended to prohibit brokers from voting uninstructed shares on the election of directors (other than uncontested elections of directors of registered investment companies), executive compensation matters, or any

[52] *See* Release No. 33-9178, *Shareholder Approval of Executive Compensation and Golden Parachute Compensation* (January 25, 2011), http://www.sec.gov/rules/final/2011/33-9178.pdf.

[53] *See* Release No. 34-63123, *Reporting of Proxy Votes on Executive Compensation and Other Matters* (October 18, 2010), http://www.sec.gov/rules/proposed/2010/34-63123.pdf.

[54] *See* Release No. 33-9199, *Listing Standards for Compensation Committees* (March 30, 2011), http://www.sec.gov/rules/proposed/2011/33-9199.pdf.

other significant matter, as determined by the Commission by rule. To date, the Commission has approved changes to the rules with regard to director elections and executive compensation matters for most of the national securities exchanges,[55] and we anticipate that corresponding changes to the rules of the remaining national securities exchanges will be considered by the Commission in the near future.

The Commission also is required by the Act to adopt several additional rules related to corporate governance and executive compensation, including rules mandating new listing standards relating to specified "clawback" policies,[56] and new disclosure requirements about executive compensation and company performance,[57] executive pay ratios,[58] and employee and director hedging.[59] These provisions of the Act do not contain rulemaking deadlines, but the staff is working on developing recommendations for the Commission concerning the implementation of these provisions of the Act.

Specialized Disclosure Provisions

Title XV of the Act contains specialized disclosure provisions related to conflict minerals, coal or other mine safety, and payments by resource extraction issuers to foreign or U.S. government entities. The Commission published rule proposals for the three specialized disclosure requirements in December 2010, and the comment period ended on March 2, 2011.[60] In October, the Commission hosted a public roundtable to discuss key issues related to the conflict mineral rulemaking, including what is covered by the rule, what steps will be required to comply with the rule, and reporting under the rule. In connection with the roundtable, the Commission

[55] *See* Release No. 34-62874 (September 9, 2010), http://www.sec.gov/rules/sro/nyse/2010/34-62874.pdf (New York Stock Exchange); Release No. 34-62992 (September 24, 2010), http://www.sec.gov/rules/sro/nasdaq/2010/34-62992.pdf (NASDAQ Stock Market LLC); Release No. 34-63139 (October 20, 2010), http://www.sec.gov/rules/sro/ise/2010/34-63139.pdf (International Securities Exchange); Release No. 34-63917 (February 16, 2011), http://www.sec.gov/rules/sro/cboe/2011/34-63917.pdf (Chicago Board Options Exchange); Release No. 34-63918 (February 16, 2011), http://www.sec.gov/rules/sro/c2/2011/34-63918.pdf (C2 Options Exchange, Incorporated); Release No. 34-64023 (March 3, 2011), http://www.sec.gov/rules/sro/bx/2011/34-64023.pdf (NASDAQ OMX BX, Inc.); Release No. 34-64121 (March 24, 2011), http://www.sec.gov/rules/sro/chx/2011/34-64121.pdf (Chicago Stock Exchange); Release No. 34-64122 (March 24, 2011), http://www.sec.gov/rules/sro/phlx/2011/34-64122.pdf (NASDAQ OMX PHLX LLC); Release No. 34-64186 (April 5, 2011), http://www.sec.gov/rules/sro/edgx/2011/34-64186.pdf (EDGX Exchange); Release No. 34-64187 (April 5, 2011), http://www.sec.gov/rules/sro/edga/2011/34-64187.pdf (EDGA Exchange); Release No. 34-65804 (November 22, 2011), http://www.sec.gov/rules/sro/nsx/2011/34-65804.pdf (National Stock Exchange, Inc.).

[56] *See* Section 954 of the Dodd-Frank Act.

[57] *See* Section 953(a) of the Dodd-Frank Act.

[58] *See* Section 953(b) of the Dodd-Frank Act.

[59] *See* Section 955 of the Dodd-Frank Act.

