



**United States
Securities and Exchange
Commission**

**2004-2009
Strategic Plan**

This is the Securities and Exchange Commission's third strategic plan prepared in accordance with the Government Performance and Results Act of 1993. The plan sets out the Commission's vision, mission, and strategic goals for the next five years (FY2004-2009). The plan also identifies the initiatives that will be undertaken to achieve SEC goals, the potential performance outcomes the agency is seeking, and possible measures that may be used to monitor performance toward achieving those goals.

Comments on this plan should be directed to GPRA-comments@sec.gov.

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Environment:

**Investor
Confidence**

**Market
Dynamics**

Globalization

Technology

**Government
Actions**

Goal 1

Enforce Compliance with Federal Securities Laws

Outcomes:

- 1.1 Potential problems or issues in the securities markets are detected early and violations of federal securities laws are prevented.
- 1.2 Violators of federal securities laws are detected and sanctioned.

Goal 2

Sustain an Effective and Flexible Regulatory Environment

Outcomes:

- 2.1 Investors are protected by regulations that strengthen corporate and fund governance and adhere to high quality financial reporting standards worldwide.
- 2.2 Industry efforts to provide innovative and competitive products and trading platforms are supported while the markets remain vibrant, fair, accessible, and financially sound.
- 2.3 Regulations are clearly written, flexible, and relevant, and do not impose unnecessary financial or reporting burdens.

Goal 3

Encourage and Promote Informed Investment Decisionmaking

Outcomes:

- 3.1 Investors have accurate, adequate, and timely public access to disclosure materials that are useful, and can be easily understood and analyzed across companies, industries, or funds.
- 3.2 Investors have a better understanding of the operations of the nation's securities markets.

Goal 4

Maximize the Use of SEC Resources

Outcomes:

- 4.1 Human capital strategies are aligned to achieve agency mission, goals, and outcomes.
- 4.2 Financial management and internal controls are sound.
- 4.3 Business improvements are promoted through the innovative use of information technology.

Chapter One

The Securities and Exchange Commission

I... recommend to the Congress the enactment of legislation providing for the regulation by the Federal Government of the operations of exchanges dealing in securities and commodities for the protection of investors, for the safeguarding of values, and, so far as it may be possible, for the elimination of unnecessary, unwise, and destructive speculation.

*Franklin D. Roosevelt
February 9, 1934*

Vision

The Securities and Exchange Commission (SEC) aims to be the standard against which federal agencies are measured. The SEC will strengthen the integrity and soundness of U.S. securities markets for the benefit of investors and other market participants, and will conduct its work in a manner that is as sophisticated, flexible, and dynamic as the securities markets it regulates.

Mission

The mission of the Securities and Exchange Commission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

Values

In managing the evolving needs of a complex marketplace and in pursuing its mission, the Securities and Exchange Commission embraces the following values:

Integrity

As the federal agency entrusted with enforcing and regulating the U.S. securities markets, each member of the SEC staff has a personal responsibility to demonstrate the highest ethical standards to inspire confidence and trust in one another and in the public the agency serves.

Fairness

As an agency with both regulatory and enforcement powers, the SEC must treat investors and market participants fairly in accordance with the law. As an employer, the SEC must seek to hire and retain a diverse staff, and ensure that all decisions affecting employees and applicants are fair and ethical. As professionals, the staff must treat all others with respect and dignity.

Accountability

The SEC staff embraces the responsibility with which it is charged. In carrying out its mission, the staff readily holds itself accountable to the public it serves and takes personal responsibility for achieving SEC goals.

Resourcefulness

The SEC staff strives to work creatively, proactively, and effectively in assessing and addressing risk to the securities markets, the public, and other market participants. The staff is committed to finding flexible and innovative approaches to the Commission's work and using independent judgment to explore new ways to fulfill the SEC's mission in the most efficient manner possible.

Teamwork

The SEC recognizes that its success requires a diverse, coordinated team committed to the highest standards of trust, hard work, cooperation, and communication. The staff is committed to these values and is striving to work more effectively as a team -- rather than as separate divisions or offices, and to coordinate more effectively with business, governments, and organizations in the U.S. and abroad.

Commitment to Excellence

The SEC demands the highest standards of excellence, integrity, commitment, and dedication from its staff. The investing public and the U.S. securities markets deserve nothing less.

Goals

To fulfill its mission, the Securities and Exchange Commission will:

- Ensure compliance with federal securities laws;
- Sustain an effective and flexible regulatory environment;
- Encourage and promote informed investment decisionmaking; and
- Maximize the use of SEC resources.

These goals are discussed in detail in Chapters Four, Five, Six, and Seven.

Statutory Authority

Following the stock market crash of 1929, Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934, which established the Securities and Exchange Commission to enforce the new securities laws, promote stability in the markets, and to protect investors. Two concepts pervade both Acts:

- Companies offering their stock to the public must disclose the truth about their business, the securities they are selling, and the risks involved in investing.
- People who sell and trade securities – brokers, dealers, and exchanges – must treat investors fairly and honestly, putting investors' interests first.

In implementing these laws, the SEC requires public companies to disclose to the public meaningful financial and other information so that investors may judge for themselves if a company's securities are a sound investment. Only through the steady flow of accurate, comprehensive, and timely information can the public make informed investment decisions.

The SEC also oversees and requires the registration of other key participants in the securities industry, including stock exchanges, broker-dealers, clearing corporations, depositories, transfer agents, investment companies, investment advisers, and public utility holding companies. Here, too, the SEC is concerned with ensuring an appropriate regulatory environment to protect investors, enforce the securities laws, promote disclosure of important information, and sustain fair and efficient markets.

Crucial to the SEC's effectiveness is enforcement authority. Each year the SEC brings hundreds of civil enforcement actions against individuals and companies for violations of securities laws. Typical infractions include insider trading, accounting fraud, violations of statutes and rules by regulated entities (such as broker-dealers, investment advisers, investment companies, and transfer agents), and providing false or misleading information about securities or the companies that issue them.

While it is the primary overseer and regulator of the U.S. securities markets, the SEC works closely with other institutions, including: Congress, other federal departments and agencies, state and foreign securities regulators and law enforcement officials, various private sector organizations and self-regulatory organizations (SROs) such as the National Association of Securities Dealers (NASD) and the stock exchanges.

The following are the major laws administered by the Commission.

- **Securities Act of 1933** requires issuers of securities to provide the public with financial and other information concerning new and outstanding issues of securities that are offered for public sale. The law also prohibits misrepresentation, deceit, and other fraudulent acts and practices in the offer and sale of securities.
- **Securities Exchange Act of 1934** requires certain issuers of publicly traded securities to file registration applications, proxy materials, and annual reports with national securities exchanges and the Commission. The Act prohibits fraud and establishes a regulatory framework for the securities markets and their participants. Amendments to the Act over the years have expanded the Commission's authority to seek penalties and bring administrative proceedings.
- **Public Utility Holding Company Act of 1935 (PUHCA)** governs the financial and corporate structure of holding companies that control electric and gas utilities. Under PUHCA, a "public-

utility holding company” must register with the Commission or seek an exemption under one of several narrowly delineated exemptions. Registered holding companies generally must limit their operations to a single integrated system confined to a single geographic area. They also must obtain Commission approval before they may issue securities, acquire securities or assets of other utilities, or diversify into non-utility businesses.

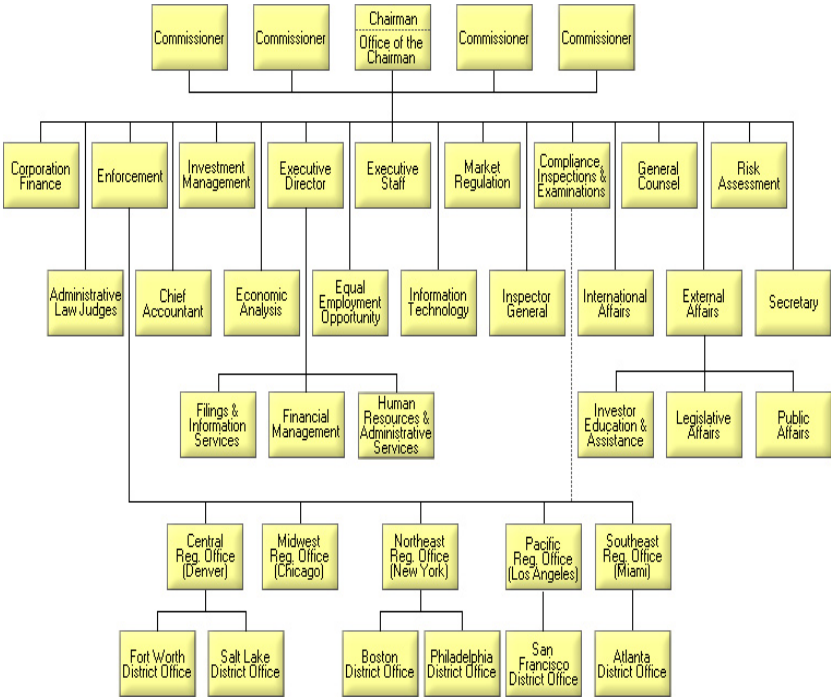
- **Investment Company Act of 1940** requires investment companies, such as mutual funds, to register with the Commission, prohibits fraud, and subjects investment companies to regulation and inspection by the Commission.
- **Investment Advisers Act of 1940** requires certain persons who, for compensation, advise others about securities to register with the Commission. The Act also forbids certain kinds of fee arrangements, prohibits fraud, and requires disclosure of conflicts of interest.
- **The Securities Investor Protection Act of 1970** creates the Securities Investor Protection Corporation (SIPC) to protect the funds of customers of broker-dealers in the event of liquidation. The Commission has examination and oversight responsibilities over SIPC under the Act.
- **National Securities Markets Improvement Act of 1996 (NSMIA)** establishes the federal government as the primary regulatory authority over certain securities and registered entities. NSMIA preempts state securities registration requirements with respect to “federal covered securities,” while permitting states to obtain fees and copies of documents filed with the Commission.
- **Gramm-Leach-Bliley Act of 1999** repeals the longstanding separation between banking and securities activities codified in the Glass-Steagall Act. The Act repeals the blanket exemption of banks from broker-dealer registration under the Exchange Act, and replaces it with targeted exceptions for certain securities activities. In addition, the Act contains financial privacy provisions that require financial institutions to provide customers with the opportunity to “opt out” of having certain non-public customer information shared with third parties.
- **Commodity Futures Modernization Act of 2000** permits the trading of single-stock futures and futures on narrow-based stock indices, and clarifies the legal status of certain over-the-counter derivatives. Under the Act, single stock and narrow-based stock index futures are defined as securities, and the Act requires a high degree of cooperation and coordination between the SEC and the Commodities Futures Trading Commission (CFTC) in regulating such products.
- **Sarbanes-Oxley Act of 2002** creates a new oversight board for the accounting profession and mandates new measures

to promote auditor independence. The Act also establishes new disclosure and certification requirements for public companies and their officers and mandates new rules of conduct and professional responsibility for attorneys and securities analysts. Among its other provisions are strengthened criminal penalties for securities fraud and new civil enforcement tools.

Organization

The SEC is an independent, quasi-judicial agency that operates under a bipartisan Commission appointed by the President and confirmed by the Senate, and headed by a Chairman. The agency is headquartered in Washington, DC. The SEC is comprised of four divisions, 20 offices (Figure 1-1), and maintains 11 regional and district offices across the country.

Figure 1-1 SEC Organization



The Chairman's Office includes three Managing Executives: the Managing Executive for Policy and Staff; the Managing Executive for External Affairs; and the Managing Executive for Operations and Management. These three individuals assist the Chairman in developing the direction for the agency and implementing major new initiatives.

The agency's staff of almost 4,100 monitor and regulate a securities industry that includes SROs (including 13 securities exchanges, 11 clearing agencies, NASD, and the Municipal Securities Rulemaking Board), more than 7,200 broker-dealers, 900 transfer agents, and almost 500 municipal and government securities dealers. In 2003, the volume traded on U.S. exchanges and Nasdaq exceeded \$22 trillion and 850 billion shares.

