Securities and Exchange Commission Historical Society
Oral History Project
Interview with Michael Halloran
Conducted on May 5, 2011, by James Stocker

JS: This is an interview for the SEC Historical Society's virtual museum and archive on the history of financial regulation. I'm James Stocker. Today is May 5, 2011. I'm talking today with Michael Halloran, who served as Counselor to the Chairman and Deputy Chief of Staff of the SEC from 2006 to 2008. Mike is also a securities lawyer with over forty years experience, currently with the firm Haynes & Boone LLP. We're talking today at his office in Washington, D.C. Mike, thank you for taking the time to talk to me.

MH: You're welcome.

JS: You spent much of your early career in California. Were you born there?

MH: Yes. I was born in Berkeley.

JS: You grew up there also?

MH: I grew up in Orinda, California, which is right behind the Berkeley hills.

JS: You decided to stay close to home for college?

MH: I did. I applied to various Eastern schools, but the scholarships were not big enough.

Dad said, "Berkeley will do." So I went to the Berkeley Engineering School.

JS: Did you originally want to have a career in engineering?

MH: Yes, because Dad was.

JS: How did you go from engineering to law?

MH: In my third or fourth year of college I took a course in speech. Actually, it turned out to be a First Amendment course in which we reviewed and argued First Amendment cases decided by the Supreme Court. I became extremely interested in this whole process of case law and wound up writing a supplementary paper on it and getting to know the professor, who was a lawyer. Initially I thought, "I can be a patent lawyer. I can do a combination of engineering and law." That was my initial decision.

JS: Did you apply to law school while you were still an undergraduate?

MH: I applied to law school after I graduated. I was working for the telephone company, now called SBC, but then called Pacific Telephone. I was working as an industrial engineer. I decided to apply to law school to see whether I could become a patent lawyer.

JS: You worked for one year after you graduated and then began law school?

MH: It was less than that, maybe six months or something like that.

JS: What year did you start law school?

MH: 1962.

JS: When you went into law school, you were thinking about doing patent law rather than securities law?

MH: That was my initial thought, yes.

JS: How did you decide to switch over to securities?

MH: Halfway through law school, and here I was in Berkeley, I discovered Silicon Valley. It was not called Silicon Valley then. I realized that there were a lot of startup companies, high-tech companies (we did not even use the word high-tech in those days), and financing going on in Silicon Valley, and as I became more and more interested in it, I decided that I could help them write their prospectuses and help them write their private placement memorandums, because I had an understanding of technology as well as a good ability to write. That seemed to me to be an interesting career. That is how I wound up there.

JS: While you were in law school, did you have any professors that steered you in the

direction of securities law?

MH: There was one. His name was Dick Jennings and he was the securities law professor. He very much stimulated my interest in securities law. In fact, he made me his T.A. or teacher's assistant. During my third year at law school, I earned a little supplementary income by being the teacher's assistant and pointing out important cases for him to add to his case book or to his lectures or briefing cases for him to tell his students about, and preparing him for class and that kind of thing. As it turned out, he was elected chairman of the Academic Senate that year. This was during the free speech movement, by the way. It was a very active time at Berkeley. It wound up that I had a lot more responsibility during that last year than I thought. I learned a lot of securities law that year.

JS: What year did you finish?

MH: 1965.

JS: Were you recruited by Pillsbury, Madison & Sutro while you were at law school?

MH: No, Dick Jennings directed me to a friend of his named Graham Sterling in Los Angeles, who was developing a venture capital/developing-stage company law firm in Los Angeles. Los Angeles paid more, you understand. My wife and I went to Los Angeles out of law school. I worked there for about a year-and-a-half. But I didn't like Los

Angeles. It was too smoggy.

JS: Right, still is.

MH: I wanted to get back to the Bay Area. I came back and I interviewed some firms. Pillsbury was one. I joined Pillsbury in 1967.

JS: At that time, Pillsbury was probably the largest law firm on the West Coast, wasn't it?

MH: It was. It had a grand total of 120 lawyers. It was the largest law firm on the West Coast.

JS: After you joined the firm, was there any sort of training, or did they just throw you on cases right away?

MH: They rotated you around for four months to various groups, litigation, securities, et cetera. It was well-determined before I joined that I would join the corporate securities group.

JS: What sorts of clients did you work on?