[60] *See* Release No. 34-63547, *Conflict Minerals* (December 15, 2010), http://www.sec.gov/rules/proposed/2010/34-63547.pdf; Release No. 33-9164, *Mine Safety Disclosure* (December 15, 2010), http://www.sec.gov/rules/proposed/2010/33-9164.pdf, Release No. 34-63549, *Disclosure of Payments by Resource Extraction Issuers* (December 15, 2010), http://www.sec.gov/rules/proposed/2010/34-63549.pdf.

reopened the comment period until November 1, 2011 to allow comments to be submitted on the matters discussed at the roundtable. On all three of these rulemakings, the staff is developing recommendations for the Commission's consideration.

Exempt Offerings

Under Section 926 of the Act, the Commission is required to adopt rules that disqualify securities offerings involving certain "felons and other 'bad actors'" from relying on the safe harbor from Securities Act registration provided by Rule 506 of Regulation D. The Commission proposed rules to implement the requirements of Section 926 on May 25, 2011.[61] Under the proposal, the disqualifying events include certain criminal convictions, court injunctions and restraining orders; certain final orders of state securities, insurance, banking, savings association or credit union regulators, federal banking agencies or the National Credit Union Administration; certain types of Commission disciplinary orders; suspension or expulsion from membership in, or from association with a member of, a securities self-regulatory organization; and certain other securities-law related sanctions. The comment period for this rule proposal ended on July 14, 2011 and the staff is currently developing recommendations for final rules.

In addition, the Commission proposed rule amendments in January that would implement Section 413(a) of the Act, which requires the Commission to exclude the value of an individual's primary residence when determining if that individual's net worth exceeds the $1 million threshold required for "accredited investor" status.[62] The comment period on this proposal ended on March 11, 2011 and the staff is preparing final rule recommendations for the Commission. This section was effective on the date of enactment of the Dodd-Frank Act; the implementing rules are designed to clarify the requirements and codify them in the Commission's rules.

Financial Stability Oversight Council

In addition to the rulemaking activity described above, Title I of the Dodd-Frank Act created the FSOC, and with it, a formal structure for coordination among the various financial regulators to monitor systemic risk and to promote financial stability across our nation's financial system. FSOC has the following primary responsibilities:

- Identifying risks to the financial stability of the United States that could arise from the material financial distress or failure – or ongoing activities – of large, interconnected bank holding companies or nonbank financial holding companies, or that could arise outside the financial services marketplace;
- Promoting market discipline by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the government will shield them from

[61] *See* Release No. 33-9211, *Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings* (May 25, 2011), http://www.sec.gov/rules/proposed/2011/33-9211.pdf.

[62] *See* Release No. 33-9177, *Net Worth Standard for Accredited Investors* (January 25, 2011), http://www.sec.gov/rules/proposed/2011/33-9177.pdf.

losses in the event of failure (*i.e.*, addressing the moral hazard problem of "too big to fail"); and
- Identifying and responding to emerging threats to the stability of the United States financial system.[63]

As Chairman of the SEC, I am a voting member of FSOC. Senior SEC staff and I have actively participated in the FSOC and found its focus on identifying and addressing risks to the financial system to be important and helpful to the SEC as a capital markets regulator. The FSOC also has fostered a healthy and positive sense of collaboration among the financial regulators, facilitating cooperation and coordination for the benefit of investors and our overall financial system. Since passage of the Dodd-Frank Act, the FSOC has taken steps to create an organizational structure, coordinate interagency efforts, and build the foundation for meeting its statutory responsibilities.

For example, SEC staff worked with staff at other FSOC agencies on the October release of FSOC's second notice of proposed rulemaking regarding systemically important non-bank financial institutions ("non-bank SIFIs"). This release proposes the processes and considerations by which FSOC will designate non-bank SIFIs for heightened supervision by the Board. As proposed, nonbank financial companies will generally be assessed in a three-stage process:

- Stage 1: FSOC will apply uniform quantitative thresholds using publicly available data to identify those nonbank financial companies that will be subject to further evaluation.

