

**Statement of the Securities and Exchange Commission
before the
House Financial Services Committee**

June 26, 2007

Chairman Frank, Ranking Member Bachus and Members of the Committee:

We are pleased to be here today to discuss the important work the Securities and Exchange Commission is doing to protect investors, foster efficient markets, and promote capital formation.

The initiatives underway at the Commission have a common theme: they are aimed at benefiting investors whose returns are dependent on healthy, well-functioning markets. This is the SEC's traditional responsibility. Back in Joseph Kennedy's day, our first SEC Chairman was amazed that "one person in every ten" owned stocks. But today, more than half of all households own securities.

In fact, when one considers the staggering growth in Americans' participation in the markets, the enormity of the SEC's task becomes apparent. About 3,600 staff at the SEC are responsible for overseeing more than 10,000 publicly traded companies, more than 10,000 investment advisers that manage more than \$37 trillion in assets, nearly 1,000 fund complexes, 6,000 broker-dealers with 172,000 branches, and the \$44 trillion worth of trading conducted each year on America's stock and options exchanges.

Perhaps the most striking development that is underway in our markets is that they are becoming increasingly interconnected with other global markets, and at an accelerating rate. This is challenging the United States and securities regulators around the world to collaborate more closely than ever before. Investors have much to gain in a truly global marketplace, but there are many risks and pitfalls as well. Not only issuers of securities and providers of capital, but fraud artists as well, have gone international.

Over the past year, a number of reports have been published which advise the SEC and Congress on how to deal with increasingly global capital markets. They have offered the Commission and policymakers in Congress and the Executive Branch many recommendations, and undoubtedly more such recommendations are on the way. While we may not individually agree with each of the recommendations and conclusions of these reports, we take seriously the detailed study that has gone into these analyses, as we do the constant and varied advice that is offered to the Commission from investors, issuers, accountants, attorneys, analysts, brokers, investment advisers, consumer advocates, and the host of financial services providers and consumers that comprise an important part of the jurisdiction of this Committee as well.

Mr. Chairman, many of the issues we face are sometimes trivialized as disputes between business and investors – as if to be pro-investor is to be anti-business, or to be pro-business is to be anti-investor. The truth is, when people invest in a company's

securities, they are risking their money on the success of the business. Only if the business succeeds will their investment prosper. That is why the SEC's first Chairman described the SEC's role, and our relationship to business, as a partnership. We take that to mean, today just as back when Joe Kennedy was Chairman, that if a business is investor friendly, the SEC will be friendly to it. But anyone who seeks to drive a wedge between the interests of the business and the interests of the investors in that business will face a relentless and powerful adversary in the Securities and Exchange Commission.

Today, the SEC's Enforcement Division is significantly larger than it was five years ago. Our staff are engaged in combating abuses ranging from boiler rooms and Ponzi schemes to stock option grants to fictitious employees. We are pursuing individuals and firms who have falsified corporate documents, engaged in self-enrichment to the detriment of their investors, and attempted cover-ups of this sort of conduct. We are investigating and filing actions against perpetrators of Internet scams, pump-and-dump schemes, and prime bank frauds, executives who have lied to their auditors, and accountants, lawyers, and other gatekeepers who have joined in the fraud themselves.

We have created special working groups within our Enforcement Division to deal with emerging risks such as hedge fund insider trading, stock options backdating, and microcap fraud. Earlier this year we filed the largest insider trading case against Wall Street professionals since the days of Ivan Boesky and Dennis Levine, involving major Wall Street firms as well as hedge funds. We have also devoted special attention to combating Internet fraud, through an office within the SEC focused specifically on the threats posed to investors such as email messages like, "This Stock's Ready to Explode," "Ride the Bull," and "Fast Money." Very recently, we have instituted emergency enforcement actions to suspend trading in stocks that have been the subjects of these spam campaigns. And we have instituted well over 100 investigations of options backdating, with the results of those cases now beginning to be seen.