MH: Big ones and little ones. For example, I worked on Pacific Bell, which became known as Pacific Telesis, now merged with SBC. I worked on developing-stage companies. I filed the incorporation papers for Intel. I represented what we now call venture capitalists,

such as Arthur Rock, and others who invest in developing-stage companies such as Menlo Ventures, as well as the companies themselves, which are too numerous to mention.

JS: Do you remember the first IPO that you worked on? Did you work on IPOs at this time?

MH: I worked on a lot of IPOs. The very first one I worked on is hard to tell. It may have been Intel since it went public so shortly after it was founded. There were many. I did not come prepared to give you a list of those.

JS: I was asking because I was interested in getting a general sense of how an IPO at this time might have differed from one today.

MH: The IPO then did not differ all that much from the IPO now, to tell you the truth. I have written a book on it, so I know what I am talking about. There is this book called *Venture Capital and Public Offering Negotiation*, which is two volumes. We published that in 1981. We gathered together some of the top IPO venture capital and developing-stage company people, and we update it every year. It all comes down to doing the due diligence, writing a prospectus that hopefully will survive the disclosure test, talking to the accountants, talking to the management - that basic hard work you would do today just like you did thirty years ago.

JS: The changes in technology and evolutions in the law have not basically changed then?

MH: I don't think so. Certainly, you have internal control requirements that are new. You file electronically. That is new. You have a much more elaborate management discussion and analysis that you have to write out. That is new. But the basic core of thinking behind all that information is the same, full disclosure – what I call "single think, double think, triple think," asking why at three different levels. Full disclosures of trends and uncertainties was just as much in our minds in 1966 as it was in 2010 after all these rules were adopted.

JS: So working at Pillsbury Madison, how long did it take to make partner?

MH: I made partner in seven years, or let's put it this way, seven years after I got out of law school, which I think is perhaps a little early. Nevertheless, it is about seven years. I became a partner in 1972.

JS: You stayed out in California at that time, right, for most of the seventies?

MH: Yes, I stayed there until the firm decided to open a Washington, D.C. office.

JS: This was in 1979?

MH: In 1979. We had these classes of lawyers. It was a big firm, so you had classes of lawyers. There were seven of us from the same class. By then we were partners. I think

there were five of us left as partners in that class. I was very much interested in getting the firm on the move. Finally at one lunch that we had – we had a monthly class lunch – I said, "Well, if nobody else will volunteer to go to Washington, D.C., I will."

The next thing I know three senior partners were sitting on my desk, asking me if I would agree to go to Washington, D.C. This happened over the July 4th weekend in 1979. Fortunately I'm married to a young lady named Gigi who grew up in the Air Force, and she is used to moving. She said, "Fine." We literally moved out over Labor Day that year.

JS: During these years in Washington you were living full-time out here?

MH: Yes, we lived right in Woodley Park in D.C. for three-and-a-half years.

JS: Tell me about setting up an office. What does that involve?

MH: I was out here all alone to start off with. I had to rent the space and get the telephones installed. I had to get myself admitted to the Bar in D.C.

JS: Very important.

MH: Then I had to go out and hire people. I hired lateral partners and associates and others to join the office. Sometimes that was easy and sometimes that was hard. It was easy if it

was related directly to our practice. It was harder if we were opening a new practice. Then about five or six months later, they sent out one other partner. Then they sent out an associate. It was a lot of work.

JS: What was the rationale behind having a Washington office? Was it to be close to the SEC?

MH: Yes. The firm had a lot of Federal Agency representation of its own clients. Certainly what I call the "green goods" agencies were important to the firm, whether banking or securities or FDIC. We represented banks and public companies. In addition, we had other concerns, like the EPA. A big agency was the Department of Energy, because we represented Chevron. They had issues before FERC, the Federal Energy Regulatory Commission.

Then I remembered that when I came out, there were gasoline price controls. There that was this whole agency called OHA, the Office of Administrative Hearings and Appeals. We had numerous cases on gasoline price-fixing before them. Reagan came into office after I arrived. He repealed that entire gasoline price-fixing thing. I guess that would have been in January 1981. I immediately had five lawyers out of work, which taught me something about Washington, D.C. law practice: "You have to be flexible."

JS: Right, and sometimes regulation is good for business. During the 1970s and 1980s, you also published a number of articles, in addition to other publications. I think the first one

that I saw was in 1971. It was an article in *St. John's Law Journal* about the Wheat Report.

MH: Oh, my goodness. You're going back in history.

JS: It was a while back.

MH: I have always liked to write, speak and publish. You can argue with some veracity that I should have been a law professor.