- Stage 2: FSOC will further analyze the nonbank financial companies identified in Stage 1 using a broader range of information available primarily through existing public and regulatory sources.

- Stage 3: FSOC will contact each nonbank financial company that FSOC believes merits further review to collect information directly from the company that was not available in the earlier stages. At the end of Stage 3, based on the results of the analyses conducted during each stage of review, FSOC may vote to make a determination regarding the company.

Financial Market Utilities ("FMUs") are essential to the proper functioning of the nation's financial markets.[64] These utilities form critical links among marketplaces and intermediaries that can strengthen the financial system by reducing counterparty credit risk among market participants, creating significant efficiencies in trading activities, and promoting transparency in financial markets. However, FMUs by their nature create and concentrate new risks that could affect the stability of the broader financial system. To address these risks, Title VIII of the Dodd-Frank Act provides important new enhancements to the regulation and supervision of FMUs designated as systemically important by FSOC ("DFMUs") and of payment, clearance

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[63] *See* Dodd-Frank Act § 112(a)(1).

[64] Section 803(6) of the Dodd-Frank Act defines a financial market utility as "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person."

and settlement activities. This enhanced authority in Title VIII should provide consistency, promote robust risk management and safety and soundness, reduce systemic risks, and support the stability of the broader financial system.[65] Importantly, the enhanced authority in Title VIII is designed to be in addition to the authority and requirements of the Securities Exchange Act and Commodity Exchange Act that may apply to FMUs and financial institutions that conduct designated activities.[66]

FSOC established an interagency DFMU committee to develop a framework for the designation of systemically important FMUs, in which staff from the SEC has actively participated. The FSOC finalized the rule establishing a designation process for FMUs in July,[67] after first publishing an advanced notice of proposed rulemaking seeking public comment on the designation process generally, and a notice of proposed rulemaking seeking public comment on the specific process it proposed to follow when reviewing the systemic importance of FMUs.

New Commission Offices

In addition to the Whistleblower Office mentioned above, the Dodd-Frank Act requires the Commission to create four new offices within the Commission, specifically, the Office of Credit Ratings, Office of the Investor Advocate, Office of Minority and Women Inclusion, and Office of Municipal Securities. As each of these offices is statutorily required to report directly to the Chairman, the creation of these offices has been subject to approval by the Commission's Appropriations subcommittees.

As discussed below, both Congressional Appropriations committees approved creation of the Office of Minority and Women Inclusion in FY 2011 in July and we created that office soon thereafter.

As for the remaining three offices, the SEC's pending FY 2012 request, if approved, would allow the agency to establish the offices at levels adequate to enable those offices to execute their new responsibilities. In the meantime, the initial functions of these offices are being performed on a limited basis by other divisions and offices.

Office of Minority and Women Inclusion

Section 342 of the Act requires that we establish an Office of Minority and Women Inclusion. In mid-July 2011, the House and Senate Appropriations Committees approved the SEC's reprogramming request to create such an office. Shortly after, the SEC established its Office of Minority and Women Inclusion (OMWI). OMWI is currently staffed by two full-time employees and an Acting Director. A nationwide search for a permanent Director of the Office

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[65] *See* Dodd-Frank Act § 802.

[66] *See* Dodd-Frank Act § 805.

[67] *See* Release *Authority to Designate Financial Market Utilities as Systemically Important* (July 18, 2011), http://www.treasury.gov/initiatives/Documents/Finalruledisclaimer7-18-2011.pdf.

is underway and our hope is to be able to announce a selection by the end of the year. Although OMWI is a separate unit from the agency's EEO Office, due to budgetary restrictions, resource challenges, and the fact that the EEO Director has been designated as OMWI Acting Director, OMWI is presently housed in our EEO Office space. A benefit from this arrangement is that OMWI is able to leverage EEO Office resources to implement its requirements under Section 342.