The Commission also regulates more than 35,000 investment company portfolios (including mutual funds, closed-end funds, unit investment trusts, exchange-traded funds, and interval funds, and variable insurance products), more than 8,200 federally registered advisers, and 28 registered public utility holding companies.

Each year, the Commission accepts, processes, and disseminates to the public more than 600,000 documents from companies and individuals that are filed through the agency's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. These filings include the annual reports of more than 12,000 reporting companies, which comprise up to eighteen million pages annually.

Chapter Two

Environment and Key External Factors

The environment in which the SEC operates stands to influence the agency's direction, goals and priorities. Recognizing this, the SEC is aggressively pursuing strategies to improve its ability to assess emerging risks, and to develop alternatives for mitigating the impact of such risks. This is true as it relates to impact on the Commission itself, as well as on investors and the markets we serve.

The agency has identified the following five key areas that represent the significant events, influences and risks that may affect the work of the Commission.

Investor Confidence

In an era marked by corporate scandals, financial fraud, and a downturn in the securities markets, the Commission moved swiftly and vigilantly to identify and resolve violations of federal securities laws. Unfortunately, in the wake of these and other violations, investors lost more than money. Confidence in the fairness and integrity of the securities markets was shaken.

In its annual survey on investor attitudes, the Securities Industry Association (SIA) found that in 2003, only 55 percent of investors reported having very or somewhat favorable attitudes towards the securities industry. The survey also reported that 43 percent of respondents volunteered that dishonesty was the main issue facing the securities industry today, while others cited the industry's reluctance to punish wrongdoers, the lack of internal controls to prevent wrongful actions, insider trading, and insufficient disclosure of risks to investors.³

Moreover, investors have mixed opinions about whether reforms will reduce abuses. The SIA survey found that 54 percent of investors have "just a little" or "not very much" confidence that corporate reforms will reduce abuses, and 51 percent of investors felt similarly toward securities industry reforms.⁴

The SIA survey reported that 82 percent of investors agree that the securities industry should take additional steps to better educate investors on how to make wise investment decisions.⁵ Only 3 percent of survey participants stated that they "know everything one needs to know to make a good investment decision."⁶ Similarly, according to a survey conducted in April 2003 by Applied Research & Consulting for NASD, nearly all respondents (97 percent) stated that it was "important" that they enhance their knowledge of investing, and close to half (44 percent) said it was "very important."⁷

To satisfy the demands of investors there must be in this great marketplace not only efficient service but also fair play and simple honesty. For none of us can afford to forget that this great market can survive and flourish only by grace of investors.¹

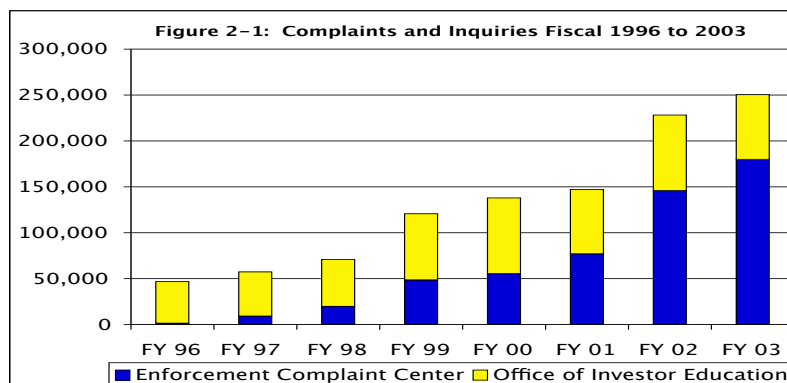
William O. Douglas

The hallmark of our business and financial system is that the rule of law must prevail and when wrong-doing occurs it must be confronted and punished. ...These cases reflect a sad chapter in the history of American business – a chapter in which those who reaped enormous benefits based on the trust of investors – profoundly betrayed that trust. The cases also represent an important new chapter in our ongoing efforts to restore investors' faith and confidence in the fairness and integrity of our markets.²

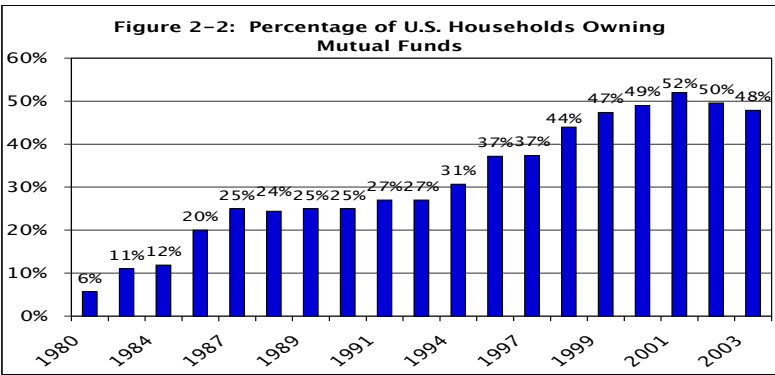
*William H. Donaldson
Chairman*

The Commission has long held that an informed public serves as the first line of defense against fraud, and recent Commission actions support increased investor education. For example, in 2003 the Commission entered into a global settlement of enforcement actions involving conflicts of interest between research analysts and investment bankers at a number of the nation's top investment firms. As a part of the settlement, an investor education fund was established to better equip Americans with the knowledge and skills required to make informed investment decisions.

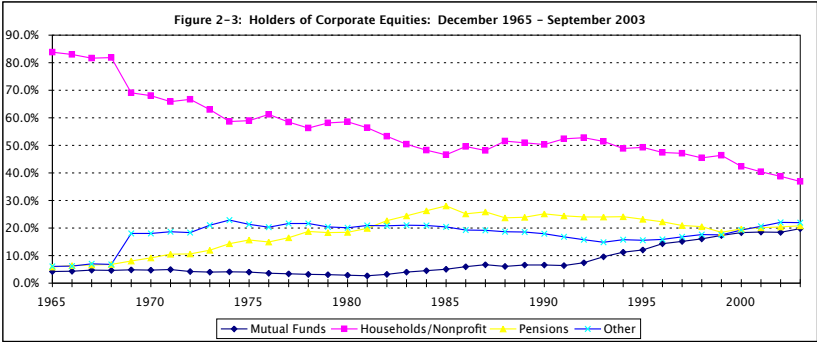
As a helpful gauge of investor perspectives, SEC staff collect data from investor complaints and use it to track trends in the securities industry. This information provides critical intelligence for the SEC, serving as an early warning system to identify problematic brokers, firms, or sales practices. During the past five years the volume of complaints and inquiries has grown over 250 percent (Figure 2-1). The SEC's Office of Investor Education and Assistance (OIEA) and the Division of Enforcement's Office of Internet Enforcement (OIE) serve as the SEC's primary points of contact for the tens of thousands of investors who complain each year about investment fraud or the mishandling of their investments by securities professionals.



While investor perceptions of the markets are mixed and their complaints are on the rise, near record numbers of Americans continue to invest in the U.S. securities markets through the purchase and sale of stocks, bonds, and mutual funds. In particular, the number and percentage of U.S. households that own mutual funds grew dramatically during the 1990's as stock and bond mutual funds became a key repository for U.S. savings dollars. Today, 53 million households (48% of all households) own mutual funds, a slight decline from the 2000 peak (Figure 2-2). While household participation in mutual funds increased greatly since the 1970's and household participation in pensions and other collective investment vehicles remained high, the portion of U.S. corporate equities owned directly by households (and non-profits) has steadily declined since the 1970's (Figure 2-3).



Source: Investment Company Institute. Fundamentals Investment Company Institute Research in Brief -- U.S. Household Ownership of Mutual Funds in 2003 -- Vol 12/ No 4 October 2003.



Source: Federal Reserve, Flow of Funds Accounts of the United States, Chart L.213 Corporate Equities. Data for the periods 1965 – 2003 are presented in multiple editions.

Because U.S. consumers rely on mutual funds to finance their retirement, housing, children’s education, and everyday expenses, it is imperative that the fund industry uphold the highest standards of integrity. Recent revelations of abusive practices in this sector have led to heightened scrutiny by the SEC, including a complete review and evaluation of the industry, as well as new rules and regulations that are designed to increase industry accountability.

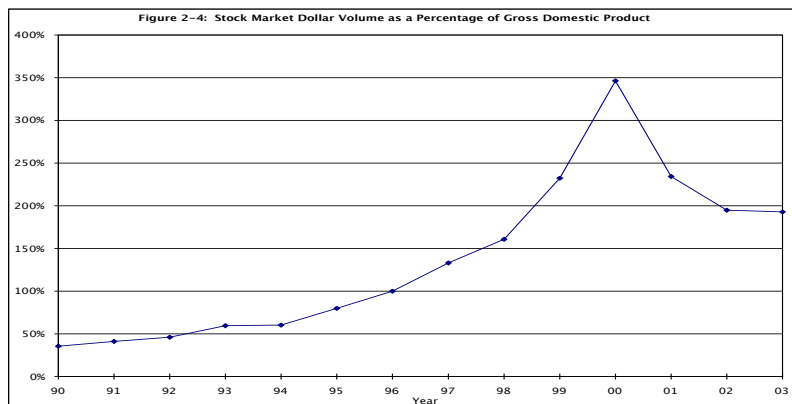
Market Dynamics

While effective regulation alone cannot cause markets to succeed, ineffective or inadequate regulation can obstruct their success, particularly if it contributes to an investor perception that markets are inefficient or unfair.⁸

*Annette L. Nazareth, Director,
Division of Market Regulation*

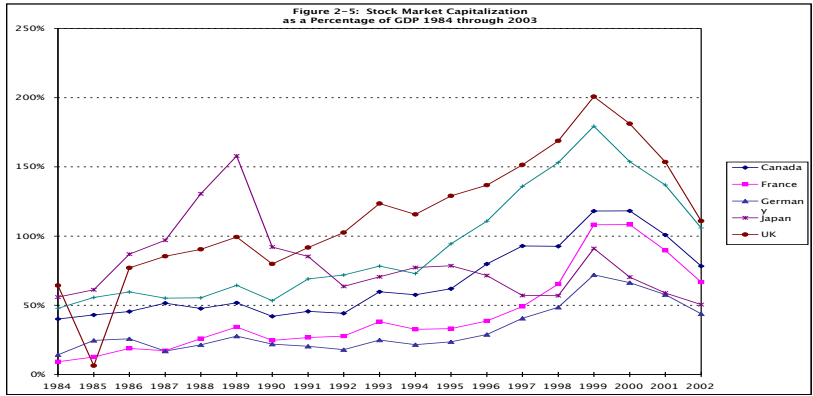
In the 1970's, Congress mandated that the Commission develop and oversee a national market system. The success of that system is attributable to many factors, with economic and other non-regulatory factors being the most significant. Competition among markets has fostered innovation and led to the creation of a broad array of trading platforms designed to meet the needs of different types of investors. New entrants, particularly those with fully electronic platforms, pressure established markets to innovate.

One indicator of the stock markets' vigor is the dollar volume of trading on U.S. stock markets and Nasdaq. Over the long term, one would expect the dollar value of transactions to keep pace with U.S. economic growth. In 1990, the annual dollar volume of trading on U.S. stock exchanges and Nasdaq was approximately one-third of U.S. GDP; by 2000 it peaked at 3.5 times GDP (Figure 2-4). Dollar volume levels as a percentage of GDP have been in decline over the last three years; however, this trend stabilized in 2003.