In 1990, in the Securities Enforcement Remedies and Penny Stock Reform Act, Congress gave us the power to levy penalties against companies and individuals, along with guidance to be certain that investors were protected and not harmed by our use of this power. Throughout the 1990s, that power was used only infrequently to sanction a company. But beginning in 2002, the Commission began to use this authority more frequently. The Commissioners, our staff, and the public were in need of guidelines for decision making with respect to penalties.

After extensive study within the Commission of the legislative language, history, and purpose of the Remedies Act, the Commissioners in early 2006 voted unanimously to publish a set of principles upon which our penalty policy and practice would be based going forward. This guidance was intended to clarify for the staff and for the public the circumstances in which issuer penalties are warranted and those in which they are not. Already the Commission has imposed nearly as many issuer penalties through the first half of 2007 alone as in any full year in the Commission's history (9 cases through the first two quarters, as compared to a previous high in any calendar year of 11). Since the adoption of the guidelines, the Commission has imposed eight penalties of \$25 million or

higher. No other two-year period in Commission history is higher. The second-highest SEC penalty ever imposed on a corporate issuer (Fannie Mae, \$400 million) occurred after the Commission adopted its penalty guidelines. As the legislative history to the Remedies Act and our own statement on penalties make clear, the appropriateness of penalties turns principally on two considerations, the presence or absence of a direct benefit to the corporation and the degree to which the penalty will recompense or further harm injured shareholders. Thus, the size or number of issuer penalties is not an appropriate indicator of the overall success of our enforcement efforts. Our duties under the Remedies Act require us to consider the facts and circumstances of each case.

The Commission continues to work with our staff across the country to ensure that as new cases are initiated and resolved, the guidelines are being implemented as intended. To that end, the staff are beginning to present their recommendations for penalties to the Commission before negotiating penalties with the issuer.

When the Commission recovers a penalty against an issuer or an individual, our efforts do not end at the courthouse door. We are increasingly using the new authority that Congress provided us in the Sarbanes-Oxley Act to use "Fair Funds" to ensure that those dollars are returned to investors as quickly as possible. We are developing a considerable expertise in the distribution of Fair Funds, and very recently, we announced our decision to create a dedicated office that will specialize in this area. Since 2005, we have returned over \$1 billion to injured investors through Fair Funds. Several additional large disbursements are pending and will be announced shortly.

All of these enforcement initiatives undergird the integrity of the U.S. capital markets and the confidence that investors can place in them. And beyond the SEC's law enforcement function, we are pursuing a number of important regulatory initiatives as well that are designed to put investors first.

With over 10,000 Baby Boomers a day turning 60 – an estimated 75 million over the next 20 years – nowhere is the need greater for the SEC's attention than in fighting fraud against older Americans. Because of the decline of defined benefit plans and the ascendancy of defined contribution plans, today's and tomorrow's seniors will need to actively manage their investments. And because they will live longer than any generation before them, many may seek a higher yield over their longer lifetimes, rather than switching into low-yield, safe investments as their parents did. Households led by people aged 40 or over already own 91% of America's net worth, and very soon, the vast majority of our nation's net worth will be in the hands of our seniors. Following the Willie Sutton principle, scam artists will swarm like locusts over this increasingly vulnerable group – because that is where the money is. And it is already occurring. Nearly every day, our agency receives letters and phone calls from seniors and their caregivers who have been targeted by fraudsters. That is why the SEC has focused its energies in this area.

Last year, the SEC organized the first-ever Seniors Summit with our fellow regulators and law enforcement officials. This year's Seniors Summit will integrate even

more of our national resources. With our partners, we are attacking the problem from all angles – from aggressive enforcement efforts, to targeted examinations and rules, to investor education. We have brought 26 enforcement actions during the past year aimed specifically at protecting elderly investors. Many of these were coordinated with state authorities. Another tool in fighting securities fraud against seniors is education. These efforts are aimed not only at seniors, but also their caregivers – as well as pre-retirement workers, who are encouraged to plan for contingencies in later life. The SEC is expanding our efforts to reach out to community organizations, and to enlist their help in educating Americans about investment fraud and abuse that is aimed at seniors. We have also devoted a portion of the SEC website specifically to senior citizens (<http://www.sec.gov/investor/seniors.shtml>). The site provides links to critical information on investments that are commonly marketed to seniors, and detailed warnings about common scam tactics.