JS: That was going to be one of my questions for you. Were you thinking about the possibility of teaching law later on in your career?

MH: I considered it several times. I guess I would say I was a deal junkie. I like doing deals. I liked getting involved in developing-stage companies and finding out how they worked, and then getting involved in mergers and acquisitions and public offerings and things like that. I felt that being a law professor would take me out of that loop, which it probably would. I did a lot of writing and speaking on my own.

I wrote this little book for my son, who became a lawyer – he's a young lawyer – after he graduated from law school. I had these little sayings on the top of each page on how to be a successful lawyer, if I can be so presumptuous. One of the sayings is, "Always write and speak. If nobody else learns, you do." I've learned a lot just by forcing myself

through the writing and speaking mechanisms.

JS: Was that part of the rationale for writing a textbook on venture capital and public offerings?

MH: Yes, because every year we update it, I learn a lot from these other lawyers around the nation who are contributors about new techniques and new provisions. In addition, we wrote it because I wanted to give it to younger lawyers to train them. If a new lawyer came out of law school or whatever and wanted to work in our area, we would just hand him the book and say, "Go away and read that for three weeks, and come back and ask a few questions. We'll put you into the corporate securities/venture capital group."

JS: At this time were you already involved with the board of trustees at Boalt Hall or was that later?

MH: That was later. I would say that was in the eighties and early nineties. That's when I returned to the West Coast. I returned from D.C. in 1983 to the West Coast.

JS: There is one other thing from the 1980s that I wanted to ask you about. In 1985 there was an article in the *Wall Street Journal* about possible candidates for positions at the SEC as Commissioners. Your name was mentioned. Did anyone actually ever speak to you about that?

MH: Yes. Jim Treadway, who was the Commissioner, approached me about going on the Commission because I had gotten to know him and several other people in the Reagan Administration or on the SEC during my tenure back here. They affirmatively asked me if I would serve on the SEC. I understand my name made it to what they call the short list. Then Don Regan was appointed Chief of Staff for the President. Don Regan cleaned all the financial agency appointments off and put in people he knew. That is how Ed Fleischman became an SEC Commissioner and I didn't. I'm not regretting anything. Ed's a good friend, I'm just saying that's how the process works.

JS: No, of course not. You were quite young at this point in time.

MH: I was quite young, if being in your early 40s is young. That actually did not happen just once. It happened two or three times. You will see my name quoted two or three times. It shows you that these appointments to these agencies can get political. You need to have the body politic behind you to achieve one of these appointments.

JS: At this time did you have much contact with the Congress at all?

MH: Yes, when I was in D.C., I represented, for example, the National Venture Capital Association in connection with obtaining amendments to the Investment Company Act of 1940 to facilitate venture funds going public. We adopted Title II to the Investment Company Act of 1940, which created a thing called a Business Development Company, which operates under a more relaxed regulatory regime, subject to various conditions,

than would a regular investment company. I got to know a lot of people on the Hill as a result of that major effort. Of course, I got to know more people on the Hill when I was with the SEC. I am just telling you what it was like in '79-'83.

JS: In 1990 you left the firm and became the Executive Vice President and General Counsel of Bank of America. How did that happen?

MH: It is the most fortuitous event of my career. I very often question whether I'm really good or I'm lucky. I remember Tom Clausen of the Bank of America gave a speech on that. He says it's an old Norwegian saying, "Is it better to be good or lucky?" He says, "The answer is lucky." (Laughter.) I was not really a bank lawyer. I had done maybe a couple of bank acquisitions. I was more of a mergers and acquisitions corporate securities lawyer. But I had worked a lot up with the American Bar Association and their Section of Business Law. Out of the blue, they made the head of their State Regulation of Securities Committee in 1980.

I was heavily involved, on behalf of the Section's Federal Regulation of Securities Committee, in the SEC adoption in the early 1980s of what is called Regulation D, which is the exemption from SEC registration for private placements. It is a safe harbor for private placements, if individual investors meet certain net worth standards and income standards. What I wanted to do was to see if we could get the states to adopt similar regulations to coordinate with the SEC Regulation D, so you could have one uniform private offering exemption system. As head of the State Regulation of Securities

Committee, I propelled that forward. Ultimately we got something like – well, all states have some form of a Regulation D exemption, but let's say forty-four to forty-six have a complete coordination with the SEC, and I take great pride in having worked on that.

