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PROTECTING INVESTORS AND FOSTERING EFFICIENT MARKETS: A REVIEW OF THE SEC AGENDA

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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PROTECTING INVESTORS AND FOSTERING EFFICIENT MARKETS: A REVIEW OF THE SEC AGENDA

Wednesday, May 3, 2006

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Michael Oxley [chairman of the committee] presiding.

Present: Representatives Oxley, Leach, Baker, Pryce, Castle, Royce, Lucas, Ney, Kelly, Paul, Gillmor, Biggert, Shays, Fossella, Kennedy, Feeney, Hensarling, Garrett, Pearce, Neugebauer, Fitzpatrick, McHenry, Campbell, Frank, Kanjorski, Maloney, Gutierrez, Velazquez, Watt, Hooley, Sherman, Meeks, Lee, Moore of Kansas, Capuano, Clay, Israel, Baca, Matheson, Scott, Green, and Cleaver.

The CHAIRMAN. The committee will come to order. Consistent with Rule 3(f)(2) of the Rules of the Committee on Financial Services of the 109th Congress, the Chair announces that he will limit recognition of opening statements to the Chair and ranking minority member of the Full Committee, and the Chair and ranking minority member of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, or their respective designees, to a period not to exceed 16 minutes, evenly divided between the majority and minority.

The prepared statements of all members will be included in the record. The Chair will make an exception for the gentleman from California in this case. The Chair recognizes himself for an opening statement.

Good morning. We are here today to hear from a former colleague and good friend, Securities and Exchange Commission Chairman Christopher Cox. Nine months ago, Chairman Cox was sworn in as the 28th Chairman of the SEC, and he assumed the responsibility of directing the Commission in its responsibilities of overseeing the capital markets and protecting investors.

As a former securities lawyer, Chairman Cox was a natural selection for that post, and an excellent one. And in making this appearance to discuss the priorities of the Commission, Chairman Cox returns to our hearing room, where he once sat as a member of this committee.

Chairman Cox takes the reigns of the Commission through a dynamic time for our capital markets. The New York Stock Exchange

has merged with Archipelago Holdings. The NASDAQ has merged with Instinet, and has taken a 15 percent stake in the London Stock Exchange. Retail investors are investing in a wider range of security products than ever before. And by almost all barometers, the American economy has recovered well from the corporate scandals that shook investor confidence several years ago.

In the wake of these scandals, this committee shepherded through the House legislation to reform corporate governance and accounting oversight. One of the goals of the Sarbanes-Oxley Act was to strengthen the financial reporting of our public companies. Although it is difficult to quantify the benefits of this legislation, it is clear that investors once again trust our capital markets. The Dow Jones industrial average hit a 6-year high just yesterday.

I must commend the efforts of the Commission in overseeing the execution of the mandates contained in the Act. It is true that the implementation of the Act's internal control requirements has been more onerous than originally predicted. However, it is critical that we allow our regulators to rectify the implementation difficulties that public companies and their auditors face.

In this regard, I am encouraged by the efforts that Chairman Cox and the Commission have made, and continue to make, in engaging in discussions with public companies and auditors about these internal control requirements.

Following up on last year's roundtable, next week the Commission and the Public Company Accounting Oversight Board will be hosting a roundtable on internal controls to discuss second year experiences with these provisions. Following that initial roundtable, both regulators issued additional guidelines relating to the internal control reporting requirements.

The Commission will also soon be taking into consideration the recommendations of its Advisory Committee on Smaller Public Companies, created by the Commission to assess the regulatory burdens smaller public companies face. Again, I am pleased by the proactive efforts of the Commission.

I also want to commend Chairman Cox for his recent initiatives to enhance the financial reporting in our public companies. Realizing that the heart of our capital markets is timely and accurate disclosure of financial information, Chairman Cox decided to make this financial information more understandable and accessible to investors.

This past December, Chairman Cox, along with Robert Herz, Chairman of the Financial Accounting Standards Board, announced an initiative to reduce the complexity in financial reporting. This effort includes revising outdated and complicated accounting standards, as well as working towards the convergence of international accounting standards.

In addition, Chairman Cox's advocacy of the use of Extensible Business Reporting Language, or XBRL, has the potential to empower millions of investors with better financial analysis.

And finally, I would like to mention one area of reform which this committee has championed since the corporate scandals a few years ago. The credit rating agency became a focus of Congressional interest because the dominant rating agencies had rated WorldCom and Enron investment grade just prior to their bank-

ruptcy filings. This committee and the capital markets subcommittee, under the leadership of Chairman Baker, have held a series of hearings focused on the lack of competition, accountability, and transparency in the credit rating industry.

Congressman Fitzpatrick has introduced legislation, H.R. 2990, that would bring more competition, transparency, and oversight to this industry. I am hopeful that this committee can work in a bipartisan manner, and with the Commission, to make this reform a reality.

We had our field hearing in Philadelphia that was, I think, very instrumental in moving this issue forward. I look forward to hearing from our distinguished witness, the Chairman of the SEC, on these and other Commission initiatives. And I yield to the gentleman from Massachusetts for an opening statement.

Mr. FRANK. Thank you, Mr. Chairman, and I am pleased to welcome our former colleague, and to express my admiration for the work he has been doing. I think that he has shown how you can be an effective and very admirable chairman. It is a body that had some fractures before, and I think he has provided a useful kind of continuity, and has been faithful to his mandate as a law enforcement officer, which is, of course, one of his primary jobs.

I want to begin by expressing my agreement with you, Mr. Chairman, on the Sarbanes-Oxley law. I believe that it is appropriate that we look to the Commission for any kind of improvements that you would expect. No one passes a law, particularly a law breaking new ground, and one that deals with a lot of complexity, and expects it to remain unchanged.

And I would hope that—I know that the chairman understands this—if there are changes that he and his fellow commissioners think appropriate, I think—I believe that there is now authority for them to make appropriate changes, in terms of the administration. If they wouldn't, they should obviously feel free to come to us, and we can work in a cooperative manner.

I do not think we should be correcting—and I don't think this committee would be inclined to go in wholesale exemptions, but improvements in the method, taking into account the impact of entities of different sizes, that would seem well within the scope that the Commission has, and I would hope that they would exercise it, and I expect that they will.

The next issue I want to get to, Mr. Chairman, is the question of executive compensation, and as you know, we have discussed this. I have a letter that has been signed by all of the Members of the minority, which invokes Rule 11 of the House Rules. Under Rule 11, when a hearing has been called on a particular subject, the minority, if it is not given a chance to have other witnesses, can invoke Rule 11, and have an additional day of hearings with witnesses that it wishes to call on a subject related to the hearing. And we are exercising our right to do that, specifically with one of the matters where the Commission is in the process of taking some very important steps, and that is executive compensation.

I have written in support—as have many others—of the proposed rule by the Commission on executive compensation. I have sponsored legislation which parallels what the Commission does. In

some respects, goes beyond what the Commission would do in other respects. And it's not clear that they have the statutory authority.

And it is clear that we have the statutory authority, although under this Administration, it is not always clear that when we have statutory authority and exercise it, anything will result from that, because the President may just decide to ignore it. But that is probably less likely to happen where the SEC is involved.

And what we have done is to say that there should be, published by every public corporation, all the information relevant to judging the compensation of the top number of executives—depending on the size of the corporation—including what happens in case of a bail-out, including what happens in case they get incentive pay and it turns out—as, for instance, happened with Fannie Mae—that the incentive pay appeared to have been granted inappropriately, because the targets that were supposed to be hit were not really hit.

We ask about pensions. We want all that information made public. And that—we are very close to what the SEC is proposing—they haven't acted on it yet—but we also ask that it be put to a shareholder vote.

We are not proposing in our legislation that any corporation be told by the Congress or anybody else what it can pay the chief executive. If the stock holders of Corporation X want to buy the newspapers of some billionaire in perpetuity, they can do that. Maybe if we get a particularly modern billionaire, they can pay for his or her Internet subscriptions, and finance his or her blogs. That's all up to the stockholders. We just think they should know that they are doing it.

We have had problems in this country where we have seen buyouts, mergers, and payments to the CEO's followed by a reduction in workforce. We have seen problems where CEO's get large amounts of money while pension funds are underfunded. I think those things are in grave error in a number of ways, but one of the things we should be very clear about—and this is one of the things that affects this committee—I think most of the people on the Financial Services Committee think that there is in the country today too little trust in the economic system, too much resistance to trade, too much suspicion about the implementation of information technology, and too much resistance to international involvement in our economy. I agree with some of those views, and it's gotten too far.

But people need to understand it's not simply that this descended on the American people. It is a reaction to trends in this economy of growing inequality. And when people read that the economy is doing well, but their wages in real terms have not gone up, and their pensions have been put at risk, when their health care may be declining in what they get, when they get laid off, and then they read not only that the economy is doing well, but a handful of people are doing extraordinarily well, receiving far more money, almost in perpetuity, than anybody ever thought was necessary, and when this appears to be, as it does look like, by virtue of every metric, unconnected to the success of the underlying institution, then those fears are greater.

So, for that reason, Mr. Chairman, we ask that we have this hearing, and we hope that we can proceed to action on the legislation that I have talked about.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Louisiana, Mr. Baker.

Mr. BAKER. I thank the chairman. I am delighted to welcome Chairman Cox back to the committee. I am very pleased to have someone of his abilities and philosophy exercising the responsibility of Chairman of the Commission. Someone might translate that into I think he agrees with me on a lot of issues. That's okay.

But, in any event, I am delighted that he has taken on this responsibility, and to make the point that in the current environment, household wealth is at an all-time high. More than half of all homeowners are invested in the markets. And this is despite the fact that much of the rules that govern securities activities were written in 1933 and 1934. So, I know that the chairman shares the view that there is much work to do.

And although it would appear to some that the goals are not necessarily cohesive, enhancing investor protection while enabling markets to function more efficiently are not mutually exclusive.

I am very pleased to hear of the chairman's interest in the deployment and broad utilization of XBRL. I am confidant that, as we examine our general accounting system, which is now a retrospective rules-based system, that we can work toward a more principles-based forward-looking system. Because the current methodologies require the expenditure of significant resources to provide the markets with a great deal of information they, in fact, may not use.

I do believe that holding those accountable for the opportunity to become a corporate official is important. I am pleased that the Commission has exercised its responsibilities, pursuant to creation of the fair fund in Sarbanes-Oxley. I am told, as of today, that the collections identified as ill-gotten gains that the Commission personnel are now pursuing exceeds $7.5 billion, with approximately $5 billion already having been collected in those enforcement actions.

That's a Commission activity that is, I think, extraordinary, and is rarely noted. But it's an instance where governmental officials are actually working on behalf of the investors by seizing ill-gotten gains, and ironically, giving them back to the people from whom they were taken. What a great idea.

And finally, I want to speak to the need for a broad and ongoing continual review. It is clear that in our internationally competitive marketplace, that we are slipping in our ability to maintain our primacy. The number of IPO's that have chosen to move offshore is a signal, I think, that regulatory review is not only appropriate, but significantly warranted. And I do not speak specifically to Sarbanes-Oxley, but the general regulatory world.

And how we can ensure that, going into the next decade, the United States maintains that role of primacy is something I look forward to working with the chairman on in the coming years, and believe it to be a vital role for our long-standing economic health within our great country. And with those remarks, I am pleased to be here, and to hear the chairman's words today. I yield back.

The CHAIRMAN. The gentleman yields back. The gentleman from Pennsylvania.

Mr. KANJORSKI. Mr. Chairman, I join with my colleagues in welcoming the Securities and Exchange Commission Chairman Christopher Cox to our panel.

While many things in this room may look familiar to him and to us, he is now sitting on a different side of the table, and serving in a different role. We should, therefore, expect him to have a different perspective on the issues that we once actively debated together.

I want to commend Christopher Cox for his hard work during his first months at the Commission. Like a number of his predecessors, he has taken over the helm of the Commission during a challenging time. I have been particularly impressed with his desire to improve financial disclosures for investors.

He has also, himself, faced and overcome personal adversity. I hope that he now continues to enjoy good health for many years to come.

As I just mentioned, the Commission presently has before it a number of important issues. One of the key issues that Chairman Cox is addressing is the implementation of section 404 of the Sarbanes-Oxley Act. I will be particularly interested in hearing his thoughts today about how we can improve the ability of companies both large and small to assess the accuracy of their internal controls without adding unnecessary costs.

Another issue that I hope that we will examine today concerns the evolving structure of our capital markets. The Commission has now approved many regulatory modifications to our national market system and our security markets are now working to implement those changes.

In addition, a number of our exchanges have gone public in recent months. These privatizations raise questions about the ability of exchanges to continue to protect investors at the same time as they work to maximize shareholders' profits.

As Chairman Cox also knows, the other side of credit rating agencies has recently been the subject of considerable discussion on Capitol Hill. The Commission has before it a proposed rule to address these matters. It is also discussing a voluntary agreement that would improve transparency and oversight of the credit rating industry.

Because we may soon consider a bill in this area, I would, therefore, like to learn more about the status of these actions. The successful and speedy resolution of both rule-making and the voluntary agreement would, in my view, likely preclude the need for us to legislate on rating agencies.

One final issue that has attracted my attention in recent weeks concerns exchange-traded funds. These funds are increasingly popular with investors, growing nearly 200 percent between the end of 2002 and the end of 2005. It seems, however, that the process to review and approve ETF applications has not kept up with investor demands.

In fact, I have heard that some applications have remained unresolved for years. I thus want to know what the Commission is

doing to address these matters, consistent with its investors' protection responsibilities.

In closing, Mr. Chairman, I look forward to hearing from our former colleague. I also hope that he will specifically advise us as to what the Commission is doing about the oversight of the rating agencies, and the process for approving exchange-traded funds.

The CHAIRMAN. I thank the gentleman. The gentleman from California, briefly.

Mr. ROYCE. I thank you, Mr. Chairman. I would just like to welcome our good friend, Chris Cox, back to this chamber, my former Orange County colleague. And Chris, while your presence in this chamber is sincerely missed, your insights and leadership at the SEC are invaluable.

I would just say that I think, on behalf of all of us, we realize that for the United States of America, our capital markets in this world economy are the niche that's most important as we compete globally, and there are probably few jobs as important as the regulation at the SEC over our capital markets, and your quest to achieve proper investor protections and to achieve transparency.

And so, I think I speak for many when I say this Nation is very fortunate to have you at the helm of the SEC, and when I say we all look forward to what you have to say here today, Chris. Thank you very much for being with us. I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman yields back. We now turn to the distinguished chairman, and former member of this committee. Welcome back, and we are glad to have you back.

STATEMENT OF THE HONORABLE CHRISTOPHER COX, CHAIRMAN, UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Mr. COX. Thank you very much, Mr. Chairman, Ranking Member Frank, and members of the committee. I want to thank you very much for your gracious words. I want you to know that, on leaving the Congress, the most difficult thing for me, the hardest part of the transition, is losing contact with the people with whom I interacted every day, and it's very nice to be back among you. Thank you for inviting me.

As you know, this is my first formal appearance in the House since I became Chairman of the Securities and Exchange Commission. I am pleased to have the opportunity to report to you on the new initiatives that the SEC is taking to protect individual investors, and specifically to improve the financial disclosure that they receive.

Of course, my brief testimony this morning is necessarily focused on just some of the top priorities of the Agency. I assure you that it does not cover the entire panoply of important issues that the SEC is dealing with on a day-to-day basis. For that reason, I am happy to be here, not only to answer your questions, but also to learn from you about your priorities.

As a member of the House for 17 years, I was constantly reminded by my constituents of the real world impact of the decisions that you make in the Capitol here, every day. Like you, I learned the importance of being a good listener, and of remembering that

the common sense of ordinary Americans is the essence and the strength of our democracy.

Most of your constituents are not investment bankers. They are not lawyers or accountants. But most of them are investors. It's a stunning fact of life in the 21st Century that a majority of Americans now own stocks. It's chiefly to serve these people that the SEC exists. Our mission, to protect investors, promote capital formation, and maintain orderly markets, must always put ordinary Americans first.

Since making the transition from the halls of Congress to the SEC, I have set out to rededicate the Agency's ongoing efforts in virtually every area to the service of the individual investor.

In keeping with this important focus, I am very pleased to announce this morning that, thanks in major part to the efforts of Chairman Oxley, Representative Frank, Chairman Baker, Representative Kanjorski, Representative Fossella, and many members of this committee, the SEC is cutting fees on securities transactions by $1 billion, starting October 1, 2006. That money will stay in investors' pockets, exactly as Congress intended.

This is great news for investors. It means individual Americans will have more money for their retirement, for college, for medical expenses, and many other important savings objectives.

As you know, the Investor and Capital Markets Fee Relief Act made this dramatic fee reduction possible. On behalf of the Commission and our Nation's investors, I would like to offer all of you who serve on this committee our sincere thanks and gratitude.

In a well-ordered market, educated consumers can choose from a number of competitive products, and find what they want at a price that they are willing to pay. But, in order to educate themselves, investors need comparative facts. So, while investors must bear the responsibility of learning what they can about their investment choices, the correlative duty of sellers of investment products is to provide the relevant information, and to do so in a way that makes that information accessible to, and understandable by, the individual investor.

To more closely match the theory of a well-ordered market with today's reality, the SEC is currently pursuing a number of initiatives to improve the quality and usefulness of disclosure for individual investors.

These initiatives include: first, moving from long, hard-to-read disclosure documents to easy-to-navigate Web pages that let investors click through to find what they want; second, moving from boiler plate legalese to plain English in every document intended for retail investment consumption; third, reducing the complexity of accounting rules and regulations; and fourth, focusing our antifraud efforts, in significant part, on scams that target older Americans.

The first of these initiatives, making the SEC's mandated disclosures actually useful to individual investors, is the reason that we are so energized about interactive data. I know that interactive data is a long standing interest to many on this committee, including, in particular, Chairman Baker. Under my predecessor, Bill Donaldson, the SEC got the ball rolling by launching an internal effort to investigate the technology.

Since then, we have launched the XBRL voluntary filing program as a first step toward getting every company to file its financials in an interactive format.

Consumers of financial data, particularly individual investors, have a great deal at stake here. Properly implemented, the move to interactive data can dramatically improve the information available to investors about their investment decisions. Mechanically, it's a relatively simple concept. Computer codes tag each separate piece of financial information and tell us what it is: operating income; interest expense; and so forth. That way, every number in a report or a financial statement is individually identified, both quantitatively and qualitatively.