The SEC has also identified the men and women of our military as an at-risk group vulnerable to unscrupulous sales practices for financial and investment products. We have directed our enforcement, examinations, and investor education resources to protecting against these abuses, and we have initiated a coordinated approach with other regulators. We worked with you in the Congress to enact the Military Personnel Financial Services Protection Act just last year, to prevent the sale of potentially abusive insurance and investment products to military personnel.

Another of our important initiatives to benefit individual investors is our drive to improve the quality and clarity of mutual fund and 401(k) disclosure, which we have undertaken along with other departments and agencies, including the Department of Labor. Forty-seven million Americans now have 401(k) accounts through their employers, and these and other defined contribution plans now represent over \$3 trillion in assets. These investments embody the hopes and aspirations of millions of Americans for a secure, decent retirement. But the disclosure that the individual investor receives about what is in the 401(k) is typically inadequate – often nothing more than one-page charts that contain extremely limited information. What is needed is clearly presented information that makes it far easier for busy Americans to understand the expenses they are being charged in connection with their investments, and the returns they are actually getting compared to an appropriate index. This sort of simplified disclosure should be readily available to every 401(k) plan participant.

Nearly half of the \$3 trillion that Americans have invested through defined contribution plans is in mutual funds, so we are hard at work on a simplified, plain English disclosure for mutual funds that gives investors what they need to know, in a form they can use. We are focused on a new, streamlined disclosure document for investors that will provide better information about investment objectives, strategies, risks, and costs. Ideally, that information could be made available online, or in writing — as the investor prefers. We are also considering making information about funds and the brokers that sell them available at the point of sale.

This is not just a matter of clearer writing, but also of clarifying our regulations concerning mutual fund fees and expenses. So the Commission is conducting a thorough review of mutual fund fees and expenses, and the disclosure of these costs to investors. That review includes an examination of the \$12 billion that investors now pay each year in Rule 12b-1 fees. Just last week, the Commission held a roundtable to focus on the future of Rule 12b-1.

With the same objectives in mind, the SEC has intensified its focus on “soft dollars” that brokers receive from mutual funds to pay for things other than executing brokerage transactions. Recently, the Commission acted unanimously to publish interpretive guidance that clarifies that money managers may only use soft dollars to pay for eligible brokerage and research services – and not for such extraneous expenses as membership dues, professional licensing fees, office rent, carpeting, and even entertainment and travel expenses. At the same time, we are examining the adequacy of current accounting and disclosure for soft dollars.

Nothing holds more promise for giving ordinary investors the information they need in a timely, useful way than interactive data. New technology that can sort through mountains of SEC-mandated disclosure and turn it into something meaningful holds enormous potential for investors. What we are calling “interactive data” will provide investors in mutual funds, 401(k)s, common stocks and other securities far more useful information than anything they have ever gotten from the SEC before.

For years, ordinary investors have been stymied by the way that supposedly public information is made so inaccessible to them. It simply takes too much time and effort to separately look up each SEC filing for every single company or fund they might own or be interested in owning. Locating the information often requires knowing the name and date of a particular SEC form. Even once the right forms are located, wading through all of the legal jargon to find the right numbers has been nearly impossible for the average investor.

Technology can help here. The SEC’s current online system, known as EDGAR, is really just a vast electronic filing cabinet that does little to exploit the power of today’s computers. Sure, it can bring up electronic copies of pieces of paper on your computer screen, but it does not allow you to manage that information in ways that investors commonly need. Interactive data would change that. It would allow any investor to quickly find, for example, the mutual funds with the lowest expense ratios, the companies within an industry that have the highest net income, or the overall trend in their favorite companies’ earnings.

