

Risks and Operational Challenges in the Securities and Exchange Commission

Edward Yang



The Securities and Exchange Commission is the government body regulating the financial markets. The mission of the Commission is to maintain fair and orderly markets, protect investors, and facilitate capital formation. The SEC requires all publicly traded companies to disclose information deemed necessary and meaningful to the public. This helps to protect investors from confusion and fraud. It also oversees financial exchanges, broker-dealers, investment advisors, and mutual funds. This helps to keep the markets orderly and efficient. The third part of the mission - to facilitate capital formation, can be seen as all equity issuances and public mergers and acquisitions are registered with the SEC.

Kenneth Johnson is the Chief Operating Officer of the Securities and Exchange Commission, a post that he has held since December 2017. Prior to that, he was Acting Chief Operating Officer, a post that he held starting in February 2017. He is the second ever Chief Operating Officer of the Securities and Exchange Commission. Before taking the position within the Office of the Chief Operating Officer, Kenneth served as Chief Financial Officer since 2010. Prior to that, he was Acting Chief Financial Officer, a post that he held starting in 2009. Before that, he served as Chief Management Analyst, and before that, as a Management Analyst in the Office of the Executive Director. Although Kenneth has mostly served at the Securities and Exchange Commission for his more than two decades-long career in the public sector, he also worked at the Congressional Budget Office for three years. With an undergraduate degree from Stanford, a Masters in Public Policy from Harvard, and an almost 16 years career at the Securities and Exchange Commission spanning a variety of roles, Ken has been able to utilize his operational and management expertise in the dedicated service to fulfill the Securities and Exchange Commission's mission.

I had the very good fortune of being introduced to him while previously interning in the Securities and Exchange Commission's Division of Economic and Risk Analysis. During that time period, one of the major events that dominated headlines was the "breach" of EDGAR, the filing and information database that contains information, public and private, about all publicly traded companies and their activities. Although the perpetrators were eventually apprehended, and Chairman Jay Clayton testified in front of the Senate Banking Committee, such an event underscores the major challenges and risks that the Securities and Exchange Commission faces on a day to day basis. The role of the Chief Operating Officer is to be on the lookout for potential risks and respond to them, while implementing forward-looking strategies to help the Commission adapt, become more flexible, and thus more efficient at maintaining fair and orderly capital markets, protecting investors, and facilitating capital formation.

Conversation with Chief Operating Officer of the Securities and Exchange Commission,
Kenneth Johnson

Q: What do you see as current major structural challenges that may impede the SEC's operations?

The key challenge for any agency is making sure that we can figure out and uncover where risks are and apply the right analysis and human resources to those risks. We've done a lot, both in trying to figure out and get better at data analytics and data visualization as well as, making sure we are nimble enough to react to what those two tools tells us. We've come a long way but the possibilities of big data can reveal new challenges and threats. A challenge we will always have is how to optimize that.

Another one is cybersecurity, which is at the top of my mind now, with regards to the SEC's own systems. What I know better, with regards to the SEC's own cybersecurity operations, is that what is incumbent upon us is collecting the data that is only necessary to securing our mission and protecting it. We are needing to have a lot of private information and other sensitive data and if we were to have some breach where market making information was dumped, that would be a huge disaster. There was a case brought against the EDGAR breach people, and that incident continues to be a reminder. It's important that we focus our energies on these two challenges.

In addition, with the money we get from Congress, another constant challenge is making sure we are eking out every last bit of value per dollar in order to maximize efficiency. With regards to things that are not as value add or high priority, we need to cut them out. We also need to identify new means to protect investors, and set up mechanisms to surface those opportunities.

Q: How can the SEC adapt and change in the face of new risks and technological developments in the financial markets?

Part of it is by making sure we hire market experts who are familiar with where the markets are going, what technologies are being used and developed, and how they're being employed. Our

budget this year has allowed us to do some hiring. The flipside of that is that we need to keep investing in our own technology. We can keep up with the markets, thus far, and achieve parity, and reasonably we will never keep up with any large financial firm (that has far more resources), but we always need to make sure that we keep investing in our people and our technology, keep focusing on technology, and keep getting better in all aspects.

- Recently Bloomberg reported that the SEC Union (part of the National Treasury Employees Union) was unhappy with a new plan to hire more workers but implement smaller raises. How can the SEC compete with private employers to attract top talent?

In 2002 we received a special pay authority that allows us that allows us to keep pace with other federal regulators; in essence, the law allows us to have a higher level of pay than most government agencies. However, it doesn't allow us to pay the salaries that a big brokerage or law firm will pay. Because it would otherwise not be legal for us to pay more, the pay authority is very helpful in closing the gap and recruiting people who would probably make a ton of money on Wall Street. We have not found it difficult, for the most part, to recruit and retain great people. To differentiate the SEC from the private sector, one could say that our mission, work ethic, and work life balance is very attractive. However, there are little pockets of specialized skill sets that we struggle to hire for. For example, we want people who have expertise in algorithmic trading and the more specific the area is, the harder it is to find the right people. Jobs involving cybersecurity are hot across government in general, but we have more resources.

- The number of employees in the financial sector has grown by more than 6.8% in the past five years, yet the number of SEC employees has decreased around 8%. How has this impacted the operations of the SEC and how has this impacted the ability of the SEC to protect financial markets?

I am not exactly sure about the 8% figure, but we certainly have a smaller workforce now than we did several years ago. Part of it has been that the investments in technology have paid off. What usually took 6 weeks (such as data analysis) can now take an hour. For example, consider our examination program. Previously, we were examining 10-11% of investment advisors, and as the population of advisors kept growing, we were barely able to keep up. However, even though the examination workforce has shrunk a bit, we now can cover 15-17%

of advisors. We can expand coverage with fewer people thanks to technology. In our budget, we have requested more for this year for hiring and we can request more for the next year. However, it doesn't necessarily follow that how much we are able to do is linked to the number of staff that we have. In general, we feel good about technology and the positive effects that it can bring.

- Recently, two whistleblowers were awarded \$50 million for information that led to the uncovering of significant fraud. The whistleblower program has been a tremendous success and has inspired models across the world. How can the SEC improve the program?

We feel pretty good about the whistleblower program. There doesn't seem to be any obvious way to improve it right now. The program was created in 2010 and it took us a little while to figure out the ins and outs, as well as have it comply with different regulations and laws. It has been a great way for us to get additional leads. It is always great to have the analytics and data, but there is nothing like a direct tip to help focus us on the right path. Having the whistleblower program has been a tremendous boon for enforcement. If someone is considering becoming a whistleblower, they have to consider the potential ramifications. You might lose job and livelihood, just to let authorities know about the fraud. Creating a program to take those barriers out of the way, as well as providing some reward is very helpful.

Conclusion

It is clear that the work of the Commission is highly important. As Chairman Clayton has decided to pivot towards focusing more on the retail investor, the nature of the Commission's work must also change. This implies a need for operational and managerial flexibility, as well as the conflicting duality of both enough resources to tackle many more cases but the nimbleness to target cases where individual actions may not be as glaring as in larger corporate investigations. Chief Operating Officer Kenneth Johnson certainly has the experience to negotiate difficult transitions, especially after navigating the data breach. I would hopefully like to follow up with him afterwards in order to learn more about current challenges, as well as any unique problems that he has faced in the time since we last spoke.