The Section of Business Law made it policy to promote what was called the Uniform Limited Offering Exemption or ULOE by the states. ULOE was supposed to coordinate with Reg. D. They appointed one George Coombe, who was a former chairman of the Section to work with me. George Coombe was the General Counsel at Bank of America. In 1990, there was going to be a new Chairman at the Bank of America to succeed Tom Clausen, named Dick Rosenberg. Usually new chairmen get to pick their own general counsel. George and I were in Santa Fe, New Mexico.

They were having a Section council retreat there in January. We were walking down Canyon Road together. He turned to me and he said, "Mike." He says, "I've got to retire as General Counsel at Bank of America." I said, "George, you seem too young for that." He says, "Well, I'm sixty-five and I've got to retire." He says, "How would you like the job?" I said, "George, I've never foreclosed on a mortgage. I've never walked into a bank regulator's office. I'm not sure I know enough." He said, "Well, let me send you my twenty-page questionnaire after I get back." Sure enough, I get back to San Francisco and here comes this twenty-page questionnaire from George Coombe. I fill it out. I send it back to him.

I said, "George, I don't think I'm qualified." I said, "All this banking stuff and so forth,

but I'm glad to do it." He calls up about a week later. He says, "I want you to interview with the chairman and the seven vice-chairmen, one-by-one." I said, "You do?" He said, "Yes." I went over and interviewed with them. It became very apparent what was going on. They wanted to launch the biggest merger and acquisition effort of any major bank in history. They wanted a merger and acquisition general counsel. After I interviewed with all these guys over a period of six weeks, I waited a very silent month. Then they called me up, called me over, and they handed me this letter.

They said, "If you sign there, you're the General Counsel of Bank of America." I was totally blown away. I was the merger and acquisition general counsel. That's why they hired me. I remember talking to Dick Rosenberg, who was my boss, the CEO. I said, "Why did you hire me?" He turned at me and laughed. He says, "Because you're cheaper than Skadden Arps." So I said: "All right, sir."

JS: That's the marketplace for you. (Laughter.) You said you already had an idea that they were interested in expanding the bank and undertaking a lot of mergers and acquisitions. At that point in time, did it seem like it was just going to be on the West Coast, or did it seem like they were looking to go all over the United States?

MH: Most of the mergers were what I call market extension mergers, which means that they were growing from California step-by-step east. We acquired Security Pacific, which at that time was the biggest bank merger ever done.

JS: One of your biggest competitors too from the West Coast.

MH: Yes. It was failing. The FDIC and the Fed really wanted us to acquire them. Sometimes we had our doubts whether we should go ahead with the deal, but we went ahead with it. Then we acquired twenty-seven savings and loans. We acquired a bank in Hawaii. We acquired a bank in Texas. When we acquired Security Pacific, we were immediately in Oregon and Washington as well. Then in 1995 we acquired Continental Illinois Bank in Illinois. Then we acquired several mortgage servicing and leasing companies throughout the nation. It's interesting. We even had discussions with NationsBank in 1995. Those broke down because Hugh McColl did not want to move the headquarters out of Charlotte.

JS: Then a few years later, Bank of America would merge with NationsBank?

MH: In 1998.

JS: In 1998. But this was after you had left the company?

MH: I left in 1996, I guess, the end of '96.

JS: Were you just ready to go back to private practice?

MH: I took nine months off. We went to Wyoming and added onto our house there. I did a lot

of fly fishing. We traveled around the world.

JS: Sounds fun.

MH: I have to say that after almost seven years of mergers and acquisitions – I was running both the Legal Department and working directly on the mergers and acquisitions – I was exhausted. The new chairman said that there was not going to be any more mergers and acquisitions. That's what I like, consistent with my deal junkie status. So I left. I got to appoint my director of litigation, who was Jim Roethe - who was from my old firm, Pillsbury - who I'd hired as the new general counsel. So I left. Nine months later I joined Pillsbury again.

JS: You must have left Pillsbury on good terms before?

MH: Yes.

JS: When you rejoined Pillsbury, did you come back to D.C. or were you on the West Coast?

MH: I was on the West Coast. I became head of their Corporate & Securities group after I rejoined.

JS: Then in 2000 Pillsbury Madison merged with Winthrop, Simpson, Putnam & Roberts?

MH: Yes. I thought it was 2001.

JS: It may have been 2001. I have July 2000 here.

MH: Well, maybe it is.

JS: I might have the wrong date. Were there any particular cases from these years that stand out in your mind that you worked on? I'm sure there must have been many clients.