For individual investors, the result of this innovation is that they will be able to quickly search for any information that they want, without slogging through an 80-page document. Investors will be able to get information fast, easily, and all in one place. And, instead of long, hard-to-read annual reports and proxy statements, investors could have easy-to-navigate Web pages that let them click through to find what they want.

With today's SEC reports, an investor or analyst who is looking to compare data on, say, annual capital expenditures of two companies, has to search through hundreds of pages of the filings of each company, page by page. Not surprisingly, this time-consuming task has created a cottage industry in re-keyboarding the information in SEC reports, which are essentially static; that information is tied to the page that it's written on.

So, that information now is re-keyboarded by commercial vendors, some in this country, some overseas in India and in China, so that it can be downloaded into spreadsheets and software. And either individual investors or, more likely, their intermediaries have to pay in order to get the benefit of the mandated SEC disclosures.

One hates to think of the human error and the data corruption that inevitably occurs in this process. I can tell you because we have examined it at the SEC, that the number is unacceptably high. Interactive data is a way to fix these problems, and to connect investors directly to the information in a company's filings.

Today, the SEC has over 800 different forms. It has been estimated that the SEC might instead have need for no more than a dozen. The key to achieving that objective is looking at the data on the forms independently from the forms themselves. That's another opportunity presented by interactive data.

The SEC is strongly committed to interactive data and has taken major steps to promote it. We have offered significant incentives for companies to file their financial information using interactive data, including expedited review of their registration statements and their annual reports.

A number of well-known companies—the list is now 17 and growing—have already begun to lead the way and are filing their reports using interactive data. And, starting in June of this year, the Commission will host a series of roundtables focused on the move to interactive data. Revolutionizing the way that the world exchanges financial information is a worthy goal, and we intend to achieve it.

When it comes to giving investors the protection that they need, information is the single most powerful tool that we have. It's what separates investing from roulette. But, if the SEC is truly to succeed in helping investors with more useful information, we will need one more ingredient: an all-out war on complexity.

It's the SEC's job to see to it that financial data and qualitative information about the issuers of securities are fully and fairly disclosed. But we can't say that we have achieved that objective if the information is provided in a way that isn't clearly understandable to the men and women for whom it's intended.

Empowering investors doesn't just mean better access to information. It means access to better information. Simply put, the question is, once that SEC-mandated information is available, is it understandable? The answer all too often is a resounding and frustrated "No".

Exhibit A when it comes to convoluted disclosure is today's regime for reporting executive compensation. Ordinary American investors have a right to know what company executives are paid, because these investors own the companies. The executives work for them. But how can an investor judge whether he or she is getting the best executive talent at the best price?

Too often, the most important parts of total executive compensation are not even disclosed at all until after the fact.

Three months ago, the Commission voted unanimously to propose an overhaul of the executive compensation rules. The proposal would require better disclosure on several fronts. First, companies would report a total figure, one number, for all annual compensation, including perquisites. Companies would also outline retirement benefits and payments that could be made if an executive is terminated and would fully disclose all compensation to board members for the prior year.

In addition, a new compensation discussion and analysis section would replace the compensation committee report, and the performance graph which now comprises mostly boiler plate and legalese.

Finally, since the purpose here is to improve communications, the proposed rules require that all of this disclosure be in plain English, the new official language of the Securities and Exchange Commission.

Just to be clear, the Commission does not propose getting into the business of determining what is the proper method or amount of compensation. It's not the job of the SEC to substitute our judgment for that of the board. Nor would I, speaking as Chairman, subscribe to the notion that all executive pay is excessive. Surely many executives deserve every penny they're paid, and more. Being a CEO requires a rarified collection of attributes and skills that are in all-too-short supply, and compensation in the market for executive talent can be fierce.

At the same time, I needn't cite here the several notoriously public cases of extravagant wastes of shareholders' assets by gluttonous CEO's and pliant compensation committees. It's a testament to the importance of this issue that we have received nearly 17,000 public comments on the proposed rule. That's one of the highest in the 72-year history of the Securities and Exchange Commission.

At the SEC, we look at results from the vantage point of the ordinary investor, and what we're finding is that, in many cases, we're not getting the right results. It's not just public companies that have a problem using plain English. Our accounting rules and regulations also can be complex and difficult to interpret. And, when the rules are difficult to interpret, they may not be followed very well. And, if the rules aren't followed very well, then, intentionally or not, individual investors are going to suffer.

Weeding out the counterproductive complexity that's crept into our financial reporting will require the concerted effort of the Securities and Exchange Commission, the Financial Accounting Standards Board, the Public Company Accounting Oversight Board, and every market participant. This can't be a one-time effort. We will have to commit for the long term, but it will be well worth it.

Finally, let me turn to our efforts to better protect older Americans against financial fraud. Consider these statistics: An estimated 75 million Americans are due to turn 60 over the next 20 years. That's an average of more than 10,000 people retiring every day. Households led by people over 40 already own 91 percent of America's net worth. Very soon, the vast majority of our Nation's net worth will be in the hands of the newly retired.

Following the Willie Sutton Principle, scam artists will swarm like locusts around this increasing vulnerable group, because that's where the money is.

On a daily basis, our agency receives letters and phone calls from seniors and their caregivers who have been targeted by fraudsters. Often the victims have already been taken in. These fraudulent schemes may begin with a free lunch, but we want to make sure that they end with a very high cost to the perpetrators.

That's why we're attacking the problem from all angles, from investor education, to targeted examinations, to aggressive enforcement efforts. And, because State securities regulators share our concerns, we are cooperating in this initiative with State regulators across the country.

Each of the initiatives I have outlined today is part of an overall strategy to make the individual investor, the average American, the ultimate beneficiary of all that we do at the Securities and Exchange Commission. Our Agency has, for many years, proudly worn the badge of investor's advocate. In the months and years ahead, we pledge to rededicate ourselves to that mission.

I appreciate the opportunity to be back with you today. I want to thank you, Mr. Chairman, Representative Frank, and members of this committee, for your continuing strong support for investor protection and for the work of the SEC. I am happy to answer any questions that you may have.

[The prepared statement of Chairman Cox can be found on page 54 of the appendix.]

The CHAIRMAN. Thank you, Mr. Chairman. And again, welcome back, and your record on a number of issues in this committee in the past have been extraordinary, and your knowledge. And I share the views of members on both sides of the aisle when I say that your appointment was excellent from many perspectives.

And also, congratulations on your priorities, particularly the announcement of the $1 billion cut in SEC section 31 fees. We worked

long and hard on that, and we—our colleague, Vito Fossella, it was his legislation, and it truly did make a difference in the markets, and we thank you for your leadership on that issue, as well as your project on interactive data, which has tremendous upside potential in molding the technology with the traditional markets. We are most appreciative of that.

I know the gentleman from Massachusetts will have some questions on executive compensation, but that area as well, your leadership is most appreciated here in the Congress.

Let me ask you, you were participating, were on the committee on the legislation that became Sarbanes-Oxley. And I'm just wondering what your view is from the other side of the divide, now that you are Chairman of the SEC, what do you think that the general impact has been on the individual investor?

And secondly, what can we do, working together, to make this legislation work even better?

Mr. COX. Well, you had pointed out that not only was I a member of this committee when we considered that legislation, but I also served on the conference committee that negotiated the final result between the House and the Senate. And I have to say that one of the most interesting parts of my new job is that I am now in a position to implement, through regulation, legislation that I worked on as a Member of Congress.

I listened very carefully to Representative Frank's comments on section 404 that he made during his opening statement, and I will say that I think, just as Mr. Frank does, that this legislation can work—and just as you do, Mr. Chairman.

There is nothing about the legislation, the law itself, that is inherently onerous, that is guaranteed to cost more than the investor benefit—than was intended. It's a very brief passage. It has a very simple concept that is unobjectionable at its core, and that is that public companies should have solid internal controls. It should be a priority of management, and there should be a way to check on that through outside auditing.

What has happened in practice is that it hasn't worked exactly as you all intended. It's more expensive, compared to the benefits that we all expect to get from that legislation, than it needs to be. And so, as the administrators of this law, the people who are bound to make it work—we at the Agency want to make sure that we get back to what Congress intended.

There is a great deal of benefit to be had from this provision, it's a very important provision, and we aim to apply it in a sensible way that squeezes out the maximum amount of shareholder benefit and investor protection at the lowest possible price. We want to make sure that there is not a focus on the unimportant. We don't want to drive down cul-de-sacs; we don't want an instinct for the capillary instead of the jugular, but rather we want to make sure we're going after those things that are material to the audit, that are material to the investor protections that Congress was interested in obtaining.

As you know, this is a particular focus for smaller public companies. The Commission has exempted them, temporarily, from compliance since the law was enacted. My predecessor, Bill Donaldson, appointed an advisory committee on smaller public companies that

looked at this problem for a year and has just reported. I commend the authors of that report for their hard work over a year. I think they have done an outstanding job at presenting the perspective of smaller public companies, and the special problems that are faced there.

Taking into account all of those recommendations and the many other sources of comment that, as you know, we have, what the SEC will next move to do is ensure that the application of section 404—not only by the SEC, but very importantly, by the PCAOB, which has written AS2, and the bulk of the specifics that are being followed to implement the law—will work together to try and get it right. I am absolutely certain that this can be done.

The CHAIRMAN. That's encouraging. Do we have any idea about the timing of that proposal, specifically the recommendations from the small business committee?

Mr. COX. Well, yes. As I mentioned, they have just provided us with their 32 recommendations after 13 months of looking at the problem. We are now on the threshold of making a decision about whether to extend the current exemption, or instead, to move forward. You can expect a result in the next few months from the Commission.

The CHAIRMAN. Thank you. The—as you know—and this is a bit far afield, but I think it's important because of its affect on the capital markets, and that is the whole CFIUS process. You obviously followed the uproar that occurred with the Dubai Ports proposal. There is now legislation in the Senate, and there is discussion here in this committee about legislation on CFIUS.

It occurs to me that we need to be very judicious about how we approach this issue, because the entire issue of direct foreign investment and its obvious benefits sometimes are lost in emotional arguments.

What kind of advice would you give the committee, going forward, regarding the CFIUS process?

Mr. COX. Well, as you know, I do not sit as a member of CFIUS. I do sit as a member of the President's working group on financial markets, which is chaired by the Treasury Secretary, and it includes the Chairman of the SEC, the Chairman of the CFTC, and the Chairman of the Fed.

The SEC, for its part, has a good deal of international focus that is certainly a cognate of the issues that CFIUS is concerned with. In particular, because of the anticipated globalization of exchanges, securities markets, and perhaps the integration of the trading platforms themselves, we're focused on potential acquisitions, not only of foreign exchanges by U.S. markets, but also the obverse, and that is the potential acquisition of our now publicly owned exchanges by foreign interests.

Because of the importance of those issues, before a real transaction is on the table, before it's clear whose ox is getting gored if we go one way or the other, I'm trying to lay out with my counterpart regulators and other nations—particularly our major trading partners—what principles we are trying to achieve with our regulation.

The national security concerns that are at the center of the CFIUS process are the special focus, in part, of the Office of Global

Security in the Securities and Exchange Commission. That's a relatively modest office, but the mission of that office is shot through the review and evaluation that is conducted in almost every case, both for offerings and for periodic filings, by the Division of Corporation Finance.

The CHAIRMAN. Well, of course, you were the first Chairman of the Homeland Security Committee, so you obviously have some interesting background, both on the foreign investment side and the market side, as well as the homeland security—

Mr. COX. I am trying to confine myself to comments that I am suited to give, as Chairman of the Securities and Exchange Commission, and not lapse into what I might tell you I think about CFIUS as a former Member of Congress.

The CHAIRMAN. Even when we ask for free advice?

Mr. COX. I will restrain myself.

The CHAIRMAN. The gentleman from Massachusetts?

Mr. FRANK. About section 404, I have to say I was talking to the chairman about this. I think this is the right time to act on this. I think there are dangers of going too far in—what I think is too far—in the total exemption for other people, and then not doing enough to be flexible. So, I am glad to hear that you are going to move on that, and I think that is useful.

On executive compensation, I very much agree with what you said. Obviously, I think we should go further and not set any guidelines here, but allowing—making sure the shareholders—I again—it's relevant to Sarbanes-Oxley, too. Sometimes we don't do a balance here.

During the bad times of MCI, and Enron, etc., there was a lot of concern about the extent to which people would feel secure investing their money in the market. You know, one of the things that Sarbanes-Oxley has done, people forget that those fears once existed. We sometimes tend to kind of pocket the good and forget that something happened.

And the stability of the market, the total confidence people feel in investing, is important for our economy, and it's one of the consequences of Sarbanes-Oxley. So it is important that we improve that some without weakening it in any substantial way.

Similarly, I think we are now at a crisis where what's happening is an increasing number of Americans don't believe that they have the kind of stake that they want to have in progress in this country. There has been kind of a disconnect between the overall GDP and their sense of how they benefit.

And if people in the financial community and the business community don't understand that the extraordinarily high levels of compensation that, in many cases, appear to be unconnected to any metric of success, that that's contributing to this problem. And when they see an over-reaction in their minds with regard to CFIUS, or excessive resistance to trade, they don't make these connections. They are missing something.

Now, let me ask you about a couple of issues that have once bubbled up here, and you now preside over them. One of the things I think we don't do, we sometimes don't give ourselves credit when something good has happened, but we also don't go back and revisit predictions of disaster, when disaster has not come.

I have shared before—it's not universally shared—that there are two phenomena which seem to me to be greatly related in one respect. That is the expensing of stock options in the financial statements of companies, and same sex marriage in Massachusetts. In both cases, we heard great predictions of chaos, travail, and tribulation. And I think most people are now pretty bored with both subjects. So, I won't ask you about the Massachusetts one, but—

[Laughter]

Mr. FRANK. But I will about stock options. We have now had the expensing of stock options. You have had to preside over some questions about it. What has been the result, so far, of the requirement that stock options be expensed?

Mr. COX. Well, you are right that this requirement is just now being digested, both by filers, registrants on the one hand, and by the markets on the other hand. And I think you are also right that the clocks haven't stopped, and the world hasn't come to an end in consequence of this.

Indeed, at the Securities and Exchange Commission, in our executive compensation proposal, we have decided to use the same approach that we're taking with stock options for financial statement presentation purposes, and incorporate that into the way that we are coming up with one number for an executive's compensation. This will put, I think, increasing pressure on the whole system to get it right.

It is very important, I think, that we keep our eye on the ball. The main object here is, to the maximum extent possible, accuracy. We want to make sure that the number which, after all, is somewhat notional—it's a forecast—is as close to reality as possible.

And so, the Office of Economic Analysis and the Office of the Chief Accountant at the Securities and Exchange Commission, as well as our Division of Corporation Finance, are going to be working very, very closely together, and interactively with the regulator community, to constantly review proposals to do a better job of getting it right.

Mr. FRANK. People who thought it was going to have a tremendous effect were underestimating the ability of investors to assimilate information. The fact that it might have been presented differently didn't change the information.

The common thread in both cases is we have confidence that if we just give information to the people who are going to be investing, they will use it wisely.

One other issue that had been an issue and may come back again, a couple of years ago this committee was very seized with the notion that it was very important to mandate that mutual funds separate the position of CEO from the position of chairman. And this was a very important issue, according to this committee.

I must say I was skeptical that it was going to make much difference, one way or the other. I didn't see any studies that showed it made much difference. But the SEC then adopted it. It was held by the courts not to have done it right in the kind of midnight judge's approach. Your predecessor, on his last day in office, readopted it. The courts re-disadopted it, and it's now back before you.

And I am wondering, because this was, at one point, a very hot issue for many members of this committee, who believed that it was essential to protect investors and the integrity of the industry, that we mandate this separation. It is now before you, before the Commission. I am wondering what the status of it is. Do people still think it's important? I'm wondering whether you will be hearing from—you know, is this committee still urging you to move ahead, or is that another issue that seems to have faded with time?

Mr. COX. Well, your rendition of the history lays the foundation for my answer very accurately. There were two parts, before and after the court decision, to my ability to influence this process as chairman.

The first, prior to the court's decision, came when I announced, virtually the day I got to the SEC, that we would implement that rule exactly as it was written, as with all rules that had been previously enacted by the Securities and Exchange Commission.

The second was very recently, when the court asked us to review, again, a particular provision of the rule that had been contested because of defects that they saw in our administrative procedure. And so we're going to do exactly what the court expects. The court, in its ruling, indicated it would withhold the issuance of its mandate for 90 days. We're due to report back to the court in 90 days. We will do so. The professional staff of the SEC and the Commissioners themselves are now discussing exactly how we will take the next step.

Separate and apart from that substantive decision, I am also working with the Office of Economic Analysis and the Office of the General Counsel to examine the way that we do economic analysis of all of our rules.

You mentioned that you hadn't seen studies that you were impressed with, contemporaneously with the consideration of this issue by the Commission last time around. I think what the court has invited us to do is to make sure we avail ourselves of the best evidence before we make a decision. So, instead of the fore-shortened process that the court objected to, we will have a very thorough process this time around.

The CHAIRMAN. The gentleman's time has expired. The chairman of the subcommittee of jurisdiction?

Mr. BAKER. I thank the chairman. Chairman Cox, I want to point out in your initial offer here to lead the Commission in the direction of a plain English disclosure standard that, in your discussion of appropriate remedies to excessive executive compensation, you spun immediately to the work perquisites, which I found sort of contradictory to the plain English standards. You might want to think more along the lines of—

Mr. COX. Perhaps I could have said "perks."

Mr. BAKER. That's probably what would have summed it up. But as I understand it, that's sort of the care and feeding standard of an executive. So if you're doing an executive washroom remodel, or the corporate jet, or catered meals, or anything he charges to the company, that's all bundled up so that the shareholder can be appropriately affronted—if that is the proper response—to the total package, not just the underlying salary, which some people have difficulty in absorbing already, and that the remedy to many

abuses in corporate America is simply a transparency standard to disclose to the affected parties that own the company, so that they might take whatever action they deem appropriate. And I just heartily commend you for the proposed rule, and the direction which you are taking.

Secondly, on the XBRL project, there are two elements of that that I want to throw into the mix, as to possible benefits. As the taxonomy is more effectively described, that may have the tangential effect of bringing foreign capital in as accounting standards become more harmonized. I am told today that many companies contemplating registering in the United States choose not to do so because of the extraordinary time and expense of coming to our generally accepted standards, and that XBRL may yield that benefit.

And then, secondly, with regard to the current practice of quarterly income disclosures, I have found that to be a contributor to many decisions made by corporate leadership to meet or beat the Street. And that, I think, energized, to some extent, some of the problems which this Congress and the Commission has had to address.