It works by giving each piece of information in a disclosure document a unique label, written in an internationally used computer language called XBRL. The Commission is investing more than \$54 million over several years to build the infrastructure to support widespread adoption of interactive data. Companies have told us that the substantial benefits of implementing XBRL will exceed the minimal costs. In addition to providing far more useful information to investors, we believe the use of

interactive data can make companies' internal processes more efficient, saving investors' dollars for the costs of registration and compliance reporting to the SEC. It will also make the SEC's own disclosure reviews more productive.

And to insure that shareholders have the opportunity to exploit this new informational power in SEC filings such as proxy statements, the Commission is updating our rules to permit the use of the Internet to improve communications between companies and their shareholders. For example, our recently adopted e-proxy rules will allow shareholders to choose whether to access their proxy materials in paper or electronically. Of course, shareholders who prefer to receive their proxy materials on paper will always be able to do so – and even then they will still have the opportunity to use the proxy materials on the Internet as well. When it comes to interactive data, the shareholders are in the driver's seat.

In connection with the Commission's review of our proxy rules governing shareholder proposals, we have just completed a series of roundtables that considered, among other issues, the future role of technology in facilitating communications not only between shareholders and their company, but also directly among shareholders themselves. As we prepare to put new proxy rules in place in time for the next proxy season to address the implications of the court's decision in *AFSCME v. AIG*, the Commission is also considering ways to facilitate greater online interaction among shareholders by removing any obstacles in the current rules, such as the ambiguity concerning whether use of an electronic shareholder forum could constitute a proxy solicitation.

Interactive data will soon enable mutual fund owners to make instant comparisons of the "risk/return summary" provided by each fund. Just last week, the Commission voted to allow mutual funds to file this key investor information on risks and returns in interactive data format, which we expect will soon lead to an increasing number of funds offering investors this new capability.

From our vantage point at the SEC, it is also clear that interactive data will significantly improve audit quality. Our Office of the Chief Accountant has reported that a significant percentage of recent public company restatements were due to misapplying basic accounting rules, rather than deliberate errors or fraud. So there is an enormous opportunity for automation to help corporate finance staffs and auditors avoid simply missing things — and to avoid the kinds of unintentional mistakes that can have big consequences.

Interactive data will soon showcase its potential to help investors in yet another area: the disclosure of executive compensation under the Commission's new rules. The new executive compensation disclosure marks a sea change. Now, instead of bits and pieces of compensation information scattered about the proxy statement, buried in footnotes, or not really clearly disclosed at all, there is one number that clearly totals all compensation from all sources. And that number is clearly broken down into its parts, so that anyone who wants to compute the totals differently can do so. That is where

interactive data comes in. Once all companies report their executive compensation information using interactive data, it will be a cinch to reconfigure the numbers any way one pleases, and to make instant comparisons across companies and across industries.

To demonstrate the power of interactive data to make the investor's job easier, the SEC itself is tagging the 2007 executive compensation information for all of the S&P 500 with XBRL labels. We will soon be posting a set of easy to use interactive data software tools on our website that will make the executive pay data interactive. Beyond performing calculations and comparisons online, anyone will be able to download the information directly into an Excel spreadsheet or other software program of their choice. Here is a brief example of how this will work.

It is important to recognize that interactive data is not just a way to improve the usefulness of SEC-mandated disclosures here in the United States – it is a truly international standard being developed in over 100 countries that will revolutionize the way financial information is exchanged across our planet. That is why the SEC is committed to doing everything in our power to ensure that XBRL remains an international, stateless, and open source standard. All of the XBRL software development that we do, and that we support, is open source. It is being contributed to the global effort to eliminate friction in the exchange of financial information, so that company data can travel at the speed of light, 24/7, with built-in automated quality control.