OMWI has been collaborating with a number of SEC divisions and offices to meet the requirements of Section 342, including, but not limited to, the Office of the Chairman, Division of Enforcement, Division of Corporation Finance, Office of Investor Education and Advocacy, Office of Human Resources, Office of Acquisitions, Office of Financial Management, Office of General Counsel, and Office of Information Technology. This collaboration ranges from providing guidance and input on the standards to be developed under Section 342, to supporting OMWI's infrastructural needs (data systems and data feeds), to actual participation in a number of diversity and pipeline development initiatives.

OMWI continues to make strides to enhance the inclusion of minorities and women in the workforce and business activities of the agency. Since OMWI's establishment, the SEC has sponsored or participated in approximately 20 events to recruit diverse talent or diverse suppliers, including, but not limited to:

- Hispanic National Bar Association Annual Convention
- National Black MBA Association, DC Chapter Pre-Conference Career Expo
- National Association of Asian MBAs Annual Leadership Conference
- National LGBT Bar Association Lavender Law Conference
- National Association of Minority and Women Owned Law Firms Annual Meeting
- Minority Corporate Counsel Association Annual Diversity Conference
- Corporate Counsel Women of Color Annual Career Strategies Conference

Cost-Benefit Analyses

We are keenly aware that our rules have both costs and benefits, and that the steps we take to protect the investing public also impact financial markets and industry participants who must comply with our rules. This is truer than ever given the scope, significance and complexity of the Dodd-Frank Act requirements. Our Division of Risk, Strategy, and Financial Innovation ("RSFI") directly assists in the rulemaking process by helping to develop the conceptual framing for, and assisting in the subsequent writing of, the economic analysis sections.

Economic analysis of agency rules considers the direct and indirect costs and benefits of the Commission's proposed regulations against alternative approaches, including, the effects on competition, efficiency and capital formation. Analysis of the likely economic effects of proposed rules, while critical to the rulemaking process, can be challenging. Certain costs or benefits may be difficult to quantify or value with precision, particularly those that are indirect or intangible. In light of recent court decisions, RSFI and the rule writing divisions are examining potential improvements in the economic analysis the SEC employs in rulemaking. Although the existing procedures and policies are designed to provide a rigorous and transparent economic analysis, we are taking steps to improve this process so that future rules are consistent with best practices in economic analysis.

When engaging in rulemaking, the Commission invites the public to comment on our analysis and provide any information and data that may better inform our decision making. In adopting releases, the Commission responds to the information provided and revises its analysis as appropriate. This approach promotes a regulatory framework that strikes the right balance between the costs and the benefits of regulation.[68]

Funding for Implementation of the Dodd-Frank Act

The provisions of the Dodd-Frank Act expand the SEC's responsibilities and will require significant additional resources to fully implement the law. To date, the SEC has proceeded with the first stages of implementation without the necessary additional funding. As described above, implementation up to this point has largely involved performing studies, analysis, and the writing of rules. These tasks have taken staff time away from other responsibilities, and have been done almost entirely with existing staff and without sufficient investments in areas such as information technology.

It is, of course, incumbent upon us to use our existing resources efficiently and effectively as we strive to fulfill statutory mandates, protect investors and achieve our mission. That said, the new responsibilities assigned to the agency under the Dodd-Frank Act are so significant that they cannot be achieved solely by wringing efficiencies out of the existing budget without also severely hampering our ability to meet our existing responsibilities.[69]

If the SEC does not receive additional resources, many of the issues highlighted by the financial crisis and which the Dodd-Frank Act seeks to fix will not be adequately addressed, as the SEC will not be able to build out the technology and hire the industry experts and other staff desperately needed to oversee and police these new areas of responsibility.[70]

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[68] After reviewing cost benefit analyses included in six of our Dodd-Frank Act rulemaking releases, the SEC's Inspector General issued a report in June 2011. While the Office of Inspector General ("OIG") is continuing to review the Commission's cost benefit analyses, this report concluded that "a systematic cost-benefit analysis was conducted for each of the six rules reviewed. Overall, [the OIG] found that the SEC formed teams with sufficient expertise to conduct a comprehensive and thoughtful review of the economic analysis of the six proposed released that [the OIG] scrutinized in [its] review." *See* U.S. SEC Office of the Inspector General, *Report of Review of Economic Analyses Performed by the Securities and Exchange Commission in Connection with Dodd-Frank Rulemakings* (June 13, 2011) http://www.sec-oig.gov/Reports/AuditsInspections/2011/Report_6_13_11.pdf at 43. We look forward to continuing to work with the OIG as it conducts a further review.