By moving beyond the current 8K standard to a more real-time material fact disclosure methodology, which is based on an XBRL platform, would be, I think, a terrific outcome of this project. So I simply want to compliment the Commission for your view on this subject, and encourage you to move forward as quickly as is practicable.

As to the question that I principally wanted to ask before I got sidetracked by all this other stuff, I am—the committee has conducted hearings over some period of time relative to the designation system for the NRSRO's. It's my opinion; I can't speak for others on the committee, that that designation system has yielded us a very uncompetitive market for all those rating agency operations.

Congressman Fitzpatrick has introduced legislation which, in essence, creates a registration system as opposed to designation. Have you had the opportunity to contemplate which methodology might be the most advisable going forward? Or, more particularly, if you have had the chance to even review the Congressman's bill, can you opine on your view of that legislation, if you can be that specific?

Mr. COX. I can do both, I think. First of all, I want to take the view, as a former Member of Congress, and as the current Chairman of the SEC, that we are going to be very respectful, as an agency, of the legislative process of the Congress. So, if the Congress is moving legislation in this area, we offer ourselves as a professional resource for technical assistance, if you seek it.

We don't know yet—I can't know, I don't think anyone knows, because of our bicameral process—whether there will be legislation in the near term. And so, simultaneously with your consideration of legislation here, we are, at the SEC, reviewing exactly these same questions.

We are concerned, as are you, with the achievement of the public policy objectives of this whole structure. We want to make sure that there is competition, transparency, and investor protection. Whether or not one or the other of the two models that you have described is superior is a question that I don't think the Commis-

sioners or, speaking separately, the professional staff, have definitely answered.

But we are very deep into this process right now. It is the central focus for us. And I know for the credit rating agencies themselves, who are working on their voluntary framework, that seeing a result of this process is vitally important.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Pennsylvania.

Mr. KANJORSKI. Following on the questions of Mr. Baker, I am very much interested in what the status is of the rule, streamlining the process for approving applications of the nationally recognized statistical rating agencies. Is the Commission moving full speed ahead, or is there some lag time?

Because there is—it seems to me there would be no need for legislation, if in fact you are ready or capable of implementing something that is acceptable.

Mr. COX. Well, the question of whether there is need for legislation to accomplish a specific objective depends, in substantial part, on how ambitious you are about restructuring regulation of the credit rating agencies. The SEC certainly has, within its existing authorities, power to do something. I do not know that we have the power to do everything that has been contemplated in some legislation.

With respect to our own rulemaking, as you know, the SEC actually proposed a rule in March of 2005, to define the term NRSRO for purposes of our own rules and regulations. We received 30 comment letters on that rule proposal. The professional staff in the division right now are formulating a recommendation to the Commission as to whether to take further action on that proposal, or instead, an alternative proposal.

Mr. KANJORSKI. Can you inform us of what the status is on the voluntary framework discussions that you are having with the credit rating agencies, is that moving forward?

Mr. COX. It is, indeed. And, as I just alluded to, I think that those agencies are, themselves, very anxious to have this process move as quickly as possible.

Our Commission staff are continuing to provide technical assistance to them in that process, in the process of their development of a voluntary framework. In fact, I understand that there were discussions via teleconference between the rating agencies and the staff last week, so this is an ongoing matter for us.

Mr. KANJORSKI. Very good. It sounds to me like there is a question of whether we're going to strive for quantity or quality. And in a way, your expertise and the Commission's expertise is far greater than the committee in understanding that issue of quality and quantity. This, of course, is an ongoing pressing issue before the committee, and you're probably unlikely to indicate to us whether we should put our foot on the pedal, or put it on the brake?

Would you give some—I mean, yes, we have 2 or 3 months now, potentially, left in this session. Should we move and devote time to this effort, or wait and cooperate with the Commission, see what the next 2 or 3 months produces, as a result?

Mr. COX. My predecessor testified that, in order to do aggressive oversight, the SEC would need greater authorities. What I have just told you is that I ought to be as respectful as I can of the separate roles that the legislative and executive branches play. I want to be sure that the SEC does not just do its level best, but does a superb job of implementing the intention of Congress when it comes to administering our statutes.

So, I—it would be the easiest thing in the world for me, as a former Member, to start opining on bills, and telling you what I would like you to do. I understand full well the legislative process, and the role of this committee and of the Senate Banking Committee. And so I am trying to resist the temptation to offer that advice. We will work with you, either way.

Mr. KANJORSKI. Thank you. Moving to another subject, I mentioned in my opening remarks the ETF's applications and the time delay. Is it possible, without causing a great deal of expense and time, that we get a handle on just how many applications are pending, and how long they have taken with the idea in mind is there something we can do to assist in that effort?

Because I am starting to wonder whether or not, since the products have been on the market for more than a decade, whether there is sufficient body of experience now in evaluating the success of ETF's mechanism to standardize the application process, and permit a wider variety of products, which seem to be in demand, but not being held back.

Mr. COX. Well, I think I share your premise, your implicit premise, that the length of time that it has taken to process exemptive applications is too long. And as Chairman, I am working to shorten it substantially.

The investment management staff—to answer your question—is currently working on over 215 exemptive applications. They range in complexity from the routine—in other words, applications for exemptive relief that have been previously issued to other applicants—to quite complex questions, such as people seeking authority to operate and actively manage ETFs.

With respect to the age of this backlog, 85 of the 215 exemptive applications—or I should say approximately 85—have been pending for over a year. The division, under my direction, is taking several steps to achieve our goal of improving the timeliness of our exemptive applications process.

First, the staff is preparing recommendations that the Commission adopt new exemptive rules that would eliminate the need for filing at all, certain of these routine exemptive applications, including fund-of-fund applications that are contributing to the backlog.

Second, we are identifying other rules that the Commission could adopt or amend, to further eliminate the need for filing other kinds of exemptive applications, such as those related to inter-fund lending, frequent capital gain distributions, and index-based ETFs.

Third, we have spent considerable resources identifying and moving out in the division applications—or I should say moving out of the division applications—involving products such as ETFs, for which the applicant has legitimate concerns regarding timing of the markets. And we are doubling our efforts to reduce the current exemptive applications backlog by identifying those pending appli-

cations that can be processed promptly, and by providing more timely comments on other applications.

The Acting Director of the Division, Susan Wyderko, is strongly committed to the steps. She has exercised a lot of management creativity, and I think she is having great success in achieving the objectives. So I hope that you will have tangible results to see in this area very soon.

Mr. KANJORSKI. Thank you.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Texas, Mr. Paul.

Mr. PAUL. Thank you, Mr. Chairman. Welcome, Chairman Cox. I had a question about section 404, but I think you have touched on that already, and I don't know whether you can add anything new on it. But I do want to assess the general principle of regulation.

As you know, I am not a champion of regulation. As a matter of fact, I see Federal regulation as nothing more than moving us toward central economic planning, and I think we can make pretty strong economic and constitutional arguments against a lot of what we do around here.

Also, on economic terms, we do know that large companies are less resistant to a lot of regulation than the small companies, because handling of regulations is much more difficult for the small company. And therefore, we have a greater penalty placed on the small company.

We also know that the general rule that when Congress or other government bodies regulate, for every regulation, every law that we pass, we generally create too many problems. And I think the case could be made that the Sarbanes-Oxley bill has had some bad consequences.

I would like to mention a few things where there has been some dire assessments of Sarbanes-Oxley, and I would like to give you a chance to refute these, and see whether or not we should refute these negative assessments, or move in the direction of reforming the legislation.

First off, I would like to quote from a rather famous economist that many of us know about, and that is Milton Friedman. And he was commenting on Sarbanes-Oxley and he said, "It's terrible. It ought to be eliminated. It's costing the country a great deal. Sarbanes-Oxley says to every entrepreneur, 'For God's sake, don't innovate, don't take chances, because down will come the hatchet, we're going to knock your head off.' " Those are pretty strong terms. I would never use that type of language.

And also, there has been other assessment. An economist writing in the Wall Street Journal not too many months ago said that it is very costly, it has cost public company shareholders $1.4 trillion, $460 for every man, woman, and child in the United States.

And another important aspect of this—and we have seen several articles on this—the London stock exchange did a survey of 80 IPO's that were coming on to the market. Of those 80, 90 percent of the 80 that contemplated American markets versus London, 90 percent chose to go overseas into the London market. So that is a consequence that we either ignore or we have to say these assessments are completely wrong.

There was another study done by Foley & Lardner, a law firm, which said that it has increased the cost associated with being a publicly held company by 130 percent. These are rather astronomical figures.

And what would it take for us to assess this, and decide that maybe we ought to back off section 404? I certainly would like to see the whole section repealed. But do we wait until problems get much worse? But if these numbers are true, this is very, very costly to us, and as time goes on these costs will increase because we're really still in the early stages of implementing this law.

Do you have any comments along this line? Or what do you think of some of these assessments?

Mr. COX. Well, I think you have nicely set the table for discussion of the broad impact of what undoubtedly was landmark legislation. The significance of the events that gave rise to that legislation is still before us. The trial is going on in Houston right now. And yet, it has been a few years. And so we have had the opportunity to assimilate some of this significant change that Congress mandated.

My considered view is that—considered, in the sense that I have now had three calendar quarters as Chairman of the SEC to look at this from that perspective—is that there is nothing about the law itself, the way it's written, that should prevent us from being wise in its administration so that the benefits that Congress hopes to get from it can be obtained, while the costs—the unnecessary costs, which are what you're talking about—can be wrung out.

It's not investor protection to cause investors to pay for something they don't want and don't need and can do without. What investors do demand are protections for their money, so that their investment will be safer, ultimately yield a higher return. We've got to distinguish between, in other words, what is worthwhile and what isn't.

I have a great deal of respect for Dr. Friedman. In fact, when I was chairman of the policy committee here in the House, we had a board of advisers, and he served ably on it. I have always been anxious to hear his perspective on things.

When he says that Sarbanes-Oxley is terrible and ought to be eliminated, I believe he is referring, in a gross sense, to some of the pathologies that are being ascribed to the law, which—in as much as he is an economist and didn't serve on this committee when we drafted the legislation, I will allow him that kind of generality. But speaking with that generalization, I think we need to recognize the difference between what the legislation mandates and what's actually happened.

When the climate in the board room is anti-risk, when people are hunkering down, they're concerned about a lot of things. Part of it was the climate that produced our legislation, and the way that everyone, from litigants to insurers, to the accounting firms themselves, which had been at the center of many of these scandals, was reacting.

And so, I think now that things have settled down a bit, we have an opportunity at the SEC—and I have been there for just a few months, so whatever costs have been incurred heretofore, be they start-up costs, initial costs, capital outlays, what have you, that's

water under the bridge. I want to make sure, going forward, that we do this wisely. And I absolutely believe that we can.

There are some things, in terms of international competitiveness that you alluded to that I think we have to be mindful of. And that is, while Sarbanes-Oxley presents compliance issues and potentially disproportionate costs for smaller companies, if you take a look at what's going on in the smaller company market, in 2005, close to 100 foreign companies registered with the SEC for the first time. That doesn't get headlines; these are mostly smaller companies.

So, that's telling us that we are still an attractive market for foreign listings, and we just need to make sure that we recognize as, simultaneously, markets in other countries are becoming more mature and more attractive, and more realistic possibilities as places to list—we didn't always have that competition in the past—that the United States of America retains its lead as the biggest, deepest, most liquid capital market in the world, in part because we also have the most predictable and safe rule of law and regulations that are consistent not only with investor protection, but also with capital formation and the maintenance of orderly markets. That is our mission. I hope we can do that.

The CHAIRMAN. The gentleman's time has expired. The gentlelady from New York.

Mrs. MALONEY. First, I would like to welcome the chairman back to the Financial Services Committee, and I congratulate him on his appointment and his hard work.

I appreciate your mentioning the Investors Fee Relief Act, which I introduced with Congressman Fossella, and I am very glad to see that you're continuing to cut the fees to reflect the reality of what is appropriate to support the regulation. It is very important to the investors I represent, and all investors.

I would like to go back to section 404. In my district, small companies are really concerned about the cost and burden of complying. I know that you are aware of the legislation that has been floated by Representatives Feeney and Sessions that would make section 404 voluntary for companies with market capitalization under $700 million.

You testified before the Senate that you want one standard, you don't want a different standard for large and small firms, but that you would be open to addressing unnecessary costs.

One idea that was put before the House Financial Services Committee by Marshall Carter, chairman of the board of the New York Stock Exchange—last week he proposed that the SEC and the Public Accounting Oversight Board move to a 3-year Sarbanes-Oxley section 404 review cycle as a way to reduce regulatory burdens. This could be accomplished without having to pass legislation to amend the law. Could this proposal help small companies by reducing the cost and the burden of compliance, which is very difficult for smaller firms? Your comments?

Mr. COX. I am very well aware of the proposal advanced last week by the chairman of the New York Stock Exchange. That proposal, as well as a wide range of alternatives, is, as you would expect, under very active consideration right now at the SEC, as we

try to make work the discussion we have been having here this morning.

We are also gathering as much data as we possibly can from the experience of companies that have already implemented section 404. And that includes a fair number of smaller public companies that, in most ways, are exactly like the companies that have heretofore been exempted. So we have ample empirical data that we can avail ourselves of.

And, as you know, we have this public roundtable coming up at the SEC next week that is going to be focused on these very issues of full implementation. That's going to be an all-day affair. If you can put it in the context of your experience here as a Member of Congress, sitting on the dais at this hearing, we as Commissioners are going to be there all day and listen to 50 witnesses. We're going to get a wide variety of perspectives. I think we're going to get a lot of quality data and comment at that hearing.

Mrs. MALONEY. Chairman Cox, as you know, the securities industry that I represent is very, very concerned about reducing global market access barriers and national treatment barriers. The United States is a world leader in providing financial services.

And although our trade deficit is over $700 billion, in the area of financial services our country boasts a trade surplus of almost $17 billion, which is very, very important. The industry tells me, though, that the barriers that they face prevent them from providing their clients with the global products and services that they demand. And they are hoping that you will do everything—and that our country, our U.S. trade negotiators, will do everything—to support the competitiveness of this very important export industry of the United States.

So, I would like to ask you, do you support the goal of securing access to foreign markets for U.S. firms that is comparable to the access foreign firms enjoy in the United States? And this access would include the ability of our firms—meaning U.S. firms—to supply services from the United States to sophisticated investors in foreign markets on a cross-border basis without having to establish a commercial presence. I would appreciate your comments on this issue.

Mr. COX. Well, it's an excellent question, and it tempts me to give a very elaborate answer, because I'm so interested in so many aspects of this topic. But the way you have put the question, it's susceptible to a yes or no answer, and the answer is yes.

Mrs. MALONEY. Would you like to elaborate further?

Mr. COX. Sure.

[Laughter]

Mrs. MALONEY. Can we achieve this? Is this competitiveness for our financial services markets a priority of our country? Will we fight at the table for their ability to sell these products without a commercial presence in the country?

Mr. COX. Yes. Obviously, our trade negotiations generally are the province of the USTR and other parts of the executive branch beyond the SEC. But, specifically with respect to securities regulation, the SEC conducts a fair amount of international intercourse with our trading partners.

Just yesterday, for example, I hosted Chairman Shang of the CSRC, China's securities regulator, and we executed a joint agreement that is going to permit us to expand substantially the level of our cooperation and information sharing. We are very anxious in China, as well as in every other country on Earth, to make sure that our financial services have the kind of access that we provide here to their firms.

And so, that principle of reciprocity is vitally important to us as securities regulators, as I am sure it is to our trade negotiators.

Mrs. MALONEY. Thank you, Mr. Chairman—

The CHAIRMAN. The gentlelady's time has expired.

Mrs. MALONEY. My time is up. I just want to tell you how much I enjoyed working with you on this committee, and your leadership on the Anti-Terrorism Insurance Act. And I hope you will continue to keep your eye on making sure that vital program is there for the American economy.

Mr. COX. Thank you for your kind comments. I certainly, as I said at the outset, miss seeing all of you here more than anything else, more even than I miss the work of the Congress, and we will have our corner of the counter-terrorism world to maintain at the SEC, and I am going to continue to apply myself there.

Mrs. MALONEY. Thank you so much.

The CHAIRMAN. The gentleman from Connecticut, Mr. Shays.

Mr. SHAYS. Thank you, Mr. Chairman, and new Mr. Chairman. It's great, Chris, to have you here. I would like to ask you about the 202 rule involving the Investment Advisory Act, and also about hedge funds.

First, with hedge funds, you are requiring, as of February, managers of certain hedge funds to register with the SEC and subject themselves to certain reporting requirements. I am interested to know the status of this rule—not in depth, but in general.

Mr. COX. It has just gone into effect. It is giving us the opportunity to gather census data, if you will, about the scope and scale of the issue that we face. We have nearly doubled the number of registrants as a result of the effectiveness of this rule. We believe that—at least we infer—that all of these new registrations are on account of the rule.

And so, I would guess that 9 to 12 months down the road we should be in a position to infer something from all of this new data that we are gaining about whether, and if so how, additional regulation of the funds themselves is advisable.

As you know, the regulation, the rule that has gone into effect, is focused on the advisers, and not the funds.

Mr. SHAYS. No preconceptions on where you are headed, just totally open about the data you're going to get and then drawing conclusions afterwards?

Mr. COX. Well, I don't have any preconceptions about the data that we haven't seen yet. Of course we have studied the issue of hedge funds, generally. And so, there is at least that preconception, if you will. We are not without a background on the issue. And indeed, for a variety of reasons, including the potential retailization of hedge funds, the systemic risk, and impact on the markets themselves, not only I, but my counterpart regulators in other countries, are watching this like hawks.

Mr. SHAYS. The other area I would like to get into is the issue of the Investment Advisors Act and the Securities Exchange Act.

There is a concern among a number—I represent a huge number of financial institutions. And there is a concern of when—if the Commission intends to provide some guidance to financial institutions in order to clarify the potential problems with the new 202 rule, in terms of when are they advisers and when are they just, you know, dealing with transactions?

And the question I am asking is do you see this as a problem, and are you hearing that guidance is needed?

Mr. COX. Well, it is, and I am also hearing that it is. We are very busy working on this right now. I am hosting collaborative discussions among the SEC and the bank regulators to implement Regulation B, which I take it is what you're asking me about.

It has been a long time since Gramm-Leach-Bliley, since we worked on that in this committee, Mr. Chairman. Indeed, it was a different millennium than we're now in. It was 1999.