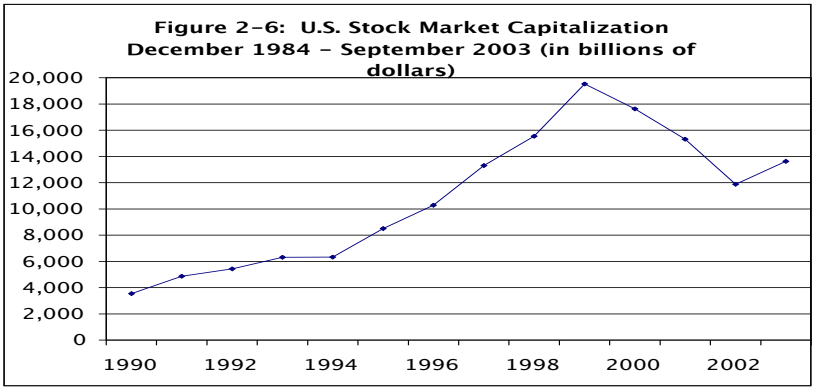


Source: 2004 Economic Report of the President, Thompson Financial, and NASD

Another indicator of the size and vigor of a country's securities markets is stock market capitalization as a percentage of gross domestic product (GDP). The following chart compares the U.S. to other developed countries with respect to this indicator (Figure 2-5). In recent years, most countries experienced declines in stock market capitalization as a percentage of GDP after substantial increases through 1999. These decreases may reflect the global economic slowdown, as well as the effects of market scandals and regulatory change. Preliminary 2003 data indicate that a moderate recovery in U.S. market capitalization is underway (Figure 2-6).



Source: Standard & Poors 2003 Emerging Stock Markets Fact Book (for market capitalization) and Bloomberg (for GDP).



Source: Federal Reserve, Flow of Funds Accounts of the United States, Chart L.213 Corporate Equities. Data for the periods 1965 – 2003 are presented in multiple editions.

In recent years, however, a variety of markets, firms, and commentators have questioned one or more aspects of the national market system, including whether market regulation has kept pace with dramatic technological changes since the national market structure's inception. Even those concurring with the fundamental elements of the national market system have questioned whether there are better ways to implement them. A fundamental question has been raised – does the national market system need to be completely retooled or simply modernized?

Today the Commission is exploring whether vastly improved communications and processing technologies have opened up new possibilities to achieve its regulatory goals in a more efficient manner. As regulators, the challenge remains how to promote the benefits of competition, while at the same time mitigating the negative effects of the fragmentation that can result when multiple markets simultaneously trade the same securities. A successful national market system allows investors to benefit from a rich diversity of trading venues, while enjoying the benefits of a system where the best price is available to all.

Efficient securities markets depend not only on the availability of high-quality financial information, but on investors being able to make valid comparisons among reporting companies. As securities markets become more and more global in nature, it becomes increasingly important for financial statements around the world to speak in similar dialects. Convergence in accounting standards is a two-way street, and will not be an easy task. ⁹

*Donald T. Nicolaisen
Chief Accountant*

A variety of other market dynamics may affect the SEC's activities over the next five years. For example, the general condition of the economy may affect the volume and complexity of public offerings that the SEC must review. The Commission may need to adjust its operations if the number, the types, or the complexity of entities regulated by the agency change over time. And despite preparation by the SEC and the SROs, the agency may still need to contend with unanticipated market disruptions.

Globalization

Increasingly inter-connected global financial markets and advanced technology allows money to move anywhere in the world at lightning speed. A crisis in any of these market areas of the world can shake investor confidence worldwide.

While cross-border diversification and technological advances have provided companies with new sources of capital and individuals with new investment opportunities, the increased international trading volumes and activity levels raise many issues. These challenges span clearance and settlement issues related to foreign exchange rates, time zone differentials in a time-sensitive environment, cross-system settlement, oversight of globally active firms, and conflicts of law. The challenges are particularly demanding for developing markets in foreign states as they seek assistance in creating safe and sound trading, clearance, and settlement systems.

In addressing the increasingly global nature of financial markets, the SEC works with many international organizations and securities regulators to improve global transparency and disclosure, strengthen the supervision of global firms and markets, reinforce regulatory standards, and enhance cross-border enforcement cooperation. In particular, U.S. and international accounting organizations and securities commissions are working together to develop strategies for "converging" upon an agreed-upon set of accounting standards and practices.

For most participants, convergence at the conceptual level is easy to support. Companies and investors benefit when financial statements, accounting standards, and auditing procedures mean the same thing from country to country. When one set of high-quality standards is applied anywhere in the world, the cost of accessing capital markets is likely to be reduced, and information disclosed to investors in one country can be as relevant and meaningful to investors in other countries.

For the United States, convergence will require the SEC to engage in a multi-year effort with a variety of standard-setting organizations, including the International Accounting Standards Board (IASB), the International Organization of Securities Commissions (IOSCO), the International Federation

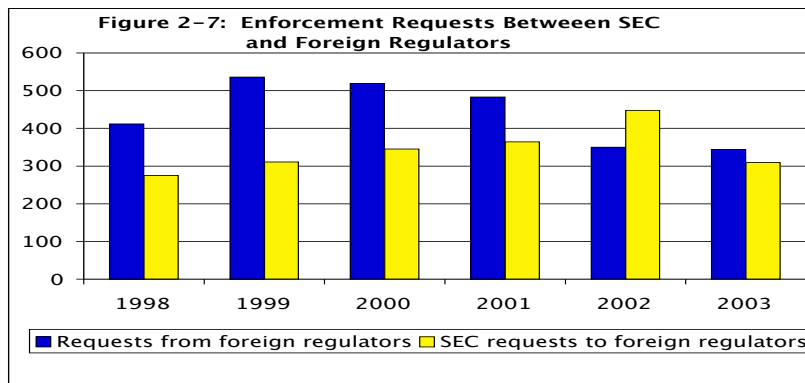
In short, this past decade has seen a tectonic shift in how securities regulators combat cross-border financial crime. In a sense, what we have now is a philosophy of collective security for securities regulators – we have the authority to view a threat to the integrity of foreign markets as a threat to our own. Those who commit financial crimes can run across borders, but they cannot hide.¹⁰

*Ethiopia Tafara, Director
Office of International Affairs*

of Accountants, the Public Company Accounting Oversight Board (PCAOB), and the Financial Accounting Standards Board (FASB). In addition, coordination with other regulatory groups, such as the European Commission and the Basel Committee on Banking Supervision, will be important. The issues to be resolved include international audit standards, quality assurance, oversight and accountability, as well as financial reporting, disclosure and corporate governance matters. The outcome of these efforts will significantly shape both domestic and international financial markets for many years to come, and the activities require extensive analysis and negotiations to ensure that U.S. companies and investors alike will benefit from the changes.

The Commission has undertaken numerous efforts to consider the international implications of implementing the Sarbanes-Oxley Act. The Act, as with securities laws that existed before it, presents its requirements without distinction between domestic and foreign market participants. Because the Commission understood that the broad scope of the Act raised concerns for foreign market participants, it asked for public input regarding those concerns, met with market participants and regulators, and held public roundtables to address the Act's international implications. Ultimately, the Commission provided a number of thoughtful accommodations to foreign market participants that allow the use of home country methods to accomplish the goals of the Act.

To maintain the integrity of domestic securities markets, the SEC also cooperates with foreign authorities in enforcement and regulatory matters to prevent and detect securities fraud, facilitate cross-border offerings, and help regulators of emerging markets develop systems that protect investors. Each year, the SEC makes or responds to hundreds of requests for enforcement assistance with foreign regulators (Figure 2-7). To ensure timely responses to inquiries from foreign regulators the agency began providing expanded registration and disciplinary history information electronically. By directing requestors to material on the SEC's website and information contained on SRO sites agency staff are now able to focus more on critical enforcement-related requests.



Securities regulators around the world have been quick to realize that global markets and globally active firms make cross-border cooperation imperative. Without the assistance of foreign counterparts, it is much more difficult to enforce U.S. laws with respect to securities activity emanating from abroad.

Sophisticated cooperative mechanisms among securities regulators are now standard. The SEC and its foreign counterparts have developed more than 30 arrangements for information sharing. There is even a multilateral information-sharing vehicle through IOSCO. Central to the success of these arrangements has been the willingness of lawmakers to enact legislative changes where necessary to provide regulators with sufficient legal authority to assist one another.

While substantial progress has been made in increasing regulators' ability to cooperate in detecting and prosecuting cross-border securities fraud, the exchange of information may no longer be enough. In particular, securities regulators and law enforcement agencies recognize that the ability to freeze the assets of those suspected of committing financial crimes is crucial to taking the profit out of financial crimes. Consequently, one of the most difficult international issues remains whether and how to establish an international mechanism to freeze and repatriate assets.

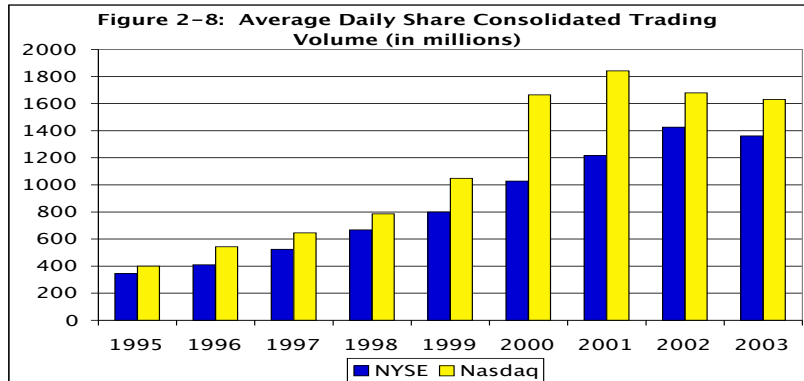
Revolutions in technology and communications and the unrelenting pace of globalization make it imperative that we revisit on a comprehensive basis the framework of our system for regulating markets.¹¹

*William H. Donaldson
Chairman*

Technology

Technology continues to shape and drive advances in the securities markets. Over the past decade, millions of retail investors began to do research and conduct trades through the Internet. Powerful networks are now making it possible for exchanges to display and execute orders in volumes previously unimaginable (figure 2.8). Between 1995 and 2003 the consolidated trading volume on NYSE and Nasdaq increased by more than 341 percent and 395 percent respectively. In addition, firms also now rely on

sophisticated computer programs to more quickly implement investment, trading, and risk management strategies.

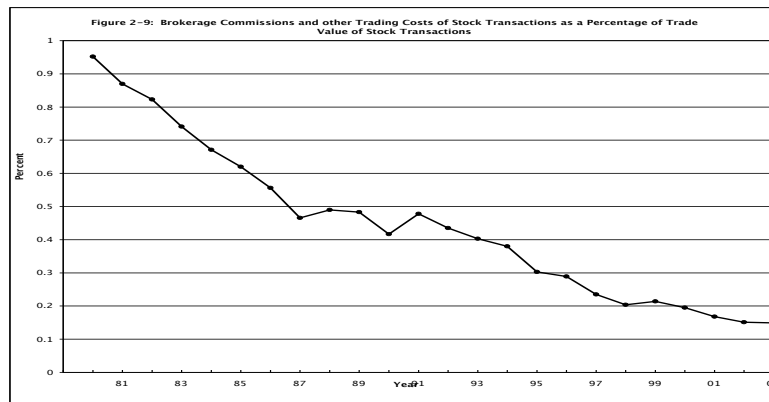


Source: Bloomberg.

Technology also has allowed new segments of the securities industry, such as Alternative Trading Systems (ATS), to grow significantly. For example, in 2003, Electronic Communication Networks (one type of ATS) accounted for approximately 40 percent of the daily share volume and approximately 50 percent of the transaction volume in Nasdaq securities. These electronic markets are employing technology to challenge traditional exchanges, using computers rather than humans to match buyers and sellers.

Technological advances also are creating new market efficiencies. For example, computer and communications advancements and the drive to reduce risk are moving the industry toward straight-through processing, eliminating any delay in the settlement of transactions. And a rapidly expanding web of connections among customers, brokers, and markets has brought diverse participants together, challenging existing institutions and making a true national market system a possibility.

This mix of technology, innovation, and competitive pressure has helped to reduce costs borne by investors. Since 1980, the aggregate amount of brokerage commissions and other transaction costs (e.g., the bid-ask spread) charged to investors relative to the dollar value of their trading declined from about 1 percent to 0.15 percent in 2003 (Figure 2-9). If trading costs had remained at their 1980 level, investors would have paid more than six times as much in transaction costs in 2003.



Source: Broker-Dealers FOCUS report and R-31 reports from exchanges and Nasdaq.

However, these advances also bring many challenges. The Internet, while a great resource for investors and the securities industry, presents new opportunities for fraud and abuse. Moreover, the reliance upon complex financial instruments and computer programs to manage risk makes it all the more important that investors and market participants understand the threats these tools may pose to the underlying safety of the markets.