MH: What I remember was the bull market. In '98, '99, 2000, all these dot-com companies were going public. There were innumerable public offerings that we were handling for either on the underwriter side or the issuer side, taking these companies public - some that do not exist anymore, I'm sorry to say, and some that do. I remember a company called E-Stamp. You take your computer and you can print out a stamp to put on your envelope, things like that. And just many other companies that we took public. We were doing them back-to-back during that period. A lot of IPOs during that period.

JS: Did you have much contact with the SEC during these years?

MH: Sure. Throughout my career I've had contact with the SEC, usually in the form of representing somebody who is filing for a public offering or is already public and is working out disclosure details with the SEC staff. My biggest contact was during two periods of my life. When I was in Washington and representing the National Venture

Capital Association, I was getting through these amendments to the Investment Company Act. There were people on the SEC 1940 Act staff who were actually opposed to these relaxations. I spent a lot of time explaining what we were doing and why, during that period. I got to know a lot of people in what we call the 40 Act Division, the Division of Investment Management.

The second time was when Bank of America kept getting sued by Bill Lerach and others whenever there was a stock drop. I don't mean a stock drop in Bank of America stock. I mean a stock drop in some company that we had that the temerity to make a loan to, like Seagate. When their stock dropped for some reason, then the plaintiff would sue not only the company and its officers, but also would sue the Bank, on the grounds that somewhere in there, it was a controlling person. My boss, Dick Rosenberg, became quite annoyed that we were spending all this money defending these suits.

He said, "I want you to solve this problem." I went back to Congress in 1992 or '93. Who should I meet with but one Chris Cox? Chris Cox was in the House of Representatives. As I recall, he was the head of the Securities Subcommittee of the House Commerce Committee. I explained our problem. Chris, like me, was from a big firm, Latham & Watkins. He understood this stuff very well. He said, "Mike, you're too late." He said, "The accountants already have their bill." I looked at the bill. I said, "But it doesn't do a lot for issuers. It does a lot for accountants."

He said, "Well, you're going to have to go back to California and do some fundraising

and get some kind of a PAC or a constituency or a coalition of companies who are concerned about this, not just Bank of America." So I went back to California and we formed this Securities Litigation Reform Coalition, and we raised $5 million. It was easy to raise. The co-head was Jack Levin, the General Counsel at Montgomery Securities. We came back and a lot of attention was paid to us. We worked for two to three years on this legislation, and met with a lot of Senators and a lot of Representatives, and I got to know Chris Dodd quite well, who was very key in the adoption of this legislation.

JS: I think some of the early versions of the bill had very strong language in it, as I read that they would have applied what they call the English Rule to lawsuits. Basically if a plaintiff's suit is dismissed that they would also be responsible for the defense's litigation costs too?

MH: This is the loser-pay rule. You are talking about legal fees and so forth?

JS: Yes, exactly.

MH: That never saw the light of day. There were some interesting provisions, like the lead plaintiff provision, which was not our idea. It was actually Al D'Amato's idea, he put that in there, which makes the litigation more efficient, because it is led by a shareholder – usually an institution that has a big financial interest. The two most important provisions are the one that basically says that the court can dismiss all discovery efforts until such time as the plaintiff proves enough of his case that he can survive a motion to

dismiss. What would happen is that the plaintiffs would bring a company to its knees just by inundating them with a discovery request.

The second one is the standard of proof; the scienter standard is the important part. In any event, I got to know Chris quite well, a lot of people in the SEC. Arthur Levitt was there and a lot of people on the Hill.

JS: Did you work closely with the White House on it too?

MH: Yes, we worked with the White House several times.

JS: I think the White House ended up vetoing the bill.

MH: I'd go over and see Abner Mikva who was the White House counsel. He's a very nice man, a former judge. I'm not sure he really agreed with me. Most litigators did not agree. I think litigators like litigation. Chris Dodd thought he had a deal with the White House, that they would not veto the bill. So we passed it in 1995. Then to our surprise Bill Lerach had dinner with the President, handed him a veto message and he vetoed it. I go back to Chris Cox and I said, "Chris, what do we do now, coach?" He says, "We override the veto." I said, "Oh, sure!" Thanks a lot to Chris Dodd because, the Senate is where that happens. In the next month they overrode that veto and it became law.

JS: I know the White House dropped its objections to the bill. They didn't try –

MH: Well, the White House did not really actively oppose the bill at the point where the veto effort was going on. So we got it adopted. What I'm saying is that is what makes fast friends. I mean, Chris Cox and I became fast friends during that litigation reform effort.