And so, it's about time that we had rules and guidance. I think it's vitally important that we do so. It has obviously been a sticky wicket, that's why it's taken this long. But I have decided to rededicate the Agency to getting it done, and I am leading those efforts personally, getting personally involved in them.

We are having a series of multi-hours-long meetings to work it out, step by step, very patiently. And I think that we can achieve a result.

Mr. SHAYS. You have only been there 9 months, and I marvel at the things that you have to be prepared for. Do you feel that you are kind of caught up, or do you still feel that you are still in somewhat of a learning mode, in terms of understanding where your fellow Commissioners are, and where your staff is?

Mr. COX. Well, I have to answer that in two ways. I believe that, in part, because of the absolutely outstanding professional staff of the Securities and Exchange Commission, it has been possible for me to get up to speed on a number of issues very, very rapidly.

But second, I have to say that you learn some humility in Congress, where you are required to take responsibility for such a broad array of different issues. We have all got to dedicate ourselves to lifetime learning. And I certainly am enjoying that opportunity at the SEC.

Mr. SHAYS. Just one last point. Not a question. I was, frankly, surprised to learn the salary of your position. And I just want to state to the chairman that I, given all the people in the position that the chairman—this chairman here, I just think we need to determine why the salary, frankly, is so low and what can be done to raise it up a bit.

The CHAIRMAN. The gentleman's time has expired. Does the chairman want to respond to that?

[Laughter]

Mr. COX. No, I just want to say, Mr. Chairman, that the Congress, if not by design, then by accident has put me as Chairman of the SEC in a remarkable position of moral leadership to talk about executive compensation.

[Laughter]

The CHAIRMAN. Well said. The gentleman's time has expired. The gentlelady from New York.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Welcome back, Chairman Cox.

Mr. COX. Thank you very much.

Ms. VELAZQUEZ. Mr. Chairman, in order to go public today, small companies must be more sophisticated and more mature than ever before, and they must employ a sizable administrative work force to comply with the many regulations they face.

In addition, other factors have increased the challenges that these firms face in accessing the public markets, such as the liquidity demands of institutional investors, as well as consolidation within the underwriting industry.

Do you believe that it is harder for small firms to go public today than it has been in the past?

Mr. COX. Well, I have no better source of information than what public companies, or companies on the threshold of going public, tell us. And there is no question what they're saying. They are saying that the answer to your question is yes. That is what we are hearing from the advisory committee that the Securities and Exchange Commission itself appointed. That's what we are also hearing from venture capitalists who nurture companies to the point where they might become public.

One can argue the point and say, "Well, this information is wrong," or, "There is another perspective." And actually, the SEC does have a different perspective in many cases. But it's impossible to deny that the people who are in this position, who are themselves smaller public companies or companies on the threshold of becoming public, are telling us that, over time, this has become a greater burden and a greater expense.

Ms. VELAZQUEZ. Is there anything that the SEC is doing to ease the burden?

Mr. COX. Yes. And I appreciate the way that you yourself have drawn our attention to this issue. On behalf of many of the smaller public companies, and the companies that are not yet public that I was alluding to, the SEC not only can do something here, but we have a very significant responsibility to do something here.

I know, from firsthand experience, as a member of the Conference Committee, that that's what Congress intended. The Congress did not intend chaos, we didn't intend unnecessarily high costs. We didn't intend expense all out of line with the investor protection benefit that it purchases.

There is nothing in section 404, which is the main focus of a lot of this criticism, that mandates that kind of chaos. Instead, I think section 404 has a very good idea expressed within it. I think it is expressed very economically. It's not a very long section.

There are hundreds of pages, on the other hand, in AS2, which is published by the PCAOB. The SEC itself has the responsibility and opportunity to provide management guidance in addition to the auditing guidance that's provided in AS2. Between the SEC and the PCAOB, I am absolutely confident that we can make this work far better.

Ms. VELAZQUEZ. Good. Thank you. The SEC permits smaller companies to use simplified forms for reporting on the Securities

Act and the Exchange Act. In order to qualify as a small business issuer under SEC Regulation SB, the company must have revenues and a public float of less than $25 million. These requirements have not been changed since the enactment of Regulation SB in 1992.

Since 1992, stock prices have increased significantly, and measurable inflation has occurred. Do you believe it is appropriate for the SEC to raise the threshold associated with regulation SB?

Mr. COX. Yes, I do. And we are preparing to consider a proposal at the Commission level that would do precisely that.

Ms. VELAZQUEZ. Okay. Earlier this Congress, Mr. Chairman, Representative Kelly and myself introduced and passed legislation modernizing the business development company statute. As you may know, modernizing the business development company statute is a past recommendation from the SEC's small business forum, and the subject of several previous legislative efforts.

These enable the SEC to meet its mission to facilitate capital formation. However, these regulations are outdated, which in turn limits the financing option for smaller companies, and also hurts those that have invested in BDCs themselves.

With this in mind, is the SEC going to propose new rules this year to modernize BDC regulations?

Mr. COX. Yes. And, in fact, I think that the Commission will be ready to consider final action some time perhaps late this summer, or maybe even early summer. I want you to know that I certainly support modernizing the definition of eligible portfolio company.

Ms. VELAZQUEZ. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. The gentlelady yields back. The gentleman from California, Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman. And it's good to see you, Chairman Cox. As the person who succeeded you—albeit it not replaced you—in Congress, I want to, first of all, thank you for leaving the California 48th Congressional District in such excellent shape, and to let you know I drove by your house the other day and it hasn't burned down or anything.

So I just have one quick question, relative to the complexity in financial reporting issue. As you suggested in your testimony, a lot of the complexity, certainly in accounting, is driven by having increasingly complex financial instruments and increasingly complex financial transactions.

I understand that you are working on, in the SEC, perhaps principles-based accounting system, and I just wanted to ask how is that progressing? Where are you—where is the SEC on that? And what is the path from here? What stands in the way, etc.?

Mr. COX. Well, the SEC, as you know, has a road map to convergence of what is a more principles-based system, IFRS, and U.S. GAAP. At the same time, we are also working very closely with the Financial Accounting Standards Board in this war on complexity that I advertised earlier. I think it's vitally important for individual investors in chief, but also for our whole system.

And part of that project, I think, is going to open up some of these questions that you are raising.

Mr. CAMPBELL. So, as far as the principles-based—it's still—at this point it's just a matter of discussion and something you're looking at, a principles-based accounting system, or—

Mr. COX. Well, U.S. GAAP is a very rules-based system. And so, as we have discussions with our overseas counterparts about our own acceptance of IFRS, as we talk about convergence of those systems, it gives us an opportunity to move perhaps to a more principles-based system.

Mr. CAMPBELL. Okay. Thank you. I yield back.

Mr. COX. But before you yield back, I want you to know that, as you know, we just bought a new house in your district last year, before I knew that the President was going to ask me to do this job. So I hope that you can keep going by the house—

Mr. CAMPBELL. I will keep checking on it.

Mr. COX. I was there one weekend in 2006, and so—

Mr. CAMPBELL. I will keep checking on it. And after I have the parties there, I will make sure that I clean up.

[Laughter]

The CHAIRMAN. The gentleman yields back. The gentleman from Missouri, Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman, and welcome back, Mr. Chairman, and welcome back to the committee.

There is an outcry among investors that executive compensation is too inflated, and that the disclosure of the compensation is too vague and confusing, at best. Will your plain English requirements apply to executive compensation reports, and do you expect that to work, if it does apply to it? Are there enforcement provisions with punitive measures if reports continue to be confusing to most investors? And could you elaborate?

Mr. COX. Yes. The answer to the first part of your question is absolutely yes. All of the revised executive compensation regulatory regime is going to demand plain English. And indeed, our ultimate goal—not just in the area of executive compensation, but in all information that is distributed to individual investors—is that we have plain English requirements.

Second, with respect to what happens if you don't follow these rules, all of the enforcement authorities that the SEC possesses with respect to observance of its rules will apply equally to these executive compensation rules.

Mr. CLAY. Okay. Thank you for that. And I support Sarbanes-Oxley, or otherwise known as SOX, and appreciate how it helped to stem the tide of distrust in our financial markets caused by the financial collapse of several large corporations. I do understand the prohibitive cost to some of our smaller publicly traded companies. Additionally, I understand that the second year cost will be less costly.

However, I do recognize the need to make adjustments in SOX for the smaller companies. Do you think that it is wise that companies be exempted completely from Sarbanes-Oxley, or don't we still need transparency? Would not the combination of lower costs after the first year, and perhaps a less frequent reporting schedule, make the process affordable while maintaining these reporting requirements?

Mr. COX. We are considering, as you would expect, a wide range of alternatives on improving the implementation of section 404, including those that you mentioned.

But, with respect to the question of exemption versus applying the law in some fashion, I think my own view as Chairman—and I need to hasten to add that the Commission has not made a formal decision on this; the Commissioners are all entitled to their views, and we are still working this out, so I am not speaking for the Commission, but for myself—I would like to see this law applied to public companies for, among other reasons, the fact that the law itself seems to contemplate that. The law does not have an elaborate exemption provision. It was the intent of Congress, I believe, that these provisions be applied.

But I also think it was the intent of Congress that they be applied in a sensible way. And I think Congress would be the first to recognize, from the wide range of experiences that Members here have, that there is a difference between General Motors and Joe's Motors, and an allowance has to be made for that in designing systems to comply with this provision.

Mr. CLAY. So, in your opinion, it's proven to be more costly for some firms than others?

Mr. COX. I think there is no question that, proportionately, the costs are going to be higher for smaller companies than for large companies. Certainly, as expressed as a percent of earnings, the impact on a small company will far outweigh the impact on a large company.

Now, whether it should be scaled in exactly that way is another question. But we need to know, going in, that proportionately, the impact is greater on smaller companies.

Mr. CLAY. I thank you for your responses. It is good seeing you again. I yield back, Mr. Chairman.

Mr. SHAYS. [presiding] Thank you. And I will now go to Mrs. Biggert. Before recognizing her, if I am still here, I need to clarify the issue of broker-dealer/financial planner. I am not quite sure when I asked my question I did the proper follow-up, and I am just going to prepare you for that.

Mr. COX. I am sorry, I answered a Reg B question, because I thought that's what you were asking about.

Mr. SHAYS. Yes. I was talking about the broker-dealer, not the financial planner.

Mr. COX. Yes. All right. Do you want to ask that question now?

Mr. SHAYS. No, I think I will just go to Mrs. Biggert now, and make sure that, before we leave, we get that on the record.

Mr. COX. Okay.

Mr. SHAYS. Mrs. Biggert?

Mrs. BIGGERT. Thank you, Mr. Chairman, and thank you, Mr. Chairman, for being here. And first of all, I would like to thank you for making financial education your top priority for the SEC. I have been working on financial literacy within the Congress, and I particularly thank you for working with the NASD to help our military and their families. It's very important. And thank you for working to educate and protect our elderly investors and retirees and future retirees. You're doing a great job.

My question. The securities and futures industries in Chicago appeared to unanimously support parity in the portfolio margining between single stock, futures, and options. I found it is rare that competing industry interests unanimously support a proposal, unless it's good for the market and good for consumers. I believe that this is an important step for the capital markets.

Under rules proposed by the CBOE and the NYSE, a broad array of products, including equity securities, listed options, OTC derivatives, U.S. securities, futures, and broad-based futures could be included in a single account margin on a portfolio basis.

But last November, I believe that the Commission committed to approving self-regulatory organization rules to permit the customer portfolio margins by June 30, 2006. And I know that you are currently taking comments on CBOE and the New York Stock Exchange rule changes.

Do you anticipate that the Commission will be able to meet its commitment to Congress to act on these proposals by June 30th?

Mr. COX. I do. And let me add that I am committed, in my capacity as a member of the President's working group on financial markets, to implementing portfolio margin rules in collaboration with the CFTC. I think it makes a great deal of sense, from the investor's standpoint, from the investor protection standpoint.

Mrs. BIGGERT. Thank you. And then, in your testimony, you mentioned improving disclosure of financial data, and there is a fair disclosure from issuers of securities. And in addition, you mention that disclosures should be in plain English, and accounting complexity should be reduced.

In 2004, this committee held a hearing on corporate governance in accounting for oil and gas reserves due to several financial restatements by the companies in these industries. And in recent days, the accounting method of last-in first-out has come into question, as it relates to these industries.

Are investors in the American public getting clear and accurate financial statements from the oil and gas companies, including accuracies about the oil and gas reserves? And is this something that the SEC is examining?

Mr. COX. It is, indeed. Rules, as you know, in this area are old. They date back to the 1970's. And one of the things that has happened, in the meanwhile, is that technology has changed. And so, the technological premise for these rules needs to be re-examined.

Under our current rules, an oil and gas company is prohibited from disclosing any reserves, other than proved reserves under this definition. And so, if there is disparity between real life and good science, on the one hand, and what's in our publicly-mandated disclosures on the other hand, we need to address it.

Mrs. BIGGERT. Are you looking at the rules to be—to see if you can bring them into the 21st Century? Is that something that you can do?

Mr. COX. We are looking at it. The view of the professional staff to date has been that they have been unable to conclude that the newer technologies in use since the 1970's have been demonstrated to be routinely reliable for the attribution of proved reserves in the context that we're talking about here, for financial reporting.

But the Commission staff did allow the use of those new technologies in calculating proved reserves in the Gulf of Mexico, following a special project that it undertook.

Allowing the use—I think we all understand here—of new technologies would likely produce reports of increased levels of proved reserves, and what we're weighing is whether or not we're going to conversely reduce the reliability of the estimate. And we don't want to do that, of course.

Mrs. BIGGERT. Thank you. Thank you, Mr. Chairman. I yield back.

Mr. SHAYS. I thank the gentlelady. Mr. Cleaver, thanks for your patience.

Mr. CLEAVER. Thank you, Mr. Chairman. Chairman Cox, thank you for being here. I did not have the privilege of serving on the committee with you, but everybody who has speaks so highly of you, so it's a privilege for me to have the opportunity to have an exchange with you.

I have become somewhat obsessed with our national debt and with the investments by foreign nations in our government. Do you know the current size of the U.S. investments held by foreign entities?

Mr. COX. I don't have that figure to quote for you right now, and I would actually be surprised if I turned around and somebody did, but I will check.

Yes, I mean it's a very easy figure for us to get, and in a very formal proceeding such as this I would hate to do it seat of the pants. So why don't we get you the precise figure following this hearing?

Mr. CLEAVER. And I am interested also, if you can, in what portion of that is held by China and Japan.

Mr. COX. We would be very happy to do that.

Mr. CLEAVER. Thank you. But is that something, though, under normal circumstances, that the SEC would monitor?

Mr. COX. Well, you know, the Securities and Exchange Commission is very concerned with cross-border capital flows, and the maintenance of healthy, transparent, open markets that look after the interest of our own investors. It's impossible to do that job these days, and restrict yourself to our national border or not notice which way the capital flows are moving, which country's regulatory regimes necessarily we are dealing with, because they are the preponderant trading partners in the capital markets, and so on.

So, I think your question is right down the center lane of what we're interested in at the SEC.

Mr. CLEAVER. Is it what you consider dangerous if the interest of foreign—the investments of foreign entities reached a portion where they actually almost controlled major portions of our Wall Street companies?

Mr. COX. Well, I don't believe that we should erect barriers to foreign investment in our country, for the simple reason that we don't want foreign countries to erect barriers to our investment.

I would see—and here I am going to try and restrict myself to the role that I am testifying in, as Chairman of the Securities and Exchange Commission, and not give you a perspective as the

Chairman of the Homeland Security Committee, or a former Member of Congress, which, being in these surroundings, I am almost tempted to do.

But what we do at the SEC is evaluate the disclosures made by market actors. And the transparency of market actors is something that we have to be able to enforce through our regulations. If the people that are making the investments are not strictly market actors, but sovereigns, that's harder to do.

And so, if you're dealing with nations themselves, or their surrogates and their wholly controlled entities, I think it presents a different public policy issue than if you were dealing with purely market actors, private market actors from other countries. I think they tend to act for market reasons; governments act for reasons of national interest.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. SHAYS. Thank you very much. The Chair would recognize Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman, and let me add my voice to the chorus of those welcoming Chairman Cox to our committee. And I am certainly just as happy as I could be that a man of his integrity and leadership and philosophy has been chosen for this position.

Chairman, let me offer an apology here. I had to run off to a prior speaking engagement. So, although I heard your testimony, I have missed much of the question and answer period. So, if this is redundant, please forgive me.

In your testimony today, you expressed concerns with ensuring that our public investors have access to accurate and useful market data. I think the Commission has now been reviewing possible reforms to the consolidated model of market data for over a decade. Even by government standards, that's a fairly excessive period of time.

Recently on the Senate side, I believe, in your hearing there, you indicated that market data reform was something that was a front burner issue for the Commission.

And so, my question is, as this issue sits on the front burner, is it on low, medium, or high? In other words, do you have a time table yet on when the Commission will address this issue?

Mr. COX. Well, it's very salient for, among other reasons, the reason that the pricing of market data and the revenue generated by market data are of exceptional relevance to the now-public markets in the United States.

Back in December of 1999, the SEC issued a concept release dealing with the regulation of market information and fees, and so on. That focused primarily on the fees charged for market information, and the role that revenues derived from those fees played in funding the operation of the SRO's, and thus the operation of self regulation in the market.

The majority of the commenters on that issue—and the concept release generated a fair amount of comment—believed that the SEC's cost base approach, which was expressed in that concept release, would be unnecessary and impractical. They weren't fans.

The commenters cautioned that, for example, classification of common costs couldn't be done without significant disagreements,

continual auditing, and considerable expense. And some of them pointed out that, historically, cost-based systems have encouraged cost padding, and creating disincentives to reduce the cost through efficient operation or innovation.

So, that then took us to the appointment of an advisory committee in 2001. And the SEC's advisory committee on market information then expressly rejected this cost-based approach in its report to the Commission. They recommended that the SEC retain the consolidation and move from a single consolidator model towards a system of competing consolidators.

Then we had Reg NMS, which was adopted shortly before I came to the SEC. That didn't take any action on the competing consolidator idea. And in fact, it even reaffirmed the single consolidator system for best-priced quotations and for last sale information.

It did take some limited steps to confirm that SRO's could sell data other than currently consolidated data, but it left it to the Commission to explore whether further action was necessary to address concerns with the pricing of consolidated market data.