In an increasingly automated environment, there is a corresponding need to address the linkages between markets. For example, while these linkages may improve market transparency and reduce investor trading costs, they also have significant implications for how markets compete. Also, firms must be able to monitor these linkages sufficiently to record and retrieve the history of electronic transactions as required under the USA PATRIOT Act, and move toward “real-time” disclosure and reporting under the Sarbanes-Oxley Act. And still other technological conveniences that make it easier to communicate with customers, e.g., electronic mail and instant messaging, create the need for new and sometimes costly compliance systems.

Technology is also driving significant changes within the Commission, as resources are increasingly being directed toward the application of new technologies to gather and analyze data. Intelligence gathering, computer forensics, and data analysis are critical components of the agency’s ability to proactively identify issues affecting the markets, assess risks, conduct enforcement investigations, and target disclosure review and inspection activities to those firms and filings that pose the greatest risk to the safety of the markets.

Government Actions

The priorities of Congress and the Administration, as expressed through legislation, hearings, and budgets, have a tremendous impact on the SEC. The following represent some of the most significant governmental actions that have impacted the agency since its last strategic plan was published.

Sarbanes-Oxley Act

The spate of major corporate accounting scandals suggested to many that the U.S. system of corporate governance and financial reporting needed improvement. In some cases, the checks and balances within the financial reporting system, such as management, auditors, audit committees, boards of directors, analysts, rating agencies, corporate counsel, standard setters, underwriters, regulators, and the investors themselves failed to detect or prevent large-scale frauds that were carried out over extended periods of time. While the U.S. financial reporting system remains fundamentally sound, and, generally, of the highest quality, these failures were a call to action.

Congress responded by passing the Sarbanes-Oxley Act of 2002, the most significant piece of securities legislation since the 1930's. Much of the Act may be viewed as a legislative attempt to better align the incentives of management, auditors, and other professionals with those of investors. In particular, the Act authorized the SEC to regulate the ethical standards of professionals in the securities marketplace and require more extensive corporate disclosures. The Sarbanes-Oxley Act also created the Public Company Accounting Oversight Board (PCAOB) to oversee the ethics, independence, quality control, and other aspects of the audit profession and gives it authority to enforce those standards, subject to oversight by the SEC.

Some of the important changes being implemented pursuant to the Act include: empowerment of audit committees to approve the services provided by independent auditors, more stringent auditor independence standards, and greater oversight of auditors through the establishment of the PCAOB. The Act also required the Commission to study nationally recognized statistical rating organizations and their role and importance in the securities markets. As part of its review, the Commission is working to determine the appropriate degree of regulatory oversight that should be applied to credit rating agencies.

In June 2002, the Commission issued an order requiring the CEO and CFO of each of the largest 945 U.S. public companies to undertake a one-time certification of the information contained in their company's recent periodic reports. That same month, the Commission proposed rules that would make such

a certification an on-going requirement. Following passage of the Act, the Commission implemented the Act's directive that the certification requirements be adopted within 30 days.

In sum, the Act called for improvement in the checks and balances that govern the financial information provided to investors and thereby served notice that those who violate securities laws will be punished.

USA PATRIOT Act of 2001

The USA PATRIOT Act is the chief regulatory tool in the fight against money laundering and the financing of terrorism. The Act continues to have a significant impact on market intermediaries and participants. The SEC is working with other federal regulators and the self-regulatory organizations (SROs) to complete implementation of the Act. Several key rulemaking projects are underway, and both regulators and financial institutions are working to comply with the broad range of rules adopted over the past two years.

Public Utility Holding Company Act of 1935 and the Energy Policy Act

The Commission's administration of the Public Utility Holding Company Act of 1935 (PUHCA) continues to generate interest as a result of the collapse of Enron, the general restructuring of the energy industry, and the Energy Policy Act legislation currently pending in Congress. Should that legislation be adopted, PUHCA would be repealed, and related SEC activities would end after a transition period.

Staffing-Related Acts

Important legislative changes helped the Commission address significant challenges in recruiting and retaining staff. In 2001, Congress and the President approved the "Investor and Capital Markets Fee Relief Act," which allowed the SEC to compensate its employees at levels comparable to those of other federal financial regulators. The SEC has used this "pay parity" authority to develop a new Pay-for-Performance system that rewards high-performing staff with merit-based salary increases and to enhance employees' vision, dental, and other health benefits.

In July 2003, President Bush signed the "Accountant, Compliance, and Enforcement Staffing Act of 2003." The Act streamlines the Commission's effort to hire accountants, economists and examiners by permitting the agency to hire staff for these positions under excepted service authority rather than through the federal competitive service process. This change allows the agency to complete the hiring process in a few weeks compared to what is required under competitive service. As a result of

these actions, the agency has cut its turnover rate by nearly half and has moved aggressively to hire new employees.

Budget Actions

Congress and the President have a substantial influence over the SEC's ability to fulfill its mission through the annual budget process. Over the last several years, the SEC has received significant increases, growing from \$514 million in fiscal 2002 to \$811.5 million in fiscal 2004. These funds have allowed the agency to hire more than 840 new staff, make badly needed investments in information systems, launch a new initiative to target the agency's activities towards the most significant risks to investors, and take a variety of other steps to increase operational effectiveness.

The Administration has requested \$913 million for the SEC in fiscal 2005, which would include 106 additional staff primarily for examinations of mutual funds and perhaps hedge funds. In addition, in fiscal 2007 federal law will reduce the fees the Commission collects to \$1.1 billion from \$2.1 billion in 2006. In the period leading up to this drop in fee collections, it may be appropriate to reevaluate the fee and funding structures and consider alternatives such as self-funding that will give the SEC a stable, long-term funding source.

Chapter Three

Strategies and Resources

Upon arriving at the SEC, I quickly concluded that 50 percent of the job should be focused on internal management, 50 percent on policy formation, and 50 percent on restoring investor confidence, through the use of the “bully pulpit.” I know that adds up to 150 percent, but it provides a sense of the urgency – and enormity – of the task. ... I want us to become better equipped to see over the hills and around the corners of problems that may be looming in the distance.¹²

*William H. Donaldson
Chairman*

To carry out its mission, the SEC is currently organized into six major program areas:

- Full Disclosure: The Full Disclosure program ensures that investors are provided with material information and deters fraud and misrepresentation related to the public offering, trading, voting, and tendering of securities. The program is comprised of the Division of Corporation Finance, the Office of the Chief Accountant, and the Office of Filings and Information Services.
- Prevention and Suppression of Fraud: Under this program, the SEC investigates and litigates violations of the federal securities laws. The Division of Enforcement, the regional and district offices, the Office of International Affairs, the Office of the Secretary, and the Office of Investor Education and Assistance all administer the program.
- Supervision and Regulation of Securities Markets: This program supervises and regulates major market participants, such as exchanges, national securities associations, and brokers and dealers, to maintain fair, honest, and efficient securities markets. The program consists of the Division of Market Regulation, the Office of Compliance Inspections and Examinations, the regional and district offices, and the Office of Filings and Information Services.
- Investment Management Regulation: This program regulates investment companies, investment advisers, and public utility holding companies to protect investors from fraud, mismanagement, self-dealing, and inadequate disclosure by those entities. The program is administered by the Division of Investment Management, the Office of Compliance Inspections and Examinations, the regional and district offices, and the Office of Filings and Information Services.
- Legal and Economic Services: This program furnishes legal, adjudicatory, and economic expertise to the Commission and its staff. It consists of the Office of the General Counsel, the Office of Economic Analysis, the Administrative Law Judges, and the regional and district offices.
- Program Direction: The goals of this program are to formulate and communicate policy proactively,

oversee policy implementation, manage agency resources, and otherwise support the operating divisions and offices. The program is comprised of the Executive Staff and the Offices of the Secretary, Public Affairs, Risk Assessment, Executive Director, Equal Employment Opportunity, Human Resources and Administrative Services, Financial Management, Information Technology, and the Inspector General.

The SEC is considering a number of changes to these programs and to its organizational structure generally. One possibility under consideration would be to better align these structures with the customers the agency serves.

Strategies

While each program is uniquely focused on a specific area of Commission responsibility, the following key strategies are employed across all programs:

- Leveraging resources with other federal, state, and foreign governments, as well as domestic and international organizations, to maximize the effectiveness of regulatory, enforcement, and educational activities.
- Expanding risk-based assessment practices to better anticipate emerging risks and market trends that may threaten the Commission's ability to fulfill its mission or potentially harm investors and market participants.
- Applying technology to enhance the operational effectiveness of the agency and to improve public access to SEC filings and other information.
- Sustaining and improving organizational excellence.

Leveraging resources with other federal, state and foreign governments, as well as domestic and international organizations, to maximize the effectiveness of regulatory, enforcement, and educational activities.

Under a regulatory structure set out by Congress, the Commission relies heavily upon public-private partnerships to oversee U.S. securities markets. While the Commission sets standards for market participants and market structure, much of the direct, day-to-day regulation of securities market participants is done by the market participants themselves and by industry SROs under SEC oversight.

Due to the considerable scope of law enforcement actions the Commission may undertake, substantial coordination and cooperation takes place with other law enforcement agencies in the United States and abroad to investigate and prosecute securities laws violations. In addition, the Commission has a variety of information sharing arrangements with foreign counterparts that promote international cooperation. In addition,

the SEC is working to promote high regulatory standards with its counterparts and through technical assistance. The Commission also works in partnership with numerous federal and state agencies, financial industry associations, consumer groups, and educational organizations to help individuals get the facts they need to save, invest, and avoid fraud.

Expanding risk-based assessment practices to better anticipate emerging risks and market trends that may threaten the Commission's ability to fulfill its mission or potentially harm investors and market participants.

For too long, the Commission found itself in a position of reacting to market problems rather than anticipating them. To better identify risks across divisional boundaries and ensure that senior managers have the information necessary to make more informed decisions, the SEC – at the direction of the Chairman – conducted a thorough internal review and established an Office of Risk Assessment. The Office will oversee risk assessment activities focusing on early identification of new or resurgent forms of fraudulent, illegal, or questionable behavior or products. Operating under the “Doctrine of No Surprises,” risk assessment teams within the Commission’s programs are mapping the risks in their areas and developing risk mitigation plans in order to anticipate and address major problems before they occur.

Such risk assessment techniques also will help the SEC focus its examination and disclosure review programs. In identifying firms and filings to examine, the Commission is shifting away from a “one size fits all” review cycle to new risk-based approaches that direct resources toward those firms, issuers, filings, or industries that most warrant review. In developing these new approaches, the agency also is reforming its business processes to take advantage of vast amounts of data on the risks posed by market participants.

Applying technology to enhance the operational effectiveness of the agency and to improve public access to SEC filings and other information.

The Commission intends to become a leader in electronic government by continuing to identify opportunities to enhance performance through new and applied technology. To do so will require that Commission employees have the necessary capabilities, equipment, and expertise to keep pace with technological innovation in the industry, and to ensure that new technologies are assessed and integrated into the Commission’s technical architecture and work processes.

At its inception, the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system represented the height of electronic innovation. The SEC will substantially upgrade EDGAR, as well as the SEC website at www.sec.gov, to ensure that the vast array of public information is more accessible and useful to the public.

The SEC's newly appointed Chief Information Officer is developing a new strategic plan for information technology. The new plan will outline the agency's strategy to accomplish the following:

- Improve the Commission's discovery and case management capabilities, including the use of image-based document management processes, and search and retrieval of electronic media such as e-mail;
- Improve the accessibility and usability of registrant filings to the public and SEC staff, through tools such as XBRL;
- Increase the SEC staff's personal productivity and work flexibility, and enable a "virtual workforce" through greater use of mobile and remote access technologies;
- Further develop the agency's enterprise architecture to streamline business processes, consolidate redundant systems, and technologies, and adopt components of the federal architecture where feasible;
- Increase information security and disaster preparedness for agency systems and data; and
- Enhance the agency's capital planning and project management processes.

Sustaining and improving organizational excellence.

The efficient functioning of the SEC is as important a component of investor protection as the rules and regulations the agency implements. The agency's efforts to improve its organizational excellence encompass recruiting and retaining a high quality staff, investing in the knowledge base of staff, and establishing a performance measurement system to better manage programs and allocate resources.