[69] As discussed below, this resource gap was highlighted in the report prepared by the Boston Consulting Group pursuant to Section 967 of the Act.

[70] For instance, the Dodd-Frank Act also established a $50 million SEC Reserve Fund to allow the SEC to invest in multi-year IT projects and respond to unexpected market events (such as the May 6th market plunge). If this fund is eliminated or the SEC is not permitted to access the fund, it would have significant consequences for important IT projects, such as modernizing the SEC's EDGAR system and sec.gov to strengthen business processes, enhance their usefulness for the public and for SEC staff, and reduce long-term operations and maintenance costs. Without

The Dodd-Frank Act requires that the SEC collect transaction fees to offset the annual appropriation to the SEC. Accordingly, regardless of the amount appropriated to the SEC, the appropriation will be fully offset by the fees that we collect and therefore will have no impact on the nation's budget deficits.

Section 967 Organizational Assessment

Section 967 of the Act directed the agency to engage the services of an independent consultant to study a number of specific SEC internal operations. Boston Consulting Group, Inc. ("BCG") performed the assessment and provided recommendations earlier this spring. Since that time, we have undertaken a comprehensive approach to assessing the recommendations, with the work organized around four principal goals: optimizing the agency's mission and structure; strengthening capabilities; improving controls and efficiency; and enhancing the workforce. Between May and November of this year we have focused on the program infrastructure, and we have created 17 distinct working groups that have analyzed various components of the BCG recommendations. The work streams are led by senior SEC staff members, each tasked with developing the proposed agency approach to a specific BCG recommendation. Additionally, we have created an Executive Steering Committee (ESC) comprised of cross-agency senior leadership to guide the efforts of the work streams, expand the approaches to the broader Commission, and ultimately recommend approval of each approach to me. Many of the working groups currently are preparing recommendations for consideration by the ESC, and we anticipate implementing many of these approaches in early 2012.

We have already made progress on implementing several of the BCG report recommendations, including:

- redesigning the Office of Information Technology to emphasize increased alignment with internal clients, improved coordination with IT groups located within the program offices, and increased efficiencies through centralization of application development and project management;

- establishing a Continuous Improvement Program to systemically reduce unnecessary costs throughout the organization;

- conducting comprehensive assessments of the Office of Administrative Services, Office of Financial Management, and Office of Human Resources operations;

- implementing a new performance management system and conducted extensive staff training to assist with the transition to the new system;

- empowering the Chief Operating Officer (OCOO) by consolidating the former Office of the Executive Director under the OCOO organization; and

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these investments, our ability to resolve longstanding inadequacies in these systems and bring important benefits to the investing public would be significantly hindered.

- focusing our limited external hiring opportunities on filling strategic, high priority skill vacancies, to include obtaining specialized industry expertise in areas such as over the counter derivatives.

It is important to remember that the BCG study estimated that between $42 and $55 million would be required over an approximately two-year period to fully implement their recommendations. This cost estimate, however, also does not include the significant amount of SEC staff time that would be needed to accomplish this. We recognize that implementation of many of the ideas in the BCG study will require a long-term commitment and sustained effort over several years to successfully implement. We are committed to an open and transparent process, and consistent with the statute we intend to report to Congress on a regular basis on the actions we take in response to the study.

Conclusion

Though the SEC's efforts to implement the Dodd-Frank Act have been extensive, we know that there is still work left to be done and we are committed to finishing the job. Thank you for inviting me to share with you our progress to date and our plans going forward. I look forward to answering your questions.