Mr. HENSARLING. But any time table on—

Mr. COX. The next step, in order to solve this problem, and to deal with it in a good way, is for us to understand with our counterpart regulators—for example, the FSA—you know, how we intend to deal with what we expect to be the new shape of the industry and the markets, now that they are for-profit entities.

It is this interplay between the interest that we have in transparency, and the transmission of this information to the market in real time, on the one hand, and the role that the revenues play in sustaining the SRO's themselves, it's that yin and yang that we have got to deal with.

So, I don't have a date that I can give you here in this hearing, by which all these questions will be resolved. But I hope it's of some comfort to you that this is a front burner, not a back burner item. It's something that we are very, very intently focused on.

Mr. SHAYS. The gentleman's time is—

Mr. HENSARLING. Unfortunately, I already see the red light is on, so apparently you didn't want to answer my other question. Thank you, Mr. Chairman.

Mr. SHAYS. Mr. Fitzpatrick?

Mr. FITZPATRICK. Thank you, Mr. Chairman. Earlier today, there was some discussion on a bill that I introduced that's pending before the committee—H.R. 2990—the Credit Rating Agencies Duopoly Relief Act. And currently, the SEC has only designated five credit rating agencies as nationally recognized statistical rating organizations, NRSRO's, for use in SEC regulations.

My view, Mr. Chairman, is that 5 is not enough. And to compound matters, 2 of the 5, Moody's and S&P, control about 80 percent of the market share. I introduced H.R. 2990, which would eliminate the SEC's designation process in order to engender some competition and to protect investors.

Congressman Kanjorski earlier asked an excellent question, which is given the fact that there is legislation pending, and at the same time SEC staff is reviewing the designation process, should we put our foot on the accelerator or the brake, he said.

And I believe you had essentially two responses. One is that, given the difference between the legislative and the executive process, you respect the legislative process we're going through, and we appreciate that.

Now, the second is that currently staff is in the process of defining the term "NRSRO," and I think you indicated, through the rule-making process that started back in March of last year—I'm not sure what—whether or not we have actually gotten to the actual definition. Has that been completed? Because it goes to Mr. Hensarling's question as to how long is this reform process going to take? Has NRSRO been defined at this point by the SEC?

Mr. COX. Well, as you know, the proposal was put out in March of 2005. We received comments on it, the comment period closed. And now we have been in extended study period. I think the inference you can draw from that is it wasn't just right the way it is.

Mr. FITZPATRICK. So, 14 months later, we still—I mean, defining an NRSRO is just the very beginning of the reform process. And 14 months later, we haven't gotten to the definition?

I think my view would underscore the need for legislation proposing reform. So I won't ask you your specific position on the legislation. But I would ask, as a general matter, do you believe that by encouraging competition in the industry, ratings quality will improve? Will costs come down?

And perhaps most importantly, will the anti-competitive practices such as—which is rampant in the industry today providing unsolicited ratings with a bill, sometimes in the industry referred to as the "shake-down," which I find very offensive, would this kind of legislation improve the process?

Mr. COX. Well, since you—if I understand your question right—are not asking me to comment on the legislation, but on the goals of the legislation, specifically competition, transparency, and possibly greater Commission authority to provide oversight in this area—those are our goals, as well.

I am not trying to be opaque in my answer, either to Representative Kanjorski or to you. So let me be very clear about what I mean to say there, when I say that I understand and appreciate the role of the Congress here.

Many times, on many different subjects, I had the pedal to the metal, my foot on the accelerator, trying to pass legislation as urgently as it could possibly be enacted. And I also was frustrated, because that didn't always happen.

So, if you ask me whether to go full speed ahead or not, even if I said yes, I still don't know whether or not that's going to result in legislation. And, if so, whether it would result in legislation this year or next year, or when. And I dare say that you might not know, either. That's the way the legislative process works. And that's all I meant.

So, what the SEC is responsible for doing is what the SEC has control over. And that is our own process. We are not waiting for something to happen here legislatively. On the other hand, we are not suggesting to you that, because we're doing something, you shouldn't. But we strongly share your goals.

And some of the things—I think I also alluded to this in my answer to Representative Kanjorski—some of the things that you

could do legislatively, we can't do through rulemaking. So the two are a little bit "apples and oranges".

Mr. FITZPATRICK. As a follow-up, your colleague, Commissioner Campos, who helped spearhead the development of the IOSCO voluntary code of conduct for rating agencies, has stated that he believes rating agencies legislation is needed, citing his unhappiness with voluntary agreement negotiations between the Commission and the SEC, designated rating agencies.

Chairman, do you think that the Commission needs statutory authority in this area to properly oversee the credit rating—the industry?

Mr. COX. The Commission has not taken a formal position on this, but I have the same position as did my predecessor, and that is that we would appreciate the provision by Congress of enhanced authorities for the SEC in this area.

Mr. FITZPATRICK. Thank you.

Mr. SHAYS. I thank the gentleman. Mr. Chairman, we have two remaining giants of the committee to ask questions, Mr. Gillmor and Mr. Leach. Mr. Gillmor?

Mr. GILLMOR. I don't feel like a giant, but thank you, Mr. Chairman. Mr. Chairman, congratulations on your appointment. I would like to welcome you back. You and I came in the freshman class of 1988, and I am glad that between you at the SEC and Porter Goss at the CIA, at least some did pretty well.

I want to bring up two areas. One, back in the 106th Congress, at that time you and I were both serving on the Energy and Commerce Committee, in the financial services area. I had introduced a bill which you cosponsored, along with then-subcommittee chairman Mike Oxley, which would have required publicly-traded corporations to disclose to their shareholders significant charitable contributions. The theory behind that was that that's the shareholder's money, they ought to know what's happening with it.

And, in fact, a lot of public companies voluntarily disclose it, but some of them don't want the shareholders to know what they're doing. And I have reintroduced that legislation this year.

I guess my question is do you still have the same view you did when you co-sponsored that bill, in terms of public disclosure, and would the SEC consider, either with or without that legislation, requiring public companies to disclose significant charitable contributions and insider-affiliated charitable contributions on an annual basis?

Mr. COX. Well, first, let me acknowledge the very generous compliments that you gave, and I want you to know how much I appreciated sitting next to you on this, and the committee across the hall. And I also recognize that you're being unduly modest in comparing a couple of your classmates to yourself. I think the country very much benefits from your being here, as well. And I appreciate the opportunity to appear before you in this capacity.

I didn't realize when I was a Member of Congress, and you and I were working on this together, that in response to your request, the SEC, before I was Chairman, conducted a feasibility study on implementing your legislation on requiring public companies and mutual funds to disclose information about their contributions in

their SEC filings. Obviously, you know about that, and I have learned about it in my capacity as Chairman.

The result, as you know, of that study was that the Commission—at least at the time—believed that requiring this disclosure would, in fact, be feasible. And public companies, the Commission believed, are capable of tracking and disclosing this information to investors.

So, from the standpoint of giving technical guidance on your legislation, I think that is still operative, and that should still help you as you deal with the legislative process here.

Insofar as our ability to do this, or our interest in doing this separate from legislation, the staff noted at the time—again, before I was Chairman—that charitable contributions make up a relatively small proportion of a corporation's financial activities. And, particularly in the case of mutual funds, the Commission staff found that the vast majority of funds didn't contribute to charitable causes.

So, given that our disclosure regime operates fundamentally on a materiality premise, the question arises whether, if that's what is guiding us here, we would do that following our own lights.

On the other hand, materiality is the floor. Everything that is material must be disclosed. Some things that our specific disclosure requirements mandate are not inherently, per se, material, and we require them anyway. This is true, for example, in the environmental area. So I think Congress would be well within its rights, if it decided, as a matter of public policy, that this kind of disclosure should be mandated, notwithstanding that it might not in every case otherwise be material under the Supreme Court standard.

Mr. GILLMOR. The other area I want to ask you about is the area of disclosure of taxes. One of the things that I am concerned about is that, in many instances, shareholders receive from companies information that is, in fact, misleading, even though it's accurate.

And one of the areas is the reporting of income for SEC purposes, which goes out on the Street, and that's what people look at as corporate earnings, in terms of determining whether to buy or sell shares.

On the other hand, there is another figure which is not always disclosed, and that's the income for public companies that is reported to the IRS.

So, the thrust of my question is, do you think it would be possible to have a system where a corporation would have to disclose SEC-reported income and IRS-reported income, similar to what companies do with executive compensation?

It seems to me that it's a rather key fact in order that investors can make a fair decision about whether they want to buy or not.

Mr. COX. Well, as you may know, the Commissioner of Internal Revenue, Mark Everson, has publicly floated this idea, and I have heard from him on it. We have discussed it. I certainly share the goal of increasing transparency of financial disclosure. I am not certain that publicizing tax returns is the best way to that result.

Mr. GILLMOR. I am not suggesting to go so far as to making the tax returns public, which I think you brought up. It's simply providing some comparable figures, so that—I may be wrong, but if a shareholders knows that a company reported $1 billion to the IRS,

but says to you they made $2 billion, and a person makes an investment on the $2 billion—so I'm not suggesting we make the whole return public.

Mr. COX. Well, your question began by noting how much of the information that's provided to investors right now might not be useful. And indeed, it might be confusing, and so on. I want to make sure, in all of the disclosure that the SEC mandates, that we are illuminating, and not making it harder for people to figure out what's going on.

Mr. GILLMOR. Right.

Mr. COX. A lot of the disclosure that the SEC requires is necessary for them to understand, for example, a corporation's tax deferral strategies. It might not be helpful to an investor's understanding of the overall financial condition of the company.

So, I am certainly going to pay close attention to this discussion, work with my counterpart regulator at the IRS, and work with the Secretary of the Treasury in my capacity as a member of the President's working group, to talk about this. I think it will get a good deal of attention.

But I want to be clear. This is an IRS idea that has been floated. It is not an SEC initiative. We are going to look at it, but I am certainly not pre-sold on it.

Mr. SHAYS. Thanks to the gentleman.

Mr. GILLMOR. Thank you, Mr. Chairman. Good luck on the new job.

Mr. COX. Thank you.

Mr. SHAYS. The Chair at this time would recognize Mr. Leach for whatever time you may consume.

Mr. LEACH. Well, thank you, Mr. Chairman. And I certainly share the earlier comments made about your service, Chris. We welcome you in this job. And I think your presentation today has been very impressive, particularly your emphasis on transparency and more simplified, timely disclosures.

I want to raise an issue that is very difficult for you, also for those of us in Congress. And that is the remuneration issue. And you point out—and I think quite properly—that you are reluctant to enter into this issue.

On the other hand, there are two perspectives that I think have to be raised at this time. One relates to the market itself. If the public loses confidence in public corporations and their mission—that is, is their mission to serve the shareholders or to serve insiders—you can have a real shake in confidence in the market. If the public loses faith in the market, that is not a trivial circumstance.

You point out—I think quite properly—that remuneration is largely the province of the board. But what happens when a board and a CEO are pretty much in tandem? I mean, we have this example that the Wall Street Journal has laid forth of a public corporation over the last decade that has given a couple of billion dollars in stock options to a CEO, and at the same time, a couple of hundred million dollar stock options to the board. That is an extraordinary situation.

I don't know if it's an SEC issue or not. But if it is, has the SEC examined this case?

Secondly, I have the good fortune to represent the University of Iowa. A distinguished scholar at the university, a professor named Eric Lee, has done a study of stock options, and he has examined literally thousands of public corporations.

He has concluded that it is rather impressive how many stock options were granted at low points, just before shares had risen. And he has concluded that the odds of such a happy coincidence for the recipients is so high that it is about twice as high as winning a Powerball with a dollar ticket, which implies that it is conceivable that some of these grants of options were done retroactively, which implies, as I understand it, a possible violation of law.

And so, my query: is the SEC looking at this particular circumstance at this time, and is there a market confidence type of dilemma that occurs with these remuneration issues?

Mr. COX. Well, particularly with the pathology that you just described, there is a market confidence issue, I mean, because that either is or borders on fraud in its most extreme forms.

When I said earlier that the SEC doesn't want to second guess the board, make judgments in place of the board about the methodology or the levels at which executives are compensated, what I mean, of course, is that we don't want to substitute our own judgment for the honest judgment, the business judgment, of the board of directors.

Mr. LEACH. Fair enough.

Mr. COX. But if an individual executive or confederates on the comp committee or on the board are in any way violating the trust of the shareholders, that's an entirely different matter. And our enforcement division is very interested in that.

Mr. LEACH. Well, I appreciate that. And I just think we would be shirking our duty if we didn't raise this kind of issue. And your institution is the singular one in our society that can look at these things. And so I appreciate your attention. Thank you.

Mrs. KELLY. [presiding] Thank you. Mr. Sherman?

Mr. SHERMAN. Thank you, Madam Chairwoman. Chairman Cox, it's good to see you again. I don't see you on the plane as often; I guess your new job doesn't involve trips to Newport Beach. Other than that, I hope you like it. I have quite a number of questions that I will pose. Maybe you will have a chance to respond, or maybe you can respond for the record.

The first is that the accounting statements that are audited contain the same information that accountants have been providing for about 100 years. A few decades ago we went beyond the income statement, the balance sheet, to a funds flow statement that is really the same information presented in a different format.

Yet the markets are much more interested in other information, and are willing to act on it, even though it comes to them in unaudited form. For example, if you are dealing with Boeing, you want to know what they have in the way of back orders. If you're dealing with a retail store, what is its revenue per square foot? All this information tends to get reported. None of it is audited on a quarterly basis, or even on an annual basis.

And so, I hope that the SEC would move beyond the 100-year-old income statement and balance sheet to at least a system where

companies would be encouraged to provide information relevant to their industry that is audited, so that it can be relied upon, and so that even if you are producing weekly or monthly reports that are unaudited, the management knows that, by the end of the year, there is going to be an audit of what they have been presenting, just as we get unaudited quarterly, and sometimes even more frequent information about the income statement, and eventually it is audited.

The second area I would like you to focus on is that of the SEC as an enforcement agency. And here, my information may be a little stale. But most of this hearing has focused on those investors who are making investments in something that a securities professional would say, "Looks like a legitimate investment." They are buying a publicly registered stock on a stock exchange, comes with a prospectus. Even Enron came with a prospectus.

But then there is a whole group of absolutely phony investments that you or I would look at and say, "My God, this is a violation of every securities law," being hawked on the Internet. And I am told that the SEC is prevented by law from even having its people pose as potential buyers on the Internet. You can't even have your people surf the Net to find the apparently bogus investments.

And I hope that, in addition to protecting the reasonable investor who is buying stocks in companies on stock exchanges, etc., that the SEC would devote some resources and get whatever legislative authority it needs to at least pose some risk to these charlatans selling investments on the Internet and in other ways.

The third issue I would like to bring up is the issue of minority shareholder rights. One that we know you have talked about, executive compensation. One way to deal with that is to have a group of shareholders dispossess the current board and install a board more responsive to shareholder interests.

And yet, we have a system in which companies go to the State with the lowest possible minority shareholder rights standards. And I hope that you would present this Congress with some ideas of setting minimum rights for minority shareholders of all publicly-traded corporations, rather than have Delaware and Nevada and others fight to provide the most possible protection for entrenched management. I would like you to respond, time permitting.

Mr. COX. Well, first, I want to thank you for your generous comments, and let you know that while my current occupation doesn't permit me to be on the plane with you as much, I certainly intend, as a Californian Chairman of the SEC, to make sure that the portion of America west of the Mississippi has just as much representation in our regulatory system as does the East Coast.

Mr. SHERMAN. Does that mean you're volunteering to speak in the San Fernando Valley?

Mr. COX. Well, we can talk about that.

Mr. SHERMAN. Okay.

Mr. COX. It's—you know, particularly we should talk about that for around January or February I think.

Moving directly to your questions. First, you're certainly one of the few CPA's I know in the Congress, if not the only one. And I think, having looked at these issues from the vantage point of a Member of Congress with that background for such a long time,

you're more keenly aware than most of the anachronism that you pointed out in your question, the mismatch between a system that relies on snapshots taken at year-end, on the one hand, and the fast moving economy that we live in today, where information moves 24/7—

Mr. SHERMAN. And if I can interject, it's also just a snapshot of the things that accountants decided over 100 years ago should be photographed, and does not include such things as employee turnover rates, which, to me as an investor, might be more important than just quarterly sales.

Mr. COX. And I think you're absolutely right, first of all. I agree with the entire premise of your question. And second, you're absolutely right that the kinds of other things that investors are interested in and could benefit from, were they available, are not only are things that are off balance sheet, off income statement, or off funds flow statement, but they may be only quasi-quantitative. They may be qualitative. In the information economy, with services being such an important part these days, the manufacturing model may not always fit.

And so, as we take a look at the overhaul of accounting and all of its complexity, one of the things that we have to keep uppermost in mind is that, to serve investors, we need to give them real information that they can use. That means, as I pointed out earlier also, that it should not be confusing; it should be in plain English.

Interactive data, which is one of the big initiatives of the SEC, as you know, is very well suited to helping us move in this direction, because it's real time, because it applies to all data, potentially. It doesn't even need to be a number; it can be text. Being able to move this information around immediately in real time is going to help the preparers. It's going to help management from an internal control standpoint, from a management control standpoint. And ultimately, I hope, therefore, it helps us to come up with better numbers, and in some cases, audited numbers that today we just can't have access to.

With respect to the SEC posing as potential buyers, the SEC—I have just consulted with general counsel—I don't believe is legally inhibited, but we can check on this. But rather, it is by long standing practice that the Commission, in our enforcement activities and in our inspection activities, foreswears any deceptive conduct.

Mr. SHERMAN. Mr. Chairman, if that's the case, I would urge that your employees get practice in using the Internet, and seeing the investments that are being put forward there, and that the tradition of "not being deceptive" should not override an efficient effort to protect Americans from the investments that you and I would laugh at, but that others are putting their money into.

Mr. COX. Yes, I assure you that—because that's where I was headed next—that we are doing so. And you would expect from an agency that is focused on interactive data, that we are very keen on exploring investor protection for those investors that are already on the Web. The SEC has very recently set up scam Web sites so that investors that think that something looks too good to be true, and are about to buy it on the Internet, can click all the way through and then find out at the end that it's really the SEC.

So, we have sort of threaded that needle. We have been able to do what you're describing. But then in the end, you know, we tell them, "This could have been real. And if it had"—and it serves as investor education.

We also have a portion of our enforcement that is focused on Internet enforcement, as you would expect. So we are very much working this area.