Recent legislative actions, including the Investor and Capital Markets Fee Relief Act and the Accountant, Compliance and Enforcement Staffing Act of 2003, have permitted the agency to establish its own performance-based pay system and expand the SEC's expedited hiring authority to include accountants, examiners, and economists. This authority also allowed the SEC to work in conjunction with the agency's union, the National Treasury Employees' Union (NTEU), to significantly enhance employee benefits. Taken together, these actions have helped reduce annual attrition rates, while ensuring that new and talented individuals can quickly be identified and hired.

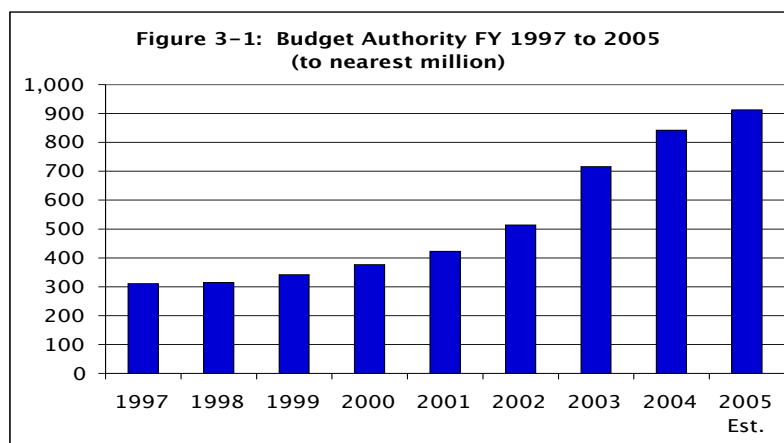
Through the "SEC University," the Commission is working to enhance the performance, skills, and industry knowledge of its managers and staff. Through on-line and in-person classes SEC staff will be able to improve their skills, remain grounded in the SEC's mission and values, and stay abreast of the developments in rapidly evolving markets.

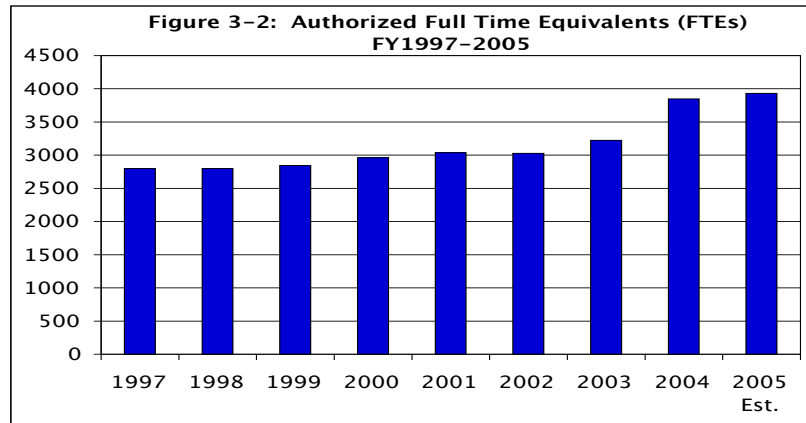
The use of performance measurement systems is helping SEC management to identify programs that are working effectively and where it may be necessary to reallocate resources. Periodic management reports called “dashboards” show a division’s or office’s progress towards budget, staffing, and performance objectives. These reports provide a more detailed picture of the Commission’s operations and effectiveness than ever before available, and are used on a regular basis to identify emerging problems, discuss possible solutions, and hold managers accountable for their staff’s activities.

The SEC also is working to build a culture of accountability, where excellence is encouraged, noted, and rewarded. For example, the Commission has developed a Pay-for-Performance system that recognizes and equitably compensates employees for contributions made that help the SEC achieve its mission.

Resources

In response to the accounting and corporate scandals and the September 11th terrorist attacks, the resources available to the agency have increased dramatically since 2001. For fiscal 2005, the President’s budget request for the SEC totaled \$913 million (Figure 3-1) and included 3,932 full-time equivalents (FTE) or 4,196 positions (Figure 3-2) for the SEC. The President’s request represents a 116 percent increase in dollars and 29 percent increase in FTE from FY2001 levels, and a significant departure from the funding pattern of the 1990’s.





Strategic Planning Process and Resource Allocation

In 2003, a team of senior managers and staff began formulating the agency's 2004-2009 strategic plan. The team, comprised of representatives from 16 of the SEC's divisions and offices, possesses extensive knowledge of the SEC's programs and major initiatives. In developing the strategic plan, the team considered and discussed the condition of domestic and international securities markets, recent changes in the marketplace, legislative developments, and issues affecting investors and the general public. Organizational considerations such as human capital, diversity management, financial resources, and technology were also evaluated.

The team crafted a new strategic vision, core values, and goals and identified initiatives that would be undertaken by offices and divisions to achieve the agency's mission. Throughout development of the plan, the team actively conferred with office and division leadership, and the staff continued to interact frequently with external stakeholders. Senior agency leadership simultaneously met to discuss and evaluate Commission priorities and provide input in the plan.

Also in 2003, in conjunction with the development of the GPRA strategic plan, the Commission began a comprehensive planning initiative to determine how to allocate its significant budget increases. Throughout the planning process, the Chairman's primary concern was that resources be deployed as effectively and efficiently as possible, maximizing the added value for taxpayers and investors alike.

To achieve this objective, the Chairman established a process by which division and office requests are considered based upon how the additional resources will be applied to fulfill the agency's

mission and accomplish its goals. Agency-wide reviews of existing and proposed organizational structures also examine whether positions are being deployed effectively to support agency priorities. These and other reviews by senior agency leaders are setting the standard for ensuring resources are targeted strategically and with an eye toward performance objectives.

Through these strategies, the Commission is making fundamental, long-term changes in the way the agency conducts its business. The SEC is working on a variety of fronts to ensure that the agency is deploying its resources and staff with maximum impact and effectiveness. Many of these initiatives are explained in more detail in the chapters that follow.

Chapter Four

Goal 1 - Enforce Compliance with Federal Securities Laws

These days, the concept of effective enforcement necessarily includes 'seeing around the corner.' What that means to us is identifying trends, practices, and risks within our capital markets that could be exploited to the detriment of investors. Ideally, if we are able to spot these issues in their infancy, we can prevent them from growing into full-fledged, confidence eroding scandals.¹³

*Stephen Cutler, Director
Division of Enforcement*

Congress designed the nation's federal securities laws to instill investor confidence in the capital markets. By providing a formalized structure and government oversight, these laws carefully balance the desire for open, accessible, and competitive markets with the need to protect investors. Among other things, they impact:

- Public offerings of securities;
- Periodic reporting by companies with registered securities;
- Mergers and acquisitions;
- Corporate governance;
- Securities trading; and
- The activities of entities such as exchanges, broker-dealers, depositories, clearing agencies, transfer agents, investment companies, and investment advisers.

The SEC works to both enforce the laws and promote compliance. With regards to the SEC's enforcement authority, the Commission seeks to detect violations quickly, publicize misconduct where appropriate to alert investors to possible wrongdoing, and take prompt action to halt the misconduct and its effects. SEC staff uncover securities violations through many sources, including surveillance activities, research and data analysis, tips and complaints from the public, the media, and the agency's examination and disclosure review programs.

Each year, the SEC brings hundreds of civil enforcement actions against individuals and companies for non-compliance with the securities laws. Depending on the type of conduct involved and the venue of the proceeding, the agency can seek a wide range of remedies. These include civil injunctions, orders requiring special actions (such as audits, accounting for frauds, or special supervisory arrangements), civil monetary penalties and disgorgement of illegal profits, orders that bar or suspend an individual from serving as a corporate officer or director, censures, industry bars, or suspensions or revocation of the registration of regulated entities such as broker-dealers and investment advisers. The Commission also is empowered to halt trading in securities where there is inadequate public disclosure.

The SEC works with the Department of Justice as part of the President's Corporate Fraud Task Force to file and prosecute criminal charges against violators, and has established more than 30 formal arrangements with foreign counterparts for information sharing and other forms of cooperation to investigate and prosecute securities law violations.

Today, examiners are increasing the frequency and depth of examination reviews for high-risk firms; increasing the use of technology and data; developing new methods to identify new or emerging areas of compliance risk; conducting more targeted “mini-sweep” examinations to identify risk areas sooner; and working more closely with other staff at the Commission to highlight problems detected, and identify possible solutions sooner.¹⁴

*Lori A. Richards, Director
Office of Compliance
Inspections and*

Such actions can help deter violations of the securities laws from occurring in the first place. But the SEC also works aggressively on a variety of additional fronts to reduce the probability that violations will occur and to detect problems before they become severe or widespread. For example, the agency works with industry participants to explain the intent and requirements of securities laws and regulations, providing guidance before activities are undertaken that could result in violations. These interactions range from phone calls requesting interpretive guidance to formal written requests for exemptive or no-action relief.

The SEC also conducts examinations and inspections to address compliance problems. Working together with firms and their compliance officers, examiners can help identify areas where entities can improve internal controls and other compliance mechanisms. When necessary, the examination program refers any potentially serious violations it uncovers to the SEC’s Division of Enforcement, or when appropriate to the registrant’s self-regulatory organization, for further investigation.

A vigorous disclosure review program helps prevent violations by shining a spotlight on an issuer’s business and financial condition. By upholding requirements for the broad and timely dissemination of material information, this program ensures that everyone, including the individual investor, learns important information, such as earnings results, at the same time.

The SEC further promotes compliance by actively monitoring – and requiring others to monitor – the condition of firms or the markets as a whole. For example, the Commission conducts research, analysis, and surveillance to identify factors impacting the markets, uncover non-compliant practices, and ensure that firms are addressing issues before undue risk adversely affects investors. Furthermore, the SEC requires that registrants actively monitor and report certain activities and that the SROs and company board committees who oversee compliance maintain their independence.

The Commission’s activities in these areas also have an additional benefit. By promoting full disclosure of firms’ activities, the SEC gives investors the tools they need to make better-informed investment decisions. As a result, securities industry participants have a powerful incentive to comply with the laws and regulations that govern their practices.

Outcomes and Initiatives: Priorities for 2004-2009

In its efforts to ensure compliance with the federal securities laws, the Commission plans to launch a variety of initiatives that will complement the agency's other ongoing activities. The SEC will monitor its progress by establishing and tracking appropriate performance measures, examples under current consideration are listed at the end of this chapter.

Outcome 1.1: Potential problems or issues in the securities markets are detected early and violations of federal securities laws are prevented.

Supporting Initiatives:

1. Risk Assessment: The SEC will expand its initiative to identify and manage emerging risks and market trends that threaten the Commission's ability to fulfill its mission. By creating a formalized risk assessment function, the agency will be better prepared to determine more quickly whether new business trends and industry practices warrant further SEC attention and to proactively adjust operations and resources to address these new challenges.
2. Risk-Based Inspection Cycles: The SEC will fully implement a risk-based methodology for selecting and setting examination and inspection cycles for investment advisers and funds. Larger or higher-risk entities will be examined more frequently to ensure that the agency quickly identifies problems before they affect large pools of savings.
3. Better Access to Registrant Data: The agency will assess strategies for establishing broader electronic access to registrant data to regularly assess their condition, compliance with the law, and risk to the markets.
4. Enhancing the Interpretive Guidance Process: The agency's enterprise architecture business model identified wide variances in how Commission staff receive, respond to, and analyze interpretive, exemptive, and no-action requests. As a significant component of the agency's workload, the effort will determine whether a more efficient "customer-driven" process can be developed that meets the needs of staff, the public, and other external stakeholders. This initiative may result in changes to business processes as well as the development or integration of information systems.

Outcome 1.2: Violators of federal securities laws are detected and sanctioned.