Technology is not only helping ordinary investors to make sense of information coming increasingly from around the world, but it is driving the rapidly accelerating globalization of capital markets. We are confronting the challenges and opportunities of more foreign listings here in the United States in a number of ways, not least of which is the growing prevalence of IFRS, or International Financial Reporting Standards. The SEC now reviews IFRS financial statements from foreign issuers, as well as U.S. GAAP statements from domestic issuers. Last week, the Commission proposed to eliminate the U.S. GAAP reconciliation requirement for foreign private issuers that file using IFRS as published by the International Accounting Standards Board. We also have been supportive of the international effort to develop a set of standards that is high-quality, comprehensive, and rigorously applied, because of the significant potential benefit of converging these two standards. A truly global set of standards would allow investors to draw better comparisons among investment options. It would also lower costs for investors and issuers, who would no longer have to incur the cost of maintaining and interpreting financial statements using different sets of accounting standards.

Of equal importance here and in the rest of the world is rationalizing the implementation of the Sarbanes-Oxley Act (“SOX”). The SEC has just finalized new guidance for management in implementing section 404 of the Act, and the PCAOB has issued a completely new auditing standard to streamline and improve the audit of a company's internal controls. The new standard, if the SEC approves it, and the new guidance should permit audit committee members to focus on the material risks that investors care about. This represents over two years of work towards improving the implementation of 404 for all companies.

Our SEC guidance represents the first time since SOX became law that management will have guidance intended for its own use in implementing 404. No longer will the auditing standard be the de facto rulebook for management's compliance with our rules. This guidance should enable cost-effective compliance with 404 for companies of all sizes. Those already complying with our rules can use the guidance to eliminate unnecessary make-work that does little to further the goal of providing reliable financial statements to investors. Those not yet complying (that is, most small companies) can benefit from the lessons learned. For them, the guidance should be a way to avoid wasteful and unnecessary compliance efforts that others have had to endure. Because we have again deferred (for the fourth time) the external audit requirement for smaller companies, management will have a full extra year to develop its own cost-effective compliance approach. It is our intention that this will make it far easier to coordinate a cost-effective external audit when it is first required of smaller public companies in 2009.

When, eventually, smaller companies do come into full compliance in 2009, the new auditing standard will allow them to tailor their compliance efforts to their own individual facts and circumstances. The new standard encourages the scaling of all audits. Small companies will be able to apply the guidance to their unique control systems – rather than create costly or complex control systems for the sole purpose of complying with the guidance. By tailoring the documentation and evaluation approaches to their particular business, we hope to avoid the one-size-fits-all, check-list approach that many larger companies have bristled under as they have tried to comply with 404.

With new guidance that allows management to scale and tailor evaluations – the better to focus on what matters most – and a significantly improved standard that should enable auditors to deliver more cost-effective audit services, one important step remains. The SEC and the PCAOB expect a change in the behavior of the individuals who are responsible for following these new procedures. To that end, the PCAOB's inspection program will monitor whether audit firms are implementing the new auditing standard in a way that is designed to achieve the intended results. And the SEC, in our oversight capacity, will monitor the effectiveness of the PCAOB's inspections. So both the SEC's and the PCAOB's inspectors will be focused on whether audit firms are achieving the desired efficiencies in the implementation of 404.

These improvements to Sarbanes-Oxley are important in the international realm, because while many countries (including the United Kingdom) have adopted requirements similar to our internal control assessment in section 404(a) of SOX, ours is the only country that requires an independent auditor's report and attestation on those controls – and that fact has been a source of friction not only with other markets but with other national regulators and international bodies. The Congress has charged the SEC with making 404 work both effectively and efficiently, and we recognize that doing so will greatly benefit U.S. investors as well as the competitiveness of U.S. companies and financial services providers in the global capital markets.