Mrs. KELLY. Thank you very much, Mr. Sherman. Mr. Scott, I am going to ask if you are prepared to go now. I have not yet asked my own questions, but since you—barring the advent of another one of our colleagues, since you are the last man standing on this committee at this point, I will do the mop up, and you go ahead, if you're ready to—are you ready for your questions?

Mr. SCOTT. I certainly am, and thank you for referencing Bruce Willis's great movie, "Last Man Standing." Those of you who haven't seen that, I am sure you will enjoy that amazing shoot-out.

Let me just commend you, Chairman Cox, on the excellent job you are doing. You certainly distinguished yourself in a very short period of time, bringing tremendous leadership and some very good, positive changes to the Securities and Exchange Commission, and I want to commend you for your leadership and the work you are doing there.

Let me ask you about regulation B in my first question. Can you provide us with some sort of report on the status of the proposed regulation B, and any efforts that the Commission has made to work with banking regulators to propose a regulation that merits the legislative intent of Gramm-Leach-Bliley?

Mr. COX. Well, in fairness, since I was asked earlier about the definition of investment advisor and broker, and I answered by giving the status of Regulation B, I should answer your question now by describing where we are in—

[Laughter]

Mr. COX. But I won't. I will tell you that because Gramm-Leach-Bliley is, at this point, not a new law, it was passed in 1999, I think it's high time that we have rules implementing the statute. And so, I am committed to promulgating Regulation B as early as is humanly possible. I have convened meetings of the banking regulators and the SEC to go over this collaboratively to come up with a solution that makes sense for all of the regulated community, and I think we can do it. I would hope that we have a result, even this year.

Mr. SCOTT. Good. All right. Thank you very much. Let's go very quickly to Sarbanes-Oxley. I don't know if this question may have been asked prior to me, but I would be very interested in getting your take on the application of section 404, and where you stand on the recommendations vis a vis the smaller cap companies and the exemptions applicable to those.

Mr. COX. First, I am very appreciative of the work that our smaller public company advisory committee did for the Securities and Exchange Commission, and for the benefit of America's investors. They worked for 13 months and produced a report very recently. As you know, I think it well reflects the concerns from smaller companies, including smaller public companies.

Their recommendations are going to be taken to heart at the SEC. They are one of several sources of information and input.

With respect specifically to that portion of their report, the 1 of their 32 recommendations that suggested that we exempt certain smaller public companies, I will say as 1 of 5 commissioners in this capacity—because this is going to be a Commission decision, and so I'm speaking now for myself—that I am hopeful that we could achieve the objective that they sought, not by the blunt instrument of an exemption, but rather by the tailored application of the statute with full mind of the Congressional intent to smaller public companies in their different circumstances.

I think that should be possible, and I think that, even in their recommendations, the advisory committee contemplated that, if there was a suitable framework for management of smaller public companies, that they wouldn't need an exemption.

Mr. SCOTT. Okay. My other question I would like to ask is your take on another very topical issue, the committee on investments by foreign countries directly in the United States.

We have had some very serious hearings on that issue, as a result of the Dubai Ports deal. And we're looking at how we can certainly protect our security, and make sure we are secure there. Do you have any words of concern, in terms of the level of overreach that we might do that could perhaps put a damper on our ability to attract much desired foreign investment in this country? And what advice would you give our committee and the Congress, as we look at reform of CFIUS?

Mr. COX. Well, I am going to constrain myself to answer the portion of your question that I am qualified to answer as Chairman of the SEC, and not stray off into the more general of national security and public policy questions that you necessarily have to take into account, and any restructure of CFIUS.

From the SEC's standpoint, obviously, we are concerned about investor protection and about maintaining the United States capital markets as the largest, deepest, and most liquid markets in the world, and we want to continue, as I think you do—I infer that from your question—the attractiveness of the United States market for foreign investors. We want to make it clear to everyone that we welcome foreign investment in this country.

At the same time, I think we want to distinguish, at least for disclosure purposes, between state actors, sovereigns, who, as one might imagine, the SEC would have a great deal of difficulty exercising its enforcement regime against, on the one hand, and market actors on the other hand. And that's a distinction that I think Congress and policy makers need to keep in mind, as well.

Mr. SCOTT. Thank you very much, Chairman.

Mrs. KELLY. Thank you, Mr. Scott. Chairman Cox, it's really a pleasure to have you here in this capacity. Having been one of our colleagues, and having served with you, I have to say I am very interested and appreciative of the effort that you have put in to make the SEC look and be responsive to some of the issues that have been troubling for me personally, and others who have been involved with the market.

Perhaps these questions that you have been asked indicate that—I don't want you to feel that this means that people, all of

us sitting here, are not appreciative of the efforts that you have made.

That being said, I understand that your testimony doesn't explicitly refer to the needs of smaller public companies. They are disproportionately affected by over-regulation. The accounting industry has been working hard to try to lower the costs of audits for smaller companies, and according to the CRA report on the 404 costs, smaller public companies' costs for 404 audits and compliance have declined by approximately 30 percent from the first year of the 404 review to the second, as companies begin to learn to work within the system.

But the industry doesn't have the authority to change the law. And it seems clear that the law really needs to be changed, especially for smaller companies. Recently, the advisory committee of the SEC, on this issue, suggested that smaller public companies needed to be excluded from portions of section 404.

You said that—in your Senate testimony—that the question is not whether to apply 404 to all companies, but how. I am concerned that this answer to the other House conflicts with your advisory committee, and also sends the message that any company unwilling to pay a tax of $1 million a year in compliance costs should not look to sell shares to the public.

The advisory committee recommended that companies with less than $10 million in revenue be excluded from section 404 below a market cap of $750 million, because the costs of compliance were disproportionate to their revenues. I am afraid that this benefits biotech companies, but it doesn't benefit the small manufacturing companies.

For instance, a firm could have higher revenues, but require the devotion of scarce personnel resources for their compliance.

I would be interested in your thoughts on exempting from 404 review companies with less than $1 million in revenue per employee, or a similar number.

Mr. COX. First of all, thank you very much for your compliments, and I want you to know how much I appreciate seeing you in the chair.

Section 404, and more generally, the regulatory burdens placed on smaller companies, are a very, very important focus for the SEC necessarily, because one of our missions is facilitating capital formation.

We are well known as the investor's advocate, but our tripartite mission includes maintaining orderly markets and facilitating capital formation, as well. And all of these things, properly viewed, are complementary. We can't say that we are doing our job of protecting investors if, in fact, companies that are offering their securities are effectively prevented from doing so by our regulation, and the products and the investments are, therefore, unavailable to the investing public.

The advisory committee's recommendation, which I have now had the opportunity to read very carefully, premises its recommendation on exemption of some smaller public companies on the lack of an available framework that is tailored to smaller public companies. I think that that is the essence of their recommendation, that if you're going to have a 404, you've got to make sure

that it applies in a tailored way across the board, and that you don't take the standard that works for Exxon and apply it to a small business.

The same applies, it strikes me, when it comes to the disporportionality of audit fees. Necessarily, the same level of expenditure is going to much more dramatically impact a company with smaller revenues and smaller earnings than it will a large company. And so, to the extent that the audit of internal controls necessitates a certain base level of activity, there is no escaping the fact that it's going to be more significant for smaller companies. The SEC needs to take all of this into account.

My hope is that we can implement 404 in a way that you all intended—and that I intended, because I was here and worked on the development of that legislation as well. I don't think any of us had in mind, when we voted for Sarbanes-Oxley and its included section 404, that this provision would produce anomalous results, or outlandish costs, or inhibit risk-taking by companies, or keep products off the market, or in any other way distort our investor protection regime.

And so, I am taking it as my charge to make sure that we can make 404 effective, and see to it that it achieves Congress's objectives at the same time that we lower the cost and make sure that there is a regime that specifically fits smaller companies.

Mrs. KELLY. I am glad to hear you say that. When you talk about facilitating capital formation, there is a small-cap, mid-cap people, these people that have revenue of less than $1 million per employee sometimes, and people who do generate this economy capital—do increase with capital formation. So that is a good stance.

We have been joined by Mr. Fossella, my colleague, and I would like to come back to pursue that line of questioning a little bit further, but let me turn to Mr. Fossella.

Mr. FOSSELLA. Thank you, Madam Chairwoman. Mr. Chairman, thank you. Thank you for your patience. And more importantly, thank you for the strong leadership you have brought to the Commission. Your consensus-building approach I think is admirable, and I can't tell you enough how I appreciate the fact that the President made the right choice in selecting you.

Having said that, I know you have answered a wide array, and you have been very patient. Let me just jump into one specific issue regarding legislation that I introduced regarding procedural reforms, and looking at ways to restructure the Commission.

In regards to procedural reforms, it included provisions aimed at increasing communication between registrants and the Commission in regards to the status and/or closure of inspections and investigations, and requiring Commission approval prior to the initiation of sweep examinations. Structurally, the legislation would restore the Commission's inspections and examinations authority to the divisions of market regulation and investment management, to insure examination staff are working alongside the division staff responsible for creating and interpreting the rules.

I think you have tried to establish and strike the right balance of protecting investors, facilitating capital formation, but also recognize that the most effective tool we have in ensuring the integ-

rity of these markets, is to have an effective and strong and vibrant SEC, especially in the inspections and examinations.

So, I know—or so I have been told—that the Commission has begun to implement aspects, or at least evaluate some of the aspects of some of the reforms that are included in the legislation. Can you please tell us what, if any, have been made, or are in the process of being made? And prospectively, what, if anything, we can anticipate?

Mr. COX. I would be pleased to do so, and I want to thank you for your interest in this area, and your active involvement, because it is in response to comments and feedback, including those that you provided to the Commission, that the Commission has recently changed in several respects the way the Commission itself oversees these SEC examinations. And let me just go through some of these changes for you.

First, it is now the policy of the Office of Compliance Inspections and Examinations, OCIE by acronym, to provide advance notice to the Chairman and to the Commission of any proposed sweep examination. That didn't use to occur. In addition, the Office has beefed up the pre-exam process, to ensure that exams aren't duplicative, and that they are as minimally disruptive as necessary to accomplish the objective.

Second, OCIE is promulgating a new policy that, if an examination hasn't been closed within 120 days after the completion of the fieldwork portion of the review, the registrant then is provided with notice that the examination is still in progress. So it is no longer the case that the subject of the examination is in the dark.

Third, at the conclusion of an examination, the registrant is provided with a letter, either setting forth the deficiencies identified by the staff, or informing the registrant that the examination is being closed without findings. We have also been working to provide greater transparency to the firms under examination in other ways.

For example, OCIE is amending the informational brochure that it provides to firms at the outset of every examination, so that they understand clearly, up front: first, that most examinations are going to be over within 120 days, after the end of the field work; second, that they are invited, as registrants under examination, to communicate with the exam staff about any questions that they might have regarding the structure of the examination; and third, they are given a phone number to call if any issues arise they feel more comfortable discussing through the SEC's examination hotline.

Staff at the SEC are also updating our public Web site so that, if you are a registrant being examined, you have immediate access to the names and phone numbers of the supervisory staff in each SEC field office.

Mr. FOSSELLA. Thank you for those initiatives and changes. I'm just curious, is there any—do you see any more changes coming down the pike, or any more formal—a ratification of some of the other questions that have been raised in the underlying legislation, or is the system a more fluid dynamic process that we can anticipate?

Mr. COX. Well, what has been accomplished has been accomplished in a relatively short period of time, as you are aware.

Mr. FOSSELLA. Yes.

Mr. COX. I am comfortable, as Chairman, that I have a good deal of organizational authority at the Commission. I am also absolutely convinced that the leadership of that office wants this process to work with as much transparency as possible, and wants to be sure that while, as you would imagine, these examiners aren't always going to be the most popular people in the world, that the function that we are performing is fully understood, and that, in a larger sense, it is appreciated, if not by the subject of the examination at the moment, then by the investing public.

And so, I think all of the Commissioners, who share this objective, and I, and the leadership of the office are going to be in a position to continually improve this process. The Office itself, as you know, is not the oldest part of the 72-year-old SEC. It's a relatively recent addition.

And I think that the additional resources that we have been able to deploy in the post-Enron world, with the additional funding that's been provided by the Congress, mean that the way we do our work in this area is becoming more salient. It will give us more feedback and an opportunity to be more responsive to the market.

Mr. FOSSELLA. Thank you very much, Mr. Chairman. Thank you.

Mrs. KELLY. Thank you, Mr. Fossella. Chairman Cox, I have two questions left. One is not mine, one is a follow-up that I have been asked by my colleague, Chris Shays, to ask. This is the question he asked me about.

He says that the Commission currently is exempting broker-dealers from the Investment Advisors Act if they give financial planning only incidental to their activities. And he is concerned about that, and wondered if you could speak about that.

Mr. COX. I am happy to speak about that, and I am very sorry that I gave him an excellent answer to the wrong question. And I am sorry he is not here to hear it, but thank you for asking it, and letting me respond to it on the record.

As you know, our broker-dealer investment adviser rule is currently the subject of litigation. There is a lawsuit challenging the rule by the Financial Planning Association. The SEC is going to be filing a brief in the next few weeks. The staff have provided some interpretive guidance that's of a few-months-old vintage, and we are going to continue to consider additional guidance on this subject in the meanwhile.

We are in the cauldron of this lawsuit right now, and I think that things rather rapidly should become clear on that front.

Mrs. KELLY. Thank you. I am sure Chris will get that answer. So thank you very much.

The final question I have is that companies in my district are increasingly coming to me with a concern about naked short-selling in their stocks. This is a practice that is sometimes used to hold down the valuations of companies, particularly manufacturers, retailers, and it leaves them vulnerable. While we know it's technically illegal, it seems that the practice is common. And not only that, there seems to be growing evidence that it may be deliberately taking place.

I understand that reg SHO has shown the need for more information from the markets about shorting and failed trade, and I wonder if you are willing today to speak about this, what's being done. I think the SEC has—with the—I think that reg SHO has shown this need, and I think perhaps you might have something that you would be willing to share with the committee on it.

Mr. COX. Well, first of all, I think you are absolutely right, that this is an important issue, and reg SHO, as written, may not be the final answer. The Commission adopted this regulation in 2004, in June. It didn't become effective until last year. And so, we are just now in a position to begin to assess whether or not the rule is working as it was intended.

Since the adoption of the rule, the data that we have assimilated thus far has told us that about 99 percent of all trades, by dollar value, settle on time without incident. So that's certainly part of the good news. And the overwhelming majority of these fails are closed in less than 5 days, even within the 1 percent.

So, on an average day, approximately 1 percent, by dollar value, of all trades including equity, debt, and municipal securities, fail to settle. And that's where we're focused here. Those failed positions, we are learning, are, in the main, getting closed out more quickly, now that the rule is in effect.

But, like you, I am very concerned about what's in the 1 percent, because it's 1 percent of a very big number. The staff are developing rule amendments to further reduce the continuation of large fails to deliver position. In the meantime, the Commission has extended our existing pilot program through August of 2007, so that we can ensure that the progress that we have already made isn't lost.

Mrs. KELLY. Are you aware that publicly-traded companies and State regulators aren't allowed to see the records of the failed trades from the Depository Trust and Clearing Corporation? Don't you think that maybe State regulators should know if the amount of shares trading in a state-chartered corporation exceeds what is allowed under the State rules?

Mr. COX. We are certainly interested in working very closely with our counterpart State regulators for a number of reasons, including the preponderance of the most egregious problems in this area, with thinly traded, smaller companies that are the normal domain of the blue sky regulators. And so there is ample opportunity to do better in this area.

Mrs. KELLY. Thank you very much.

Mr. COX. May I say also for Congressman Shays, who isn't here—because I neglected to do so—that when the Commission, before I was Chairman, last looked at the issue of investment advisers and broker-dealers, they charged the staff with proposing a study of this issue. The staff have now given me enough information so that I can make a decision whether to go forward with that study, and how, and I very recently did so.

So, among the other bits of news on that topic is that there will be an effort, in a very serious way, to infer from marketplace data what we should do by way of distinguishing between the roles of investment advisers, on the one hand, and broker-dealers, on the other hand.

Mrs. KELLY. Thank you. You have been very patient with us on a very busy day, which is why so many people have come in and out of the committee. We are very grateful for the time that you have spent here, Mr. Chairman.

The Chair notes that some members may have additional questions for this panel, so without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses, and to place their responses in the record. This hearing is adjourned.

[Whereupon, at 12:58 p.m., the committee was adjourned.]

A P P E N D I X

May 3, 2006

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Protecting Investors and Fostering Efficient Markets: A Review of the SEC Agenda

May 3, 2006

Good morning. We are here today to hear from a former colleague and a good friend, Securities and Exchange Commission Chairman Christopher Cox. Nine months ago, Chairman Cox was sworn in as the 28th chairman of the Securities and Exchange Commission, and he assumed the responsibility of directing the Commission in its responsibilities of overseeing the capital markets and protecting investors. As a former securities lawyer, Chairman Cox was a natural selection for the post. And in making this appearance to discuss the priorities of the Commission, Chairman Cox returns to our hearing room where he once sat as a member of this Committee.

Chairman Cox takes the reigns of the Commission at a dynamic time for our capital markets. The New York Stock Exchange has merged with Archipelago Holdings; the Nasdaq has merged with Instinet and has taken a 15 percent stake in the London Stock Exchange. Retail investors are investing in a wider range of securities products than ever before.

And by almost all barometers, the American economy has recovered well from the corporate scandals that shook investor confidence several years ago. In the wake of those scandals, this Committee shepherded through the House legislation to reform corporate governance and accounting oversight. One of the goals of the Sarbanes-Oxley Act was to strengthen the financial reporting of our public companies. Although it is difficult to quantify the benefits of this legislation, it is clear that investors once again trust our capital markets: The Dow Jones Industrial Average hit a six-year high just yesterday.

I must commend the efforts of the Commission in overseeing the execution of the mandates contained in the Sarbanes-Oxley Act. It is true that the implementation of the Act's internal control requirements has been more onerous than originally predicted. However, it is critical that we allow our regulators to rectify the implementation difficulties that public companies and their auditors face.

In this regard, I am encouraged by the efforts that Chairman Cox and the Commission have made and continue to make in engaging in discussions with public companies and auditors about these internal control requirements. Following up on

last year's Roundtable, next week the Commission and the Public Company Accounting Oversight Board will be hosting a Roundtable on Internal Controls to discuss second-year experiences with these provisions. Following that initial Roundtable, both regulators issued additional guidance relating to the internal control reporting requirements.

The Commission will also soon be taking into consideration the recommendations of its Advisory Committee on Smaller Public Companies, created by the Commission to assess the regulatory burdens smaller public companies face. Again, I am pleased by the proactive efforts of the Commission.