Supporting Initiatives:

1. Risk Assessment: Through the SEC's risk assessment initiative, a new Office of Risk Assessment and risk assessment teams within each program will map out potential risks that threaten investors. This risk assessment process will help the agency be much more proactive in identifying and addressing fraud.
2. Coordination with Other Securities Regulators: Because fraud often reaches beyond U.S. borders, law enforcement must also have a global reach. Therefore, the agency will work to enhance cooperation with foreign authorities in overseeing globally active firms and improve information sharing on investigations and cases to enhance compliance with federal securities laws. The SEC also will build upon its strong partnerships with other domestic authorities that oversee the securities markets.
3. Document Management: The SEC receives millions of pages of documents in the course of its examinations and enforcement investigations. The examiners and attorneys who handle these activities could enhance their efficiency and effectiveness by having access to imaged documents in an electronic document management system that allows for better search, analysis, and disaster recovery.
4. Automated Tools: Over the next several years, the Commission will expand the use of automated tools to organize, analyze, and recognize aberrant patterns and exceptions in large databases of information to target high-risk activity, monitor registrants, and more quickly identify violations. In addition, the agency will modernize the Commission's extensive databases to improve its ability to detect potential violations.
5. Staff Training: The SEC strongly believes that a well-trained staff is key to the agency's success in pursuing wrongdoers. Through efforts like "SEC University," the agency will provide professional development opportunities that improve the performance, skills, and industry knowledge of staff. The SEC will share tools and techniques with financial regulators and other government agencies to ensure that the agency's training program reflects the best practices in this area.

Potential measures for monitoring progress:

1. Percentage of investment advisers and investment companies examined relative to risk-based exam cycles.
2. Number of interpretive requests, no-action letters, and exemptive requests responded to by staff.
3. Results of broker-dealer, investment company, and investment adviser examinations, including the number/percent of examinations with “significant findings.”
4. Criminal proceedings relating to SEC investigations or cases.
5. Monetary remedies or civil penalties ordered and collected.
6. Number, nature, and complexity of requests to and by foreign regulators for enforcement assistance.

Chapter Five

Goal 2 - Sustain an Effective and Flexible Regulatory Environment

Good corporate governance is not primarily about complying with rules. It is about inculcating in a company, and all of its directors, officers and employees, a mindset to do the right thing.¹⁶

*Alan L. Beller, Director
Division of Corporation Finance*

The recent fund scandals underscore the importance of rules and processes. They are not meaningless red tape. They serve a legitimate purpose—and that is to ensure that insiders and overly aggressive market participants do not take advantage of ordinary fund shareholders. Fund shareholders must trust that the system works for them. That trust has been shattered, and it is up to all of us to rebuild it again.¹⁵

*Paul F. Roye, Director
Division of Investment
Management*

Federal securities laws seek to promote fair, orderly, and competitive markets that protect investors from undisclosed risk while fostering innovation and market access. The Commission's role is to put those laws into action—by establishing a regulatory environment that permits competition to flourish, while at the same time protecting investors.

Most securities regulation flows from two central principles. First, all investors should have equal access to accurate, complete, and timely information about the securities they buy, sell, and hold. Securities regulations require that issuers and other regulated entities disclose information about their current and expected future financial performance, to provide investors with an accurate idea of what a security represents.

Second, investors should be able to rely upon self-regulatory organizations (SROs), broker-dealers, investment advisers and investment companies, and other market participants to conduct their securities transactions efficiently and in the investor's best interests. For example, the regulations often require that these entities register with the Commission, disclose potential conflicts of interest, and maintain effective internal controls.

Federal law gives the Commission broad authority to shape the regulatory framework for the securities industry. Rulemaking may be required because of Congressional mandates, changing economic conditions, advances in technology, the advent of novel products or services, or new types of abuses. When properly crafted, these rules serve to protect investors and promote competition, market efficiency, and capital formation. Therefore, rulemaking is designed to strengthen the structure of the trading markets, improve corporate governance, enhance disclosure, promote reliable accounting standards, ensure the accountability of market professionals, and facilitate the flow of important information to the public, among other goals.

The Commission's rulemaking activities are supported by a wide range of analyses, with the goal of promoting the mission of the SEC while minimizing undue burdens on market participants. The division or office proposing the rule, along with the Office of the General Counsel, examines the legal basis for the rule and its interactions with other laws and regulations. An important component of the rulemaking process is economic and quantitative analysis performed by the proposing division or office and the Office of Economic Analysis (OEA), in an effort to make sure that a rule is narrowly

tailored to achieve its intended objective, avoids unintended consequences, and is economically and financially sound.

The various statements and reports that issuers, broker-dealers, and others are required to file with the Commission are submitted in a format or form proscribed by the SEC's rules. The forms specify which rules are applicable and explain who must file, the amount of the information required, and when the information must be provided. Since disclosure is such an important part of the regulatory landscape, these forms play an important part in defining the extent of the disclosure obligation and carry the legal force of the rules they implement.

Economics suggests that regulation is necessary where markets don't function properly and the benefits of intervention justify the burden. Otherwise, regulators should support well-functioning markets.

*Chester S. Spatt, Chief
Economist
Office of Economic Analysis*

Beyond its rules and forms, the agency provides guidance when it sets forth the views of the Commission or its staff on questions of current concern, without stating them in the form of legal requirements. The principal form of these statements is through a publicly distributed SEC bulletin containing the staff's position on a particular legal or accounting issue or its interpretation of a rule or regulation. The Commission also issues concept and other releases that solicit the views of the public on securities issues, so that it can better evaluate the need for future rulemaking. This collaborative process ensures a broad and accessible forum in which interested parties can offer input on regulations—input which sometimes can have a significant impact on the shape of the final rule proposal. This collaboration serves to make the final rules that are adopted by the Commission better structured and more effective.

The staff also responds to inquiries from individuals or companies about whether an activity undertaken in a specified manner would violate the securities laws. The inquiries take the form of written requests that the staff not recommend enforcement or other action to the Commission if the activity is completed as specified. The originators of “no-action” requests submit their inquiries privately, but the staff publicly releases both the request and the agency's response upon completion.

In addition, in order to ensure that the financial statements investors use to make investment decisions are presented fairly, consistently, and with credibility, the Commission monitors or participates in domestic and international standard setting initiatives involving accounting and auditing practices.

Finally, because rulemaking is one of the SEC's primary functions and involves staff in virtually every program, the agency recognizes that regular reviews of Commission regulations and its rulemaking processes are necessary to confirm that intended results are being achieved. Just as the securities rules require that company disclosures be clear and precise, the Commission also attempts to write rules that are easily understood and not overly prescriptive. For that reason, the agency makes a concerted effort to eliminate obsolete and redundant filing requirements, especially when it promulgates new rules that must work in concert with existing regulations.

As required by the Sarbanes-Oxley Act, the Commission has engaged in extensive rulemaking to address issues of corporate and fund governance. New standards for the independence of directors and key board committees and the governance policies and practices of SROs will have significant effects for years to come. Many companies are recognizing anew that it is a good business practice to comply not just with the letter of the securities laws, but also with their spirit and underpinnings. If market participants view reforms as opportunities to improve internal controls, improve the performance of the board, and improve their public reporting, they ultimately will be better managed, more transparent, and therefore more attractive to investors.

Outcomes and Initiatives: Priorities for 2004-2009

In its efforts to sustain a flexible and effective regulatory environment, the Commission plans to launch a variety of initiatives that will complement the agency's other ongoing activities. The SEC will monitor its progress by establishing and tracking appropriate performance measures, examples under current consideration are listed at the end of this chapter.

Outcome 2.1: Investors are protected by regulations that strengthen corporate and fund governance and adhere to high quality financial reporting standards worldwide.

Supporting Initiatives:

1. Accounting Profession Oversight: The SEC will work closely with the Public Company Accounting Oversight Board on regulation of the accounting profession and the promulgation and interpretation of auditing standards.
2. Investment Management Industry Regulation: The agency will complete and monitor the results of rulemaking initiatives that will promote mutual fund investor rights. These rules would, among other things:
 - a. Provide mutual fund investors with more information about fees and expenses, including fund transaction costs, sales load breakpoints, point-of-sale information about brokers' fees and other items, and the reasons why the board of directors approved the fund's advisory contract and fees;
 - b. Require that fund fees and expenses be presented in dollars as well as percentages;

- c. Provide more frequent disclosure of fund portfolio investments and additional information about the portfolio manager's relationship with the fund;
- d. Establish a code of ethics for investment advisers;
- e. Prohibit funds from using brokerage commissions to pay broker-dealers for selling fund shares;
- f. Combat late trading, market timing, and selective disclosure abuses in the mutual fund industry; and
- g. Explore alternatives for possible hedge fund manager oversight.

3. Corporate and Fund Governance Rules: The SEC will complete rulemaking activities that strengthen corporate and fund governance practices by:

- a. Enhancing shareholder access to the proxy process, and bolstering the disclosure requirements related to shareholder proxy access;
- b. Enhancing independence of the chairs and other members of mutual fund boards of directors;
- c. Expanding interpretive guidance regarding critical disclosure requirements such as management's discussion and analysis of financial condition and results of operations, and
- d. Enhancing SRO efforts to strengthen market governance.

4. Global Accounting Standards: The agency supports ongoing convergence initiatives between the Financial Accounting Standards Board and the International Accounting Standards Board to enhance the quality of financial reporting worldwide. The SEC also will support ongoing efforts to improve audit standards and mechanisms for their oversight worldwide.

5. Accounting Studies: The SEC will follow up on recommendations from the staff study and report on the *Adoption by the United States Financial Reporting System of a Principles-Based Accounting System*, and complete a report for the President and Congress on the use of, and financial reporting for, off-balance sheet transactions and the special purpose entities used to facilitate such transactions.

Outcome 2.2: Industry efforts to provide innovative and competitive products and trading platforms are supported while the markets remain fair, vibrant, accessible, and financially sound.

Supporting Initiatives:

1. Review the National Market System: Taking into account the increasingly global nature of the markets, the SEC will propose and analyze public input on updating the national market structure. The agency also will enhance the operational efficiency of the clearance and settlement process in markets with a view toward straight-through processing.
2. Review Changing Market Conditions: The SEC will assess the need for a regulatory structure for credit rating agencies. In doing so, the agency will evaluate alternatives for obtaining disclosure from a broader community of filers, including hedge fund managers and government-sponsored enterprises.
3. Facilitate Market Access: The SEC intends to reduce the number of requests by investment companies for exemptive relief by adopting rules that address the growth and evolving operations of these vehicles. The agency will propose rules to provide accelerated access to capital markets for the largest and most liquid issuers, and provide more specificity regarding disclosure and registration requirements for asset-backed and other derivative securities transactions.
4. Assure Market Continuity of Operations: The agency is working with critical market participants to develop adequate plans and procedures so that back-up infrastructure and personnel are able to maintain continuity of operations through any future market disruptions.

Outcome 2.3: Regulations are clearly written, flexible, and relevant, and do not impose unnecessary financial or reporting burdens.

Supporting Initiatives:

1. Improve Agency-Wide Coordination of the Rulemaking Process: The SEC will seek additional ways to break down internal organizational barriers and foster greater collaboration among divisions and offices on rulemaking initiatives. The agency will establish collaboration tools to more effectively gather and analyze data from across the SEC and

manage rulemaking activities. The agency also will explore new ways to collect and disseminate rulemaking-related information electronically.

2. Enhance the Economic and Quantitative Support for Commission Rules and Regulations: The SEC will work to enlist the assistance of the Office of Economic Analysis (OEA) earlier and more often in the rulemaking process, so that the Commission's rules and regulations will be more firmly grounded in economic reasoning and analysis.
3. Update and Consolidate Forms and Guides: The SEC will update Commission rules and guidance to reflect the current requirements for electronic submission and eliminate references to paper-based filings, e.g., 1933 Act and 1934 Act Industry Guides, Regulation C under the 1933 Act, and Regulation S-K and S-B requirements. The agency also intends to simplify forms currently in use, such as Form D, and standardize those forms used by multiple regulators, such as Regulation A offering statements.
4. Assess the Impact of Prior Commission Rulemakings: The SEC will periodically assess the impact of past Commission rulemakings to gauge their effectiveness and determine whether more effective alternative approaches may have become available. Where possible, these determinations should employ empirical analysis. Pertinent divisions and offices will establish collaborative tools to more effectively conduct and coordinate such ex post analyses, which should inform current rulemaking.