As our markets continue to converge across national boundaries, issues such as cross-border fraud are driving national regulators to work together as never before. We all understand that we cannot go it alone, if ever we could before. And as the SEC works with our counterparts overseas, we are increasingly finding that in many areas our regulatory objectives are very much the same. We are currently exploring whether in some cases, convergence and harmonization is the right approach; whether in other cases, an intentionally different national approach is best; and whether sometimes, simply offering investors a choice after full disclosure might be the way to go. The current efforts to converge U.S. GAAP and IFRS represent an example of the first approach; our insistence on a high level of national securities market enforcement represents the second; and our current consideration of the possibility of selective mutual recognition of other regulatory regimes represents the third approach. These are all tools in our toolkit as we work together with our counterpart regulators in other countries.

Yet another area in which U.S. regulation is being updated to deal with the environment in international financial services is the entry of banks into the securities business. The Gramm-Leach-Bliley Act was a significant step forward in recognizing the changing landscape of the financial markets, including by lowering the barriers between the banking and securities industries that had been erected in the early 1930s. Today, the Commission is engaged with the Federal Reserve Board and other banking regulators to implement the specific provisions of Gramm-Leach-Bliley that sought to rationalize the web of regulation governing when banks need to register with the SEC as brokers. We expect that the final rules interpreting the bank-broker exceptions of Gramm-Leach-Bliley will be completed early this fall.

No discussion of the work the SEC is doing in international financial markets would be complete without reference to our role as the consolidated supervisor for the country's largest investment banks. When the European Union issued its Financial Conglomerates Directive, which essentially requires non-EU financial institutions doing business in Europe to be supervised on a consolidated basis, the Commission in 2004 crafted a new comprehensive consolidated supervision regime that was intended to oversee the holding companies and material affiliates of major broker-dealers. The rule is designed to address the Commission's concern, in our role as the functional regulator of U.S. broker-dealers, that a broker-dealer could fail due to the insolvency of its holding company or an affiliate. This risk, exemplified by the bankruptcy of the Drexel Burnham Lambert Group and the consequent liquidation of its broker-dealer affiliate in 1990, has become more salient as broker-dealers have affiliated within ever-more complex holding company structures.

The Commission's CSE program for group-wide risk monitoring of firms with a large and well-capitalized broker-dealer has five principal components. First, CSE holding companies are required to maintain and document a system of internal controls that must be approved by the Commission at the time of their initial application. Second, before approval and on an ongoing basis, the Commission examines the implementation of these controls. Third, CSEs are also monitored continuously for financial and operational weakness that might place regulated entities within the group or the broader

financial system at risk. Fourth, CSEs are required to compute a capital adequacy measure at the holding company that is consistent with the International Convergence of Capital Measurement and Capital Standards of the Basle Committee on Banking Supervision. Finally, CSEs are required to maintain significant pools of liquidity at the holding company, where these are available for use in any regulated or unregulated entity within the group without regulatory restriction. This program enables the Commission to monitor these major securities firms, which is of growing importance given their possible systemic implications.

Mr. Chairman, this is a necessarily summary description of just some of the most important work underway at the Securities and Exchange Commission. But it is a fair survey of the regulatory and enforcement landscape, and the domestic and international challenges we face in the days ahead.

Since we have the opportunity to appear before you today as a full Commission, let me offer a word about the way we function as a body. This particular group of Commissioners has worked hard together to achieve our common goals of investor protection, efficient markets, and healthy capital formation. During Chairman Cox's tenure as Chairman, 98% of the Commission's decisions have been the result of a unanimous vote of the Commissioners. That is not because the issues just described are easy, or because we always agree. Rather, it is because the capital markets of the United States – and now, the world – depend upon clarity and consistency in our regulatory and enforcement programs. The agency's non-partisanship has underscored that it is the rule of law, not one's political point of view, that should determine our actions. It is in this spirit that we intend to continue to tackle the significant challenges that lie ahead.

Thank you for this opportunity to appear before the Committee. We look forward to working with you to meet the needs of our nation's investors, issuers, and markets, and we would be happy to answer any questions you may have.