I also want to commend Chairman Cox for his recent initiatives to enhance the financial reporting at our public companies. Realizing that the heart of our capital markets is the timely and accurate disclosure of financial information, Chairman Cox has sought to make this financial information more understandable and accessible to investors.

This past December, Chairman Cox, along with Robert Herz, Chairman of the Financial Accounting Standards Board, announced an initiative to reduce the complexity in financial reporting. This effort includes revising outdated and complicated accounting standards as well as working towards the convergence of international accounting standards. In addition, Chairman Cox's advocacy of the use of eXtensible Business Reporting Language, or XBRL, has the potential to empower millions of investors with better financial analysis.

Finally, I would like to mention one area of reform which this Committee has championed since the corporate scandals a few years ago. The credit rating agency became a focus of congressional interest because the dominant rating agencies had rated WorldCom and Enron investment grade just prior to their bankruptcy filings. This Committee and the Capital Markets Subcommittee, under the leadership of Chairman Baker, have held a series of hearings focusing on the lack of competition, accountability, and transparency in the credit rating industry. Congressman Fitzpatrick has introduced legislation, H.R. 2990, that would bring more competition, transparency, and oversight to this industry. I am hopeful that this Committee can work in a bipartisan manner and with the Commission to make this reform a reality.

I look forward to hearing from our distinguished witness, Chairman Cox, on these and other Commission initiatives.

STATEMENT OF REPRESENTATIVE GARY L. ACKERMAN
HOUSE FINANCIAL SERVICES COMMITTEE

HEARING ENTITLED
"PROTECTING INVESTORS AND FOSTERING EFFICIENT MARKETS: A REVIEW OF THE SEC AGENDA"

WEDNESDAY, MAY 3, 2006

Good morning. I want to thank Chairman Oxley and Ranking Member Frank for holding this important hearing. I would also like to welcome Chairman Cox back to the committee; its good to see you and I look forward to your testimony.

I am particularly interested in hearing about your efforts to improve financial disclosures so that individual investors will be able to better understand the financial information surrounding securities they own or are considering buying. With more than half of all Americans currently owning stock, either directly or through a mutual fund, it is essential that we provide these investors with resources they can understand so that they are able to make informed decisions.

I am pleased to see that the SEC's "war on complexity" includes changes to the disclosure requirements for executive compensation, and I believe that this rule is a step in the right direction, but I am concerned that the proposed rule may not go far enough. It is no secret that compensation for corporate executives has skyrocketed over the past few years. What concerns me is how the incentives contained in these elaborate executive agreements may impact a company's shareholders over the long run. Since these compensation packages are often tied to a company meeting certain thresholds, such as earnings requirements, an executive may use aggressive accounting practices in order to meet investor expectations. The executive will get their pat on the back and cash in their bonus, but if the company is later forced to restate its earnings, the shareholders end up paying the price as they watch the value of their stocks plummet. As we all know, shareholders are the owners of public companies, which means these executives work for them, and yet the shareholders remain powerless in these situations. Something must be done to remedy this inadequacy.

I look forward to hearing from Chairman Cox, and again welcome him back to the committee.

OPENING STATEMENT OF
CONGRESSMAN PAUL E. KANJORSKI

COMMITTEE ON FINANCIAL SERVICES

HEARING ON PROTECTING INVESTORS AND FOSTERING EFFICIENT MARKETS

WEDNESDAY, MAY 3, 2006

Mr. Chairman, I join with my colleagues in welcoming SEC Chairman Christopher Cox to our panel. While many things in this room may look familiar to him and to us, he is now sitting on a different side of the table and serving in a different role. We should, therefore, expect him to have a different perspective on the issues that we once actively debated together.

I want to commend Chairman Cox for his hard work during his first few months at the Commission. Like a number of his predecessors, he has taken over the helm of the Commission during a challenging time, and I have been particularly impressed with his desire to improve financial disclosures for investors. He has also himself faced, and overcome, personal adversity. I hope that he now continues to enjoy good health for many years to come.

As I just mentioned, the Commission presently has before it a number of important issues. One of the key issues that Chairman Cox is addressing is the implementation of Section 404 of the Sarbanes-Oxley Act. I will be particularly interested in hearing his thoughts today about how we can improve the ability of companies both large and small to assess the accuracy of their internal controls without adding unnecessary costs.

Another issue that I hope that we will examine today concerns the evolving structure of our capital markets. The Commission has now approved many regulatory modifications to our National Market System, and our securities markets are now working to implement those changes. In addition, a number of our exchanges have gone public in recent months. These privatizations raise questions about the ability of exchanges to continue to protect investors at the same time as they work to maximize shareholder profits.

As Chairman Cox also knows, the oversight of credit rating agencies has recently been the subject of considerable discussion on Capitol Hill. The Commission has before it a proposed rule to address these matters. It is also discussing a voluntary agreement that would improve transparency and oversight of the credit ratings industry. Because we may soon consider a bill in this area, I would therefore like to learn more about the status of these actions. The successful and speedy resolution of both the rulemaking and the voluntary agreement would, in my view, likely preclude the need for us to legislate on rating agencies.

One final issue that has attracted my attention in recent weeks concerns exchange-traded funds. These funds are increasingly popular with investors, growing nearly 200 percent between the end of 2002 and the end of 2005. It seems, however, that the process to review and approve ETF applications has not kept up with investor demand. In fact, I have heard that some applications have remained unresolved for years. I thus want to know what the Commission is doing to address these matters, consistent with its investor protection responsibilities.

In closing, Mr. Chairman, I look forward to hearing from our former colleague. I also hope that he will specifically advise us as to what the Commission is doing about the oversight of rating agencies and the process for approving exchange-traded funds.

TESTIMONY
OF

CHRISTOPHER COX, CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

IMPROVING FINANCIAL DISCLOSURE
FOR INDIVIDUAL INVESTORS

BEFORE THE COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

MAY 3, 2006

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Testimony of Christopher Cox
Chairman
U.S. Securities and Exchange Commission

Improving Financial Disclosure for Individual Investors

Before the Committee on Financial Services
U.S. House of Representatives

May 3, 2006

Chairman Oxley, Ranking Member Frank, and Members of the Committee: This is my first formal appearance in the House since I became SEC Chairman last summer, and I am delighted to come before my former committee and my colleagues here. I am pleased to have the opportunity to report to you on the new initiatives that the SEC is taking to protect individual investors – more specifically to improve the financial disclosure they receive. While my testimony focuses on a key element of the agency's mission, I assure you that it does not cover the entire panoply of important issues the agency is dealing with on a day-to-day basis, so I am happy to be here to hear from you and to answer any questions you may have.

Introduction

As a Member of the House for 17 years, I was constantly reminded by my constituents of the real world impact of the decisions we make here in the Nation's Capitol. Like every one of you, I learned the importance of being a good listener, and of remembering that the common sense of ordinary Americans is the essence and the strength of our democracy.

Most of your constituents are not investment bankers, or lawyers, or accountants. But most of them are investors. It is a stunning fact of life in the 21st century that a majority of Americans now own stocks, either directly or through mutual funds. It is chiefly to serve these people that the SEC exists. Our mission – to protect investors, promote capital formation, and maintain orderly markets – must always put ordinary Americans first.

Since making the transition from the halls of Congress to the SEC, I have set out to rededicate the agency's ongoing efforts in virtually every area to the service of the individual investor.

In a well ordered market, educated consumers can choose from a number of competitive products and find what they want at a price they are willing to pay. But, in order to educate themselves, investors need comparative facts. So, while investors must bear the responsibility of learning what they can about their

investment choices, the correlative duty of sellers of investment products is to provide the relevant information. What's more, in order for investors to make sound decisions, the seller's information has to be understandable, accessible, and accurate.

These are the basic ingredients of healthy competition in every corner of the financial marketplace.

To more closely match the theory of a well ordered market with today's reality, the SEC is currently pursuing a number of initiatives to improve the quality and usefulness of disclosure for individual investors. These initiatives, taken together, are designed to insure that investors have ready access to more accurate and understandable information about the securities they own or are considering buying. These initiatives include:

(1) Moving from long, hard-to-read disclosure documents to easy-to-navigate Web pages that let investors click through to find what they want;
(2) Moving from boilerplate legalese to plain English in every document intended for retail consumption;
(3) Reducing the complexity of accounting rules and regulations; and
(4) Focusing our anti-fraud efforts on scams that target older Americans.

Improving Disclosure via Interactive Data

Those of you who know me know that I have a great interest in how we can use technological advances to advance the welfare of our citizens – in the present case, individual investors. And I want to do it by cleaning out the cobwebs that can clog the SEC's own complex system of forms and reports. We are not just asking for improved efforts from those whom we regulate. We are starting in house and improving what needs to be improved there.

Today, the SEC has over 800 different forms. Each form is required to have its own cover page. The genesis of this requirement dates back to when reports were hand-filed in steel cabinets. Back then, the cover pages helped Commission staff do the filing – but today, they provide no useful information to the public, or to the SEC. Despite the fact that every individual company is required to file many different forms, these cover pages ask over and over again for the very same information in a slightly different format. In other words, more junk disclosure that no one needs, or wants.

If one goes beyond the cover pages to the entire form, to focus only on the truly unique information in each one, it's been estimated that instead of the 800 forms now required, the SEC might have need of no more than a dozen. The key to making this happen is looking at the data on the forms independently from the forms themselves, making the data interactive.

Interactive data is a concept that I know has been of long-standing interest to Chairman Baker. Bill Donaldson, my predecessor at the SEC, also saw the promise of interactive data and got the ball rolling by launching our internal efforts to investigate the technology. Under his watch, we launched the XBRL voluntary filing program as an important initial foray into getting company financials into interactive format. I, too, see the promise and potential that this concept holds for consumers of financial data, particularly individual investors, and believe that it will someday soon transform the way we as individuals interact with information about our investments. It's a relatively simple concept. Computer codes tag each separate piece of information on a report and tell us what it is: operating income, interest expense, and so forth. That way, every number in a report or financial statement is individually identified, both qualitatively and quantitatively.

For individual investors, this means they'll be able to quickly search for any information they want without slogging through an 80-page document. And it means they could search through our database not by the names of individual reports, but instead just by looking up the companies that file them. We'd no longer need what we have for domestic issuers today:

9 Securities Act registration statement forms,
3 Exchange Act registration statement forms,
2 annual report forms,
2 quarterly report forms,
1 current report form.

And I haven't even gotten to all the forms for proxy materials, annual reports, securities ownership, tender offers, and mergers and acquisitions. Investors, and the analysts who interpret financial information for them, shouldn't have to hunt around for each separate form – all the information should be in one place, organized by company. Today, every one of these forms has to be filed and processed separately, which adds to the SEC's workload; and then the investors have to separately hunt down every different form for a single company, making more work for all of them.

Our initiative to let investors get information fast, easily, and all in one place envisions this added benefit: instead of long and hard-to-read annual reports and proxy statements, investors could have easy-to-navigate Web pages that let them click through to find what they want.

Another benefit of interactive data is that it will not only make today's 10Ks, proxies, and mutual fund prospectuses more useful to investors, but it will also reduce much of the time and expense that companies currently devote to filing SEC reports.

For preparers of financial reports, interactive data could streamline and accelerate the collection and reporting of financial information to the SEC and the public. Further down the road, the potential exists for companies to use interactive data as a means of getting real-time management control information.

You may have heard the technology involved in this process variously described as data tagging, or XBRL, or my personal favorite, interactive data. But whatever one calls it, the point is the same: to allow investors to more easily access, search, analyze, and compare data provided by public companies.

The move to interactive data represents a sorely needed upgrade in the SEC's electronic disclosure regime.

From the 1930s to the 1980s, the Commission required that disclosure documents be filed exclusively on paper. Thousands of companies mailed us hundreds of thousands of documents. Each document was date-stamped, copied, sent to various divisions for review, and made available to the public for physical inspection in a Washington, DC library that is still maintained by the agency at significant expense.

In the 1980s, the Commission pioneered the use of electronic filing on our EDGAR system. (EDGAR stands for Electronic Data Gathering, Analysis and Retrieval.) This was a significant leap forward, and it became even more so with the dawn of the Internet. Now, investors and analysts are able to download documents with the click of a mouse instead of making a trip to the SEC's library in Washington, D.C.

But, while EDGAR was a great improvement for the 1980s, 20 years is a lifetime in the computer age. EDGAR may be electronic, but it isn't interactive. It doesn't begin to tap the potential of the Web. Because today's EDGAR filings are really just snapshots of paper reports that are stored in electronic form, the information they contain isn't searchable. Nor can it be used in any of the myriad ways that electronic data now speed around offices, home computers, and the Internet.

With today's SEC reports, an investor or analyst who is looking to compare, say, data on annual capital expenditures of two companies, has to search through perhaps hundreds of pages of the filings of each company page-by-page. Not surprisingly, the burden of this time-consuming, tiresome task has led to the creation of a cottage industry in re-keyboarding the information in SEC reports, so that it can be downloaded into spreadsheets and other software. Investors, or more precisely the intermediaries whose fees they pay, can then buy this information from both domestic U.S. firms and overseas providers to whom the drudge work has been outsourced. Once the information is manually input, it is often first sold to third or fourth parties for further reduction and analysis before it eventually is made available to an individual investor.

One hates even to think of the human error and data corruption that inevitably occurs in this process. We know from experience that the error rate is unacceptably high.

Interactive data is a way to eliminate these problems and to connect investors directly to the information in a company's filings – accurately, cheaply, and quickly. It will allow anyone to easily search, extract, compile, compare, and analyze financial and qualitative data according to each individual's preferences.

The SEC is strongly committed to interactive data. This is why we have taken major steps to promote it and why I am highlighting it in my testimony before you today. We have offered significant incentives for companies to file their financial reports using interactive data. These include expedited review of registration statements and annual reports. A number of well known firms – the list is 17 and growing – have already begun to lead the way and are filing their reports using interactive data.

And because mutual funds and exchange-traded funds have become the investment of choice for millions of Americans, I am very encouraged that the Investment Company Institute and its member funds recently decided to throw their weight behind interactive data.

Throughout 2006, the Commission will host a series of roundtables focused on the move to interactive data. The first roundtable is in June. The discussions will focus on several topics:

- What investors and analysts really need from interactive data;
- How to encourage the development of software for companies, institutions, and retail investors that takes full advantage of the potential of interactive data; and
- How to redesign the SEC's disclosure requirements to maximize the advantage of using interactive data.

Our aim is to move from long, hard-to-read disclosure documents to easy-to-navigate Web pages that let investors click through to find what they want. We want to emancipate the data from the page and let it find its way across the Internet and around the world in the form of RSS feeds, AJAX applications, and whatever comes next. Revolutionizing the way the world exchanges financial information is a worthy goal. We intend to achieve it.

The War on Complexity: Making Disclosure Understandable for Ordinary Investors

When it comes to giving investors the protection they need, information is the single most powerful tool we have. It's what separates investing from roulette. But, if the SEC is truly to succeed in helping investors with more useful information, we'll need one more ingredient: an all-out war on complexity. Complexity in disclosure, complexity in accounting.

It is, of course, true that a complex world often requires complex solutions. And certainly there are desirable states of complexity – the ones that arise from a thing's intrinsic nature: DNA. A snowflake. Encryption algorithms. There, the complexity is essential to the function. But it's the contrived, artificial complexities that cause the problems – intricacy without function. Winston Churchill said it best: "However beautiful the strategy, you should occasionally look at the results."

That, Mr. Chairman, is what we're now doing at the SEC. We're looking at results from the vantage point of the ordinary investor. And what we're finding is that, in many cases, we're not getting the right results. The complexity of the disclosure and accounting mandated by our rules too often adds nothing to function.

It's the SEC's job to see to it that financial data and qualitative information about the issuers of securities are fully and fairly disclosed. But surely we can't say we've achieved that objective if the information is provided in a way that isn't clearly understandable to the men and women for whom it is intended. Empowering investors doesn't just mean better access to information – it also means access to better information. Simply put, the question is: once that SEC-mandated information is available, is it understandable? The answer all too often is a resounding and frustrated "no".

Even though they are nominally written in English, the disclosures in some documents that are provided to investors are often so full of legal jargon and boilerplate disclosure that they can actually obscure important information.

Convoluted language and disclosure in footnotes may serve lawyers and insurance companies, but they don't improve an investor's ability to understand the most important facts about a particular investment.

Improved Executive Compensation Disclosure

Exhibit A when it comes to convoluted disclosure is today's regime for reporting executive compensation. Ordinary American investors have a right to know what company executives are paid, because those investors own the companies. The executives work for them.

It's a direct corollary of the fact that more than half of Americans own stock today that executive compensation will be judged just like every other labor and

material cost that a firm incurs. Gone are the days when investors were mostly a privileged, high-income elite. Today's investors come from middle class households that sit around the kitchen table and make tough choices about their monthly budgets. They expect the companies they invest in to do the same.

But how can an investor judge whether he's getting the best executive talent at the best price? Too often, the most important parts of total compensation are hidden away in footnotes, scattered in different parts of the proxy statement, or – depending on the form the compensation takes – not even disclosed at all until after the fact.

Three months ago, the Commission voted unanimously to propose an overhaul of the executive compensation rules. This marks the first time in 14 years that the SEC has undertaken significant revisions of the disclosure rules in this area.

The proposal would require better disclosure on several fronts.

First, companies would report a "total" figure – one number – for all annual compensation, including perquisites.

Second, retirement benefits would be clearly outlined in new tables showing the defined-benefit and defined-contribution plans of top officers.

Third, there would also be clear descriptions of payments that could be made if an executive is terminated. No such disclosure is required under our current rules.

Fourth, for the first time, all compensation for the last year to board members would be fully disclosed.

Fifth, a new Compensation Discussion and Analysis section would replace the Compensation Committee Report and the performance graph, which is now often mere boilerplate and legalese. This new narrative section will allow the board members to have a frank discussion with their bosses, the shareholders, about how they have gone about determining the compensation for the company's top executives.

Just to be clear, the Commission does not propose getting into the business of determining what is the proper method or level of compensation. It is not the job of the SEC to substitute our judgment for that of the board. Nor would I, speaking as Chairman, subscribe to the notion that all executive pay is excessive. Surely many executives deserve every penny they're paid, and more. It should go without saying that being a CEO requires a rarefied collection of attributes and skills that are in all too short supply. And it's a fact that competition in the market for executive talent can be fierce. At the same time, I needn't cite

here the several notoriously public cases of extravagant wastes of shareholder assets by gluttonous CEOs and pliant compensation committees.