Potential measures for monitoring progress:

1. Number of SRO rule filings reviewed and closed and of those, the number that significantly enhance the quality and efficiency of the securities markets.
2. Time to complete SEC reviews of SRO rules.
3. Amount of funds lost resulting from failure of SROs to ensure compliance with its rules.
4. Number of requests from foreign regulators for non-enforcement related technical assistance.
5. Stock market capitalization as a percentage of gross domestic product by country.
6. Average cost of trading.
7. Percentage of households owning securities and mutual funds.
8. Global access to U.S. markets: number of new foreign private issuers registering under the '33 and '34 Acts, and the dollar amount of securities registered by foreign private issuers.

9. Volume of trading in new markets or exchanges resulting from granting exemptive requests.
10. Dollar value of investor holdings of new types of investment company issuers.
11. Reductions in burden hours for filing requirements.
12. Number of duplicative or obsolete rules eliminated.
13. Length of time to respond to no-action letters, exemptive applications, and interpretive requests.

Chapter Six

Goal 3 – Encourage and Promote Informed Investment Decisionmaking

Effective investor education can help all Americans become better positioned to achieve personal financial security and reach their savings and investing goals, including home ownership and college education for their children.¹⁷

*Susan Ferris Wyderko,
Director
Office of Investor Education
and Assistance*

Investors who have access to information and know what questions to ask will be more likely to invest wisely. Because an educated investor ultimately provides the best defense against fraud and costly mistakes, the federal securities laws place great emphasis on ensuring that the issuers of securities provide clear, complete, and truthful information to the investing public. The Commission helps promote informed investment decisions through two main approaches: its full disclosure program and investor education initiatives.

First, as part of its full disclosure program, the SEC requires issuers to disclose meaningful financial and other information to the public, which provides a common pool of knowledge for all investors to use to judge for themselves if a security is a good investment. The Commission staff review the filings that companies and other entities submit to determine whether the disclosures are adequate and accurate. Reviews can involve in-depth accounting and legal analysis of a filing's financial and business discussions as well as any incorporated documents. In connection with a review, the agency may issue comments to prompt better compliance with applicable disclosure requirements. In response, a filer may revise financial statements or amend the accompanying narrative to provide additional or improved information. Compliance may avert costly investor litigation or Commission enforcement action.

Most recently, the Sarbanes-Oxley Act requires the Commission to review disclosures made by reporting issuers and investment companies at least once every three years. The SEC also is refining the disclosure review program further to ensure that resources are directed toward those issuers, filings, companies, or industries that most warrant review.

On an annual basis, the Commission receives and processes more than 15 million pages of information from corporate, investment company, and individual filers via the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. Because it is important for investors to have access to meaningful information on which to base their investment decisions, the Commission requires that almost all of these documents be filed electronically and makes a majority of those filings immediately available to the investing public through the SEC's website www.sec.gov.

The SEC also works together with self-regulatory organizations like the National Association of Securities Dealers and the North American Securities Administrators Association

(NASAA) to ensure that the public can access information on stockbrokers and investment advisers. For example in 2001, the SEC began providing electronic access to the Investment Adviser Public Disclosure (IAPD) website www.adviserinfo.sec.gov. The site contains registration forms filed by investment adviser firms, including important information about each firm's business operations and certain disciplinary events involving the adviser and key personnel. Comparable information on brokers is available on NASD's website at www.nasdr.com.

The second component of the Commission's efforts to promote informed investment decisions is investor education. The Commission's investor education staff works closely with numerous federal and state agencies, financial industry associations, consumer groups, and educational organizations to leverage collective resources and to minimize duplicative efforts. The Commission uses its materials as a catalyst to help foster investor education initiatives throughout the nation.

Over the past decade, the SEC has developed extensive materials to help investors understand the basics of investing on such topics as:

- The risks and rewards of various products and strategies;
- The importance of diversification;
- How to research stock brokers and investment advisers; and
- Where to find disclosure and other information about companies.

The Commission also undertakes targeted initiatives to promote informed investment decisions and help investors detect and avoid fraudulent schemes. For example, during 2002 and 2003, the SEC launched a series of fake scam websites designed to warn investors who rush into investment opportunities on the Internet without fully investigating the offers. Borrowing from the tactics of stock market con artists, the websites appeared to be investment opportunities offering tremendous financial gains. Despite containing obviously fictitious claims, the websites have received hundreds of thousands of hits. Individuals who attempt to invest funds land on a warning page that states: "If you responded to an investment idea like this...you could get scammed!" The page also tells investors how to research investment offers and where to call for help.

In addition to the fake scam websites, other targeted educational initiatives include:

- An investor information page on the SEC website that features a searchable database of answers to frequently asked questions; dozens of publications on products, strategies, and other investment related topics; interactive

- quizzes and calculators; and investor alerts;
- Educational events held throughout the U.S., including elder fraud programs, visits to high schools and colleges, and investor seminars;
- Free publications that educate investors;
- A toll-free investor assistance telephone line; and
- Individual responses to investors who contact the SEC with questions or complaints.

The SEC's investor education program benefits not only individual investors, but also the agency itself. The Office of Investor Education and Assistance (OIEA) staff collect data from investor questions and complaints and use it to track trends in the securities industry and to identify problematic brokers, firms, or sales practices. Sharing this information contributes to the agency's overall approach to risk assessment and helps target the resources and shape the initiatives of other SEC offices and divisions.

Moreover, a public that learns to recognize securities fraud and knows where to report it promptly can serve as an important early warning system to help regulators fight fraud. During fiscal year 2003, the OIEA and the Division of Enforcement's Internet Complaint Center received nearly 250,000 e-mails, including tips, complaints, questions, and forwarded spam e-mails that contain potentially fraudulent securities-related solicitations.

Outcomes and Initiatives: Priorities for 2004-2009

In its efforts to encourage and promote informed investment decisionmaking, the Commission plans to launch a variety of initiatives that will complement the agency's other ongoing activities. The SEC will monitor its progress by establishing and tracking appropriate performance measures, examples under current consideration are listed at the end of this chapter

Outcome 3.1: Investors have accurate, adequate, and timely public access to disclosure materials that are useful, and can be easily understood and analyzed across companies, industries, or funds.

Supporting Initiatives:

1. Expand Disclosure Requirements: The SEC will enhance market transparency through broader dissemination of information by market participants including:
 - a) Disclosing fees and expenses paid by investment company shareholders;
 - b) Disclosing incentives and conflicts of interest that intermediaries have in offering investment company shares to investors;

- c) Expanding the types of significant events that must be reported;
- d) Accelerating the filing periods for which certain activities are reported; and
- e) Disclosing company activities which raise concerns about global security risks that are material to investors.

2. Modernize Commission Databases: SEC databases will be enhanced so that information on mutual funds is more accessible and the electronic disclosure of information about investment advisers is enhanced.

3. Enhance Disclosure Review: The SEC will examine the business processes and supporting technology of the disclosure review program, with an eye towards streamlining these activities, enhancing the information available to the public, and making it easier for the public to analyze that data.

Outcome 3.2: Investors have a better understanding of the operations of the nation's securities markets.

Supporting Initiatives:

1. Investor Education Fund: The SEC will assist with the establishment of a non-profit grantmaking program designed to equip investors with the knowledge and skills necessary to make informed investment decisions, using funds from the global settlement of enforcement actions involving analyst conflicts of interest.

2. Website Enhancements: The agency will redesign the Commission's website to improve access to information, expand the use of technology to provide investors with prompt, accurate responses to their questions and complaints, and implement selected e-government initiatives sponsored by the Administration that improve the public's ability to interact with federal agencies.

3. Targeted Investor Education Initiatives: The SEC will explore new ways to shape and target education initiatives to maximize their impact among the investing public. For example, the agency will analyze complaint data on a regular basis to spot trends that will inform its education programs.

Potential measures for monitoring progress:

1. Percentage of investment company and issuer disclosures reviewed annually.
2. Average time to issue initial comments on full review registration and merger proxy statements.
3. Number of disclosures significantly changed in response to staff comments.
4. Percentage of filings that can be analyzed because

- they are submitted in a structured format.
5. Percentage of filings submitted electronically.
 6. Rate of use for agency website and number of on-line searches.
 7. Percentage of filings that are publicly available on the website.
 8. Total number of investor contacts broken out by complaint type.
 9. Average time for resolution of investor complaints or questions.
 10. Number of investor education initiatives and campaigns shaped by analysis of complaint data.
 11. The number of visitors to the Fast Answers interactive database of commonly asked questions.

Chapter Seven

Goal 4 - Maximize the Use of SEC Resources

An efficient, well-managed, anticipatory SEC is critical to protecting investors and the markets. As such, the Commission is concentrating on enhancing organizational effectiveness, as well as investing in staff, new technologies, and new internal controls.

Over the past two years, dramatic changes have occurred in the Commission's operating environment. Starting in fiscal year 2002, legislation was adopted that allowed the agency to begin offering salary and benefit packages to its employees that are competitive with those of other federal financial regulators. In 2003, the President and Congress approved significant funding and staffing increases that allowed the SEC to hire hundreds of new employees to help address the challenges facing the securities industry. Additional legislative changes in the Commission's hiring authority made it possible for the agency to move more quickly to add highly qualified candidates to its staff. Taken together, these changes are helping the SEC to retain talented and experienced staff while recruiting new highly qualified individuals that reflect the population from which they are drawn as well as the citizens they will serve.

These new resources also allowed the SEC to create and begin implementing a multi-year strategy to enhance its information technology systems. This strategy will give SEC staff new and innovative tools to analyze and scrutinize investigatory evidence, company disclosures, and other information used by the staff. In addition, the investment strategy revitalizes the agency's long-standing commitment to citizen-centered electronic government by providing the public with greater access to more information, more quickly than ever before.

Consistent with the President's Management Agenda, the agency is exploring ways to improve management activities in the areas of performance measurement, improved financial controls, and budget and performance integration. This emphasis on agency management and operations will improve the SEC's ability to assess and enhance its performance and establish accountability for mission success.

The Commission's ability to fulfill its mission depends upon a stable long-term funding source. Under current law, the agency collects fees from the securities industry that offset the budget. In 2007, the law reduces the fees collected by the Commission from their peak in 2006 of about \$2.1 billion to an estimated \$1.1 billion. In anticipation of this drop in fee collections, it may be appropriate to consider whether self-funding or other changes to the fee and funding structure are necessary.

Strategic Management of Human Capital

On a variety of fronts, the SEC is moving proactively towards its goal of becoming the “employer of choice” in the federal sector. Competitive compensation, a rewarding and challenging mission, a culture of empowerment with accountability, work-life balance, opportunities for learning on the job through enhanced training programs - these are essential components of our efforts to attract and retain the very best talent available to fulfill the SEC’s critical mission.¹⁹

*Peter Derby
Managing Executive for
Operations*

The Commission’s most vital asset is its workforce. Yet throughout the 1990’s, the Commission had difficulty attracting and retaining qualified staff. For reasons ranging from uncompetitive compensation to an increasing workload, the agency lost employees to the private sector or to other federal regulatory agencies. Each time this happened, the agency incurred costs to train replacement staff to work on the enforcement investigations, inspections, disclosure reviews, or other projects that were underway. Now with pay parity, excepted service hiring authority, and increased financial resources, the agency has made considerable progress in keeping turnover rates low, while recruiting hundreds of first-rate employees from a variety of sources.

The expertise and specialized skills intrinsic to the field of securities regulation is a significant factor shaping the agency’s human capital planning efforts. The SEC must identify the mission-critical roles and competencies the agency requires today and in the future. To ensure a pool of trained and prepared staff, senior management, working with human resources staff, must identify the requisite skills, determine whether gaps exist in the SEC’s workforce, and develop ways to bridge these gaps through training or recruiting strategies. In addition, the agency must plan for filling leadership positions by establishing strategies on succession planning, supervisory training, and management development.

To attract and hire the correct people to fill these gaps, the SEC will continue its nation-wide recruitment efforts. Recently, the agency bolstered its efforts to identify and attract highly qualified accountants by retaining two executive recruiting firms – a first in the agency’s history. The Commission also has reaffirmed its commitment to a diverse workforce, structuring its recruitment efforts to attract new staff from a wide variety of demographic groups. Additionally, the SEC is broadening the range of skills for which it recruits in order to ensure that the agency maintains a staff reflective of those it oversees and serves.

The SEC recognizes that employee satisfaction plays a major role in recruitment, retention, and employee performance. As such, the agency is working to help staff maintain an appropriate balance between work and personal life by enhancing employee benefits, offering classes and counseling, and working to build a “virtual workforce” with expanded options for telecommuting and working remotely.

To enhance the staff’s knowledge base, the SEC is implementing initiatives such as the “SEC University” (SEC-U), a comprehensive redesign of the agency’s training and orientation programs. Through a variety of in-house and electronic courses, SEC-U will help the agency develop and reinforce a strong operating culture, enhance employee performance, and broaden staff knowledge of industry trends.

Another important goal of SEC-U is to help the agency maintain quality leadership. Through training and mentoring, SEC-U can help current and future managers more effectively motivate and manage staff. This effort is particularly important given that 14 percent of SEC managers will be eligible to retire by the end of 2005.

The SEC is working to build a culture of accountability, where excellence is encouraged, noted, and rewarded. For example, the Commission has developed a Pay-for-Performance system that recognizes and equitably compensates employees for contributions made that help the SEC achieve its mission. Supporting the Pay-for-Performance system is the agency's effort to establish a system that tracks key measures and holds managers and staff accountable for achieving the Commission's strategic and performance goals.

The SEC will continue to explore ways to improve the design of its programs and its organizational structure. In particular, the SEC will examine whether these structures could be better aligned towards the customers the agency serves.

Information Technology and Electronic Government

Technology plays a major role in determining how the SEC conducts its business and how it interacts with the public and its partners. Effective integration of improved technology into the Commission's work processes is key to the agency's ongoing success. As a result of recent funding increases, the Commission is moving much more aggressively to identify and develop strategic IT initiatives that improve agency business functions and enhance operational effectiveness.

Using a rigorous planning process that is consistent with the requirements of the Clinger-Cohen Act and OMB guidance, the SEC's technology planning committees are strengthening the agency's decisionmaking processes by requiring that all requests for new information systems be developed in a consistent manner. The process also requires that requests be reviewed and approved by a diverse group of senior program staff based upon the needs and priorities of the entire agency.

To continue meeting its technology planning and management challenges, the SEC is conducting an in-depth review of all information technology efforts and developing a comprehensive, multi-year strategic IT plan. Coupled with the agency's enterprise architecture efforts, this strategic IT plan will help ensure the effective implementation of innovative technologies that meet the needs of staff and the public for years to come.

In particular, the IT program is focused on the following strategic priorities:

- Improving the Commission's discovery and case management capabilities;
- Improving the accessibility and usability of registrant filings to the public and SEC staff;
- Increasing the SEC staff's personal productivity and work flexibility;
- Using enterprise architecture principles to streamline processes and better leverage technology investments;
- Increasing information security and disaster preparedness; and
- Enhancing the agency's capital planning and project management processes.

The Commission's recent investment decisions reflect how technology is driving significant changes within the agency, as resources are increasingly being directed toward the application of new technologies to gather and analyze data. In particular, electronic discovery, computer forensics, and data analysis continue to be critical components of agency efforts to proactively identify issues affecting the markets, assess risks, conduct enforcement investigations, and target disclosure review and inspection activities to those firms and filings that pose the greatest risk to the safety of the markets.

Because the agency increasingly conducts its activities electronically, the public and other stakeholders are in turn demanding far greater access to Commission data and services via the Internet. The agency's strategic IT plan will build upon past successes in the electronic government arena, which include the SEC's website, www.sec.gov and the EDGAR system.

Budget and Performance Integration

The use of performance measurement systems is helping SEC management identify programs that are working effectively and efficiently. In early 2003, the Chairman created periodic management reports, known as "dashboards," that illustrate division and office progress towards budget, staffing, and performance objectives. These reports provide a more detailed picture of the Commission's operations and effectiveness than has ever before been available. The Chairman and senior managers will use these reports regularly to identify emerging problems, discuss possible solutions, and hold managers accountable for staff activities and performance.

A performance budget for the agency's fiscal year 2006 request will reflect this strategic plan and efforts to introduce activity-based costing and performance-based budgeting into SEC programs.

Improved Financial Performance

Under the recently enacted Accountability of Taxpayer Dollars Act of 2002, the Commission is required to meet all proprietary accounting guidelines for federal agencies and to undergo annual audits. Prior to the Act, the Commission was working to enhance its internal controls and meet applicable reporting requirements. In early 2002, the Inspector General conducted an assessment of Commission financial management systems controls. This assessment did not find any systematic problems that would indicate the Commission lacks the ability to account for any funds.

However, the assessment did identify several issues that are being addressed through the creation of internal task forces, support from contractors, and the hiring of additional staff. The SEC is implementing an aggressive plan to upgrade some of its management systems and processes in order to undergo its first complete financial audit in 2004. Efforts to upgrade financial systems, strengthen and streamline business processes, and improve information technology security will continue as a multi-year effort.

The SEC's Inspector General requested and the Comptroller General agreed that the General Accounting Office (GAO) will act as the Commission's auditor for an initial period.

Outcomes and Initiatives: Priorities for 2004-2009

To maximize the use of SEC resources, the Commission plans to launch a variety of initiatives that will complement the agency's other ongoing activities. The SEC will monitor its progress by establishing and tracking appropriate performance measures, examples under current consideration are listed at the end of this chapter.

Outcome 4.1: Human capital strategies are aligned to achieve mission, goals, and outcomes.

Supporting Initiatives:

1. Linking Performance to SEC Mission: The SEC will implement a Pay-for-Performance System and other aspects of the pay parity program that strengthen incentives and recognize performance in achieving the Commission's strategic and performance goals.
2. Enhance Recruitment and Staffing: The agency will aggressively implement strategies to achieve targeted staffing levels throughout the Commission

by using intensive recruiting campaigns to reach applicants, hire staff through excepted service authority, and automate classification and staffing processes to reduce hiring cycle times.

3. Enhance Benefits and Work/Life Programs: The SEC aims to enhance employee satisfaction and staff retention by expanding benefits and developing additional work/life programs.
4. Virtual Workforce: The agency will explore ways to help staff work from home or other off-site locations, working to create the technological and management infrastructure for this purpose.
5. SEC University: Through the SEC-U, the agency will enhance and redesign the agency's staff development activities, including revising the SEC orientation program for new employees, developing a competency model for senior managers with training curricula for each level of agency management, and offering online courses to provide staff with continued opportunities for professional growth.

Outcome 4.2: Financial management and internal controls are sound.

Supporting Initiatives:

1. Audited Financial Statements: Under the authority of the Accountability for Taxpayer Dollars Act, the SEC will prepare its first audited financial statements, which will cover fiscal year 2004. As part of these efforts, the agency will implement a new disgorgement system for tracking penalties and complete the certification and accreditation of general support and financial management systems.
2. Section 31 Fees: The SEC adopted Rule 31 which establishes an auditable system for the collection of payments made pursuant to Section 31 of the 1934 Exchange Act.
3. Performance Budgeting: The agency will explore new ways to monitor and evaluate agency performance and integrate budget and performance systems. New performance budgeting systems should help the agency clarify and delineate links between the risks it identifies, the strategies it will employ to address those risks, and the allocation of budgetary resources.

Outcome 4.3: Business improvements are promoted through the innovative use of information technology.

Supporting Initiatives:

1. Strategic IT Plan: The agency will assess its strategic IT needs based on a combination of program-specific priorities as well as agency-wide priorities, and establish a plan for transitioning the agency to its desired architecture and systems.
2. Electronic Discovery and Case Management: The SEC will move towards an inspection and discovery process based on electronic search and retrieval of imaged documents, and integrate the document workflow into an overall set of automated case management and examination management processes and tools.
3. Accessibility and Usability of Registrant Filings: The SEC will explore the use of “tagged data” formats such as XBRL for financial disclosure, streamline forms and filing processes for registrants, and improve the internal processes and analytical tools used by staff to review filings.
4. Rulemaking and Correspondence Management: The agency will streamline the receipt and tracking of comment letters and other correspondence by integrating processes across Commission offices and by types of communication.
5. Enhanced Employee Productivity: The agency aims to improve the personal productivity of Commission staff through:
 - a. Automation and collaboration technologies to facilitate “workforce virtualization” and improved information flow,
 - b. Knowledge management tools that capture and institutionalize the expertise of staff, and
 - c. Web-based forms and workflow automation tools to automate internal Commission activities.
6. Enterprise Architecture Migration: The SEC will establish a comprehensive plan to consolidate redundant Commission applications, centralize and simplify Commission data repositories, and enhance data sharing and collaboration within the Commission and with registrants and regulatory partners.
7. Presidential Management Agenda e-Government Initiatives: The SEC will continue to participate in government-wide electronic government initiatives, including those currently under review such as e-Travel, e-Rulemaking, and e-Authentication.

8. Secure and Reliable Systems: The agency will establish a fully functional alternative disaster recovery site, certify and accredit major agency systems for security, and continue to monitor and improve the security of Commission systems and the privacy of Commission data.

9. IT Capital Planning and Project Management

Processes: The SEC will enhance the process used to select and manage IT investments to ensure that all projects promote agency-wide priorities, capture the benefits of business process redesign, and contribute to the agency's enterprise architecture, and leverage federal e-government initiatives where feasible.

Potential measures for monitoring progress:

1. Staff vacancies/percentage by program area.
2. Length of tenure for accountants, attorneys, examiners and supervisors.
3. Attrition rate for accountants, attorneys, examiners and supervisors.
4. Percentage of management and staff attending training programs.
5. Audited financial statements are issued without qualified opinions.
6. Length of time to issue audited financial statements after year end.
7. Percentage of centrally managed applications meeting federal security requirements for accreditation and certification.
8. Percentage of examinations and enforcement actions relying primarily on electronic format discovery.
9. Percentage reduction in hours required to complete agency filings, as measured by the Paperwork Reduction Act.
10. Implementation dates achieved for disaster recovery plans including alternate data center.
11. Percentage of projects with costs and benefits clearly defined and tracked throughout project lifecycle.

Chapter Eight

Program Evaluation

The Commission has a long history of gathering data on and seeking independent assessment of its programs and policy proposals. Since the Commission published its previous GPRA Strategic Plan in 2000, more than 120 audits, studies, and evaluations of SEC programs and securities-related industry issues have been conducted. These assessments provide important information used to improve programs and support strategic and annual performance planning efforts.

The agency's data-gathering efforts include assembling expert advisory panels, conducting industry roundtables and focus groups, preparing studies and reports, and holding public meetings. Additionally, the SEC frequently consults industry groups, former staff, and other experts for advice and input on the effectiveness of its programs and a broad range of other issues. One such method the Commission employs is to study trends in the industry and the implications for the agency's activities. These assessments often result in formal Commission action to improve programs or industry practices. As a follow up to Commission actions, the Office of Economic Analysis also frequently conducts studies to determine whether desired results are achieved, and to monitor the economic effects of policy initiatives.

The Commission also recently instituted new management reports that allow the Chairman and program directors to determine the progress made toward budget, staffing, and performance objectives. The reports, called "dashboards," regularly provide a more detailed picture of the Commission's operations and effectiveness. The Chairman and division and office heads will be reviewing the dashboards in quarterly meetings to discuss the issues they raise, possible solutions, and potential reallocations of resources.

The General Accounting Office (GAO) and the Commission's Office of Inspector General (OIG) also evaluate Commission programs. GAO evaluates the effectiveness and results of SEC programs at the request of Congress, while the OIG focuses its audits on agency operations.

During 2003, the Office of Management and Budget (OMB) conducted a review of the Commission's full disclosure program. The performance assessment evaluated the program's purpose and design, strategic planning, program management, and results. The evaluation determined that the program was generally well designed and well managed. OMB encouraged the Commission to continue efforts to refine its performance measures so that they

better reflect program results. The Administration also increased the fiscal year 2005 funding of the program by 30 percent in recognition of the important role it plays in improving corporate disclosure. In 2004, the SEC's prevention and suppression of fraud program also will undergo an OMB performance review.

(Endnotes)

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