By improving the total mix of information available to investors, the directors who work for them, and the marketplace, we can help shareholders and compensation committees to better inform themselves and reach their own conclusions.

Sixth, and finally: Since the purpose here is to improve communications, the proposed executive compensation rules require that all of this disclosure be in plain English – the new official language of the SEC. That will be true whether the information is in a proxy statement, an information statement, or an annual report.

Disclosure in Plain English

Plain English uses plain words – and, among other basic ingredients, the active voice. We want to promote the use of the active voice not just because it makes for punchier sentences, but because it requires a definite subject to go with the predicate. That's the only way that investors will be able to figure out who did what to whom.

It's a testament to the importance of this issue that, when the comment period on the proposed executive compensation rules closed on April 10, we had received nearly 17,000 comments. That's one of the highest totals in the SEC's 72-year history. We are now reviewing these comments and look forward to incorporating them into any final rules that the Commission may adopt for improved, plain English compensation disclosure.

And we won't stop there. Some years ago, under Chairman Arthur Levitt, the SEC began a crusade for plain English in investor documents. It was a noble first step that has been carried on by both Harvey Pitt and Bill Donaldson. During my time at the Commission, I hope to advance this cause still further, so that ultimately every communication aimed at retail investors is so free of jargon and legalese that it could pass muster with the editors of the Money section of *USA Today.*

Reducing Accounting Complexity

It is not just public companies that sometimes have difficulty using plain English. Our accounting rules and regulations also can sometimes be complex and difficult to interpret. And, when the rules are difficult to interpret, they may not be followed very well. And, if the rules aren't followed very well, then intentionally or not, individual investors inevitably will suffer.

When complexity needlessly adds to the costs and efforts involved in financial reporting, it's the investors who foot the bill. And, when a company takes advantage of detailed standards and complex reporting to hide information from investors, rather than to disclose it, investors are doubly damaged.

Not surprisingly, users of financial statements – investors and regulators alike – are looking for more balance in making financial reporting comparable and understandable. Preparers and auditors are also looking for standards that are easier to understand and implement.

The SEC has been helping to lead a major national effort to reduce complexity in financial reporting. The laboring oar is being manned by the Financial Accounting Standards Board, which is already intently focused on improving the understandability, consistency, and overall usability of the existing accounting literature. The SEC staff are working closely with the FASB in a supportive role.

The first step is to systematically re-address specific accounting standards that do not provide the most relevant and comparable financial information. Examples of standards in need of reworking for this reason include consolidations policy, certain off-balance sheet transactions, performance reporting, and revenue recognition.

The second task is to codify Generally Accepted Accounting Principles. The codification will be a comprehensive and integrated collection of all existing accounting literature, and it will be organized by subject matter. The aim is to provide a single, easily accessible source for all of GAAP. A dividend of this project is that it will provide a useful roadmap to those areas most in need of simplification.

A third priority is to stem the proliferation of new accounting pronouncements from multiple sources. We are encouraging the FASB to consolidate U.S. accounting standard setting under its auspices, and to develop new standards more consistent with a principles-based, objectives-oriented system.

The final element of this strategy is to strengthen the existing conceptual framework for U.S. GAAP in order to provide a more solid and consistent foundation for the development of objectives-oriented standards in the future.

Making financial reporting more user-friendly goes far beyond the work of the FASB. Weeding out the counter-productive complexity that has crept into our financial reporting will require the concerted effort of the SEC, the FASB, the PCAOB, and every market participant. This cannot be a one-time effort; we will have to commit for the long term. But it will be well worth it.

Financial Education for Retirees and Elderly Investors

Finally, let me turn to our efforts to better protect older Americans against financial fraud.

Consider these statistics: An estimated 75 million Americans are due to turn 60 over the next 20 years. That's an average of more than 10,000 people retiring every day. Households led by people aged 40 or over already own 91% of America's net worth. The impending retirement of the baby boomers will mean that, very soon, the vast majority of our nation's net worth will be in the hands of the newly retired.

Following the Willie Sutton principle, scam artists will swarm like locusts over this increasingly vulnerable group – because that's where the money is.

On a daily basis, our agency receives letters and phone calls from seniors and their caregivers who have been targeted by fraudsters. Sometimes there is still time to help. But often, the victims have already been taken. These fraudulent schemes may begin with a free lunch, but we want to make sure that they end with a very high cost to the perpetrators.

That is why we are attacking the problem from all angles – from investor education, to targeted examinations, to aggressive enforcement efforts. And, because state securities regulators share our concern about fraud aimed at seniors, we're cooperating in this initiative with state regulators across the country – the local cops on the beat.

A top priority is education. SEC programs are aimed not only at older Americans and their caregivers, but also at pre-retirement workers, designed to help them reach their personal savings and investing goals as they age. While we cannot tell investors which products to purchase, we can arm them with the information they need to assess various products and investment strategies.

We are expanding our efforts to reach out to community organizations, and to enlist their help in educating older Americans about investment fraud and abuse.

A portion of the SEC website is devoted specifically to senior citizens (http://www.sec.gov/investor/seniors.shtml). We provide links to critical information on investments that are commonly marketed to seniors – including variable annuities, equity-indexed annuities, promissory notes, and certificates of deposit.

On the SEC website, investors can also find detailed warnings against the dangers of listening to the sales pitches of cold-callers. We're alerting seniors to the very real threat of affinity fraud – scams that prey upon members of groups to

which they may belong, including their religion, their nationality or ethnic heritage, or their profession.

Seniors are often subjected to high pressure sales pitches that are simply not true, such as telling seniors that equity-indexed annuities "just can't lose money." There are also "free lunch" seminars that encourage seniors to buy complex products that don't fit the risk profile of a retiree with a relatively short life expectancy. There are also outright scams, such as Ponzi schemes.

To detect abusive sales tactics that target seniors, examiners in our SEC field offices will share regulatory intelligence with their counterparts at the state level, and with other regulators. Once we identify firms that may be preying on seniors, we'll examine those firms to make sure their sales practices are lawful.

This effort has already started in Florida, where we've recently initiated on-site compliance examinations, along with the State of Florida and the NASD, of firms that sponsor "free lunch" investment seminars. Our goal is to see that the sales people at these seminars are properly supervised by their firms, and that the seminars aren't used as a vehicle to sell unsuitable investment products to seniors.

Each of our offices across the country will work closely with state and local law enforcement, and both federal and state regulatory agencies, to target scams aimed at seniors. And they'll work together to bring both civil and criminal actions aimed at shutting them down. This effort is already well under way in California.

Finally, when we do find fraud, you can be sure that we will do something about it. Over the past two years, the SEC's Division of Enforcement has brought at least 26 enforcement actions aimed specifically at protecting elderly investors. Many of these actions were coordinated with state authorities.

In one notable case, SEC v. D.W. Heath and Associates, the Commission coordinated with the Riverside County District Attorney's Office to crack down on a $144.8 million Ponzi scheme that lured elderly victims in southern California to workshops with the promise of free food. The Commission's complaint alleged that the defendants then bilked them out of their retirement money by purporting to sell them safe, guaranteed notes.

Just last month, in SEC v. Reinhard et al., the Commission halted another possible Ponzi scheme, this time in Allentown, Pennsylvania. The Commission's complaint alleges that the defendants raised more than $3.9 million from at least 50 investors in several states by claiming to sell certificates of deposit that did not exist.

The complaint further alleges that the primary salesman lured investors, many of whom are elderly, with promises of above-market rates on FDIC-insured CDs

purportedly issued by a non-existent entity called the "Liberty Certificate of Deposit Trust Fund." The complaint also alleges that the defendants distributed fictitious investment documents and account statements to attract investors and to ensure they continued to invest in the scheme.

As reflected in these recent cases, any would-be fraudsters should consider themselves on notice that the SEC's enforcement staff will aggressively investigate and file actions against anyone who preys upon seniors.

Conclusion

Mr. Chairman, members of the Committee – thank you for your interest in these vital issues. Each of the initiatives I have outlined is part of an overall strategy to make the individual investor – the average American – the ultimate beneficiary of all that we do at the SEC. Our agency has for many years proudly worn the badge of the "Investor's Advocate." In the months and years ahead, we are pledged to rededicate ourselves to that mission.

I appreciate the opportunity to be back in your company today,. From my new perspective as Chairman of an agency under your oversight and carrying out the responsibilities you have vested in the Commission, I can tell you that this is important work of real benefit to your constituents whom we all serve. Thank you for your continuing strong support for the work of the Commission and the trust you have vested in us. I am happy to answer any questions you may have.

Honorable Deborah Pryce
May 3, 2006
House Financial Services Committee hearing
Questions Submitted for the Record

Chairman Christopher Cox
U.S. Securities and Exchange Commission

1. Chairman Cox, I applaud the work you are doing at the SEC to increase the transparency of executive compensation. On that topic, I am interested in hearing whether there are tools we can give shareholders directly, rather than indirectly through compensation committees, to approve or disapprove of compensation packages? What would be the advantages or disadvantages of having public companies put the pay of their top executives to a shareholder vote as they do in the U.K.?

ANSWER:

The comprehensive disclosure rules regarding executive compensation are designed to provide shareholders with important information that might help them determine if the company is using corporate assets to what the shareholder believes is good use and whether the company has what the shareholder believes to be good corporate governance. Armed with this information, the shareholder can act accordingly within the existing corporate governance structures and applicable state and federal laws.

The internal governance of corporations has historically been controlled by state law, which provides a shareholder with the ability to commence a lawsuit if she believes the directors have breached their fiduciary duty or the company has misused corporate assets. Beyond the rights afforded by state law, if the shareholder believes the company is not using corporate assets the way she would like or does not have adequate corporate governance, the shareholder may express her approval or disapproval of compensation packages by:

- Withholding her vote for directors she believes are not steering the company in the direction the shareholder would like to see it go, or initiate a campaign to withhold votes for particular directors, including the members of the compensation committee;

- Interacting directly with the board and management to encourage changes – many companies have board members or members of management who meet frequently with shareholders and the Commission's rules require each public

company to disclose whether or not its board of directors provides a process for shareholders to send communications to the board of directors;

- Attending the annual shareholder meetings and proposing a resolution from the floor;

- Submitting to the company a shareholder proposal to be voted on at the next annual meeting of shareholders – the Commission's Rule 14a-8 and staff interpretations require a public company to include in its proxy statement, alongside management proposals, shareholder proposals that focus on executive and director compensation. In the current proxy season, at least one company has included a shareholder proposal that requests the company to provide shareholders with a means to effect an advisory vote on the company's description of its executive compensation program.

Requiring an advisory shareholder vote on executive compensation in the manner contemplated by the UK rules would constitute a fundamental departure from the existing state and federal system that has prevailed in the United States.

2. Marshall Carter, the Chairman of the NYSE, testified before the Subcommittee on Capital Markets last week that of the top 24 IPO's last year – only one of them listed in the United States. By contrast, in 2000, 9 out of the top 10 IPO's listed in the U.S. Is this a trend we will see continue? Of the possible factors leading to this trend, which do you give the most weight towards: corporate governance, litigation, listing requirements, the nature of the companies, many being formerly state-owned enterprises, or some other factor?

ANSWER:

The opportunity for companies to access worldwide capital is a positive trend that reflects the health of the U.S and the global equity market, and one that we expect to continue. IPOs in the U.S. capital markets are the largest segment of global IPOs, with $33 billion raised in 2005, and represent 20% of the global capital market activity.

While the number and size of IPOs in the U.S. has dipped slightly in recent years, many smaller companies continue to list on the NYSE and Nasdaq. In 2005 over 70 countries hosted IPOs of over $1 billion and the largest offerings were conducted overseas. That so many foreign companies chose to list their securities in foreign markets is a welcome indication that the quality and liquidity of those markets has increased and that accounting and corporate governance standards are improving worldwide. However, as globalization provides companies with a wider choice of markets in which to raise capital, we have seen a decrease in multiple listings as companies seek to reduce their costs.

The SEC has responded to foreign company concerns about compliance with Sarbanes-Oxley requirements and their inability to deregister with a number of initiatives intended to reduce their compliance burdens while maintaining our high standards of investor protection. Among these initiatives is a proposal to facilitate the ability of foreign issuers to terminate their SEC reporting obligations when there is relatively little interest in their securities among U.S. investors. Foreign issuers also benefit from extended Section 404 internal control deadlines and the SEC's continued evaluation of these requirements. Finally, the SEC supports efforts to converge accounting standards, and I have stressed the SEC's commitment to creating a "roadmap" for eliminating a requirement to reconcile financial statements prepared using International Financial Reporting Standards to U.S. GAAP.

Honorable Emanuel Cleaver
May 3, 2006
House Financial Services Committee hearing

Chairman Christopher Cox
U.S. Securities and Exchange Commission
Answer Submitted for the Record

Mr. CLEAVER. Thank you, Mr. Chairman. Chairman Cox, thank you for being here. I did not have the privilege of serving on the Committee with you, but everybody who has speaks so highly of you, so it's a privilege for me to have the opportunity to have an exchange with you.

I have become somewhat obsessed with our national debt and with the investments by foreign nations in our government. **Do you know the current size of the U.S. investments held by foreign entities?**

Mr. COX. I don't have that figure to quote for you right now, and I would actually be surprised if I turned around and somebody did, but I will check. Yes, I mean it's a very easy figure for us to get, and in a very formal proceeding such as this I would hate to do it seat of the pants. So why don't we get you the precise figure following this hearing?

Mr. CLEAVER. And I am interested also, if you can, in what portion of that is held by China and Japan.

Mr. COX. We would be very happy to do that.

ANSWER:

The latest Treasury Bulletin shows that at the end of March 2006, foreigners owned about $2.087 trillion, or 25 percent of the $8.371 trillion of outstanding U.S. Treasury securities. Japan held $640 billion (30.7 percent of the foreign total or 7.6 percent of total Treasury securities outstanding) while Mainland China plus Hong Kong held $368 billion (17.6 percent of the foreign total and 4.4 percent of total Treasuries). These two countries together owned nearly half of the foreign total. Rounding out the top five in Treasury securities ownership, United Kingdom, Korea and Taiwan held $180 billion, $72 billion and $69 billion respectively. It should be noted that over a ten year period (March 1996 - March 2006), the national debt increased by 64 percent to $8.371 trillion from its 1996 level while foreign debt ownership increased by 130 percent to $2.087 trillion from its 1996 level.

Foreign holdings by China and Japan of U.S. equities are much smaller than their holdings of U.S. Treasury debt. As of June 30, 2005, the latest data available from the

Treasury Department's annual survey of foreign portfolio holdings of U.S. securities, Japan held $178 billion of U.S. equities while Mainland China plus Hong Kong held $26 billion. Japan and Mainland China plus Hong Kong combined held only 9.5% of the $2.14 trillion of U.S. equities with foreign ownership.

Honorable Vito J. Fossella
May 3, 2006
House Financial Services Committee hearing
Questions Submitted for the Record

Chairman Christopher Cox
U.S. Securities and Exchange Commission

1) This Committee has held hearings on the credit rating agency industry and, the need to increase competition and remove the barriers to entry that currently exist. My understanding is the SEC has been working on developing a framework for reform that gives due consideration to the Technical Committee of the International Organization of Securities Commissions (IOSCO) principles that lay out high level objectives for all regulators and credit ratings agencies on an international level. Given our discussions about the value in converging FASB and IASB accounting principles to reduce barriers to US markets, giving due consideration to the IOSCO principles seems to be consistent with such a value in efforts to reform the US credit rating agency industry. Where is the SEC in developing this framework? How have/will the IOSCO principles be incorporated into the SEC framework?

ANSWER:

In December 2004, the IOSCO Technical Committee released its *Code of Conduct Fundamentals for Credit Rating Agencies* (IOCSO Code). The principles set forth in the IOSCO Code are meant to be included as part of a credit rating agency's individual code of conduct. Each of the five firms identified as NRSROs by SEC staff has endorsed the IOSCO Code and subsequently adopted its own individual code of conduct to align its policies and procedures with the IOSCO Code.

The NRSROs also have been working since the fall of 2004 on a voluntary framework under which they would agree to document and implement policies and procedures to address issues that have been raised with respect to how they issue credit ratings, handle conflicts of interest, protect nonpublic information and comply with applicable laws. The staff is discussing the framework with the NRSROs.

The proposed voluntary framework currently provides that each NRSRO will adopt and adhere to a Code of Conduct that is consistent with the IOSCO Code. To comply with the voluntary framework, an NRSRO would be required to disclose its Code of Conduct to the SEC and the public and describe how the provisions of that Code of Conduct implement the provisions of the IOSCO Code. If an NRSRO's Code of Conduct deviated in any material respect from any IOSCO Code provisions, the NRSRO would be required to disclose where and why such deviations exist. Under the framework, the NRSROs would agree to share results of internal reviews of their policies with the Commission but would not agree to SEC examinations.

2) I understand that pursuant to the proposed SRO rules the only pricing model that could be used for determining margin requirements is the OCC's TIMS model. As a practical matter, I am told that notwithstanding the aim of including a very broad range of financial instruments within the terms of the rules, over-the-counter instruments such as swaps, OTC options, etc. will be unable to benefit. As the underlying logic of "portfolio margining" is that margin should be determined on the basis of all the financial instruments in a given portfolio, is the Commission considering expanding the category of eligible models, including the use of firm proprietary models?

ANSWER:

The NYSE and CBOE filed proposals in 2006 to expand the products eligible (including certain) for their respective customer portfolio margin pilot programs. If over-the-counter derivatives are approved as eligible products, the OCC staff indicated that its model can accommodate them. Further, they have stated that they are working with the industry to develop operational protocols for submitting OTC derivative contract information to OCC so that it can be incorporated into a firm's portfolio margin calculation.

Under the pilot program, theoretical pricing models must be approved by the exchanges and submitted to the SEC in order to qualify. This rule provision, however, makes it possible for other theoretical pricing models to be approved, provided that the model's inputs comply with the specifications set forth in the rule (e.g., market movement ranges). The OCC's model has been approved because its parameters comply with these specifications. Presumably, other models could be approved if they incorporate the required inputs.

The staff of the Commission also has discussed other potential refinements to portfolio margining with the NYSE and CBOE, including using proprietary risk management models. In responding to comments with regard to its recent rule proposal, the NYSE noted that it would like to gain additional experience with the use of such risk models before it can permit member organizations to utilize these models for margining purposes. After obtaining such experience the NYSE stated that, in consultation with the industry, it will consider the use of such models.