JS: All right, Mike. So tell me how you came to join the SEC. You mentioned that you already knew Chris Cox.

MH: Well, I had gotten to know Chris well in the '92-'95 period when we were working on private securities litigation reform, and I stayed in touch with him for years thereafter. When he was appointed by the President to be Chairman of the SEC, he wound up calling various people he knew for help in various areas. He called Brian Cartwright at Latham to become SEC General Counsel. Then he called me up one day. He said, "I'm having trouble finding a Chief Accountant because some people that we've talked to have conflicts. Can you help me?" I called Con Hewitt.

JS: How did you know Con Hewitt?

MH: Con Hewitt was the chief outside accountant with Ernst & Young for Bank of America. Con and I spent a lot of time together setting reserves on litigation and things like that.

JS: This was probably in early 2006?

MH: Yes, Chris first got in contact with me in early 2006, maybe January, February. So I called him back. I said, "You really need to talk to Con Hewitt." I said, "I think Con will be willing to do it and he has a wealth of practical experience. He's also been a regulator. He was a banking superintendent of the State of California."

Chris called Con and interviewed him at the Stanford Directors' College that June. The next thing you know Con is SEC Chief Accountant. I am convinced to this day that the two of them conspired to get me. As a matter of fact, Con says he did. He immediately went into the Chairman's office. He says, "Okay, now, you've got to get Halloran in here." I got a call almost immediately after Con accepted, I would say in late July, maybe mid-early July from Chris, asking me if I would become Counselor to the Chairman.

JS: Was there an interview process or did you just get the job right off the bat?

MH: I had to fly back to Washington and I had to interview with the Chief of Staff and a couple of other people.

JS: Tell me a little bit about this position of Deputy Chief of Staff. In organizational terms, are you actually under the chief of staff or do you work for the Chairman himself?

MH: No, I work for the Chairman himself. My primary title and role was Counselor to the Chairman. They put out a press release in September, as I recall, describing what I would

do. It said I would advise the Chairman on all the matters that relate to the overall investor protection function of the SEC. I was like the Chairman's chief personal counsel or personal lawyer. I had a staff of six or seven attorneys who I hand-picked who reported to me up on the tenth floor of the SEC near the Chairman's office.

JS: Were they people from your firm or from –

MH: No, they for the most part, were people that were already with the SEC who I had known as a result of my experiences with the SEC, or came from the outside into the SEC. In one or two cases I hired some people from the outside. They were highly qualified people, a number of whom are still at the SEC and have gotten to great heights within the SEC. In addition, toward the end of the process, the Chairman said that I also had to take this title called Deputy Chief of Staff.

He said, "In order to get you paid" – because apparently Deputy Chief of Staff is in the pay schedule or something, whereas counselor to the Chairman is not, even though it's something that a lot of people have done. For example, Jim Doty was Counselor to the Chairman for Breeden. Carrie Dwyer, General Counsel of Schwab, was the Counselor to Levitt. It is a well-known position, but apparently it is not in the SES pay grade. He said, "You'll be Deputy Chief of Staff too."

JS: Yes. To make the structure of the bureaucracy fit the management style.

MH: What the job turned out to be was that, you could argue with some veracity, and I don't want to overdo this because it's not fair, that I would be sort of second-in-command of the SEC, particularly when Chris was not there, very much second-in-command, because Chris after all is the Chairman. Basically everything in the Commission of a legal nature would come through me. Everything of an administrative nature would come through the chief of staff, who was not a lawyer. His name was Peter Uhlmann. All of the divisions and offices of the SEC that have a legal dominance, all their stuff would come through me, which is a lot of what the SEC does.

In addition to the matters of a legal nature, the Chief Accountant came through me, primarily because of Con Hewitt and the Chairman making that happen, also because I had been involved with a lot of public company SEC accounting issues. The Division of Investment Management came through me. The Division of Corporate Finance came through me. Trading and Markets came through me, because they are intensely legal in nature.

JS: Did you have any priorities before going in that you knew that you definitely wanted to work on, any specific issues, or were you just going to get in and adapt to your environment?

MH: I think the answer to that is, "No." I was basically there to serve the Chairman. What he felt I should work on, I would work on.

JS: Obviously the Chairman had some priorities. He had been there some time before you joined. I think he had already started working on a few major issues. For instance, the issue of executive compensation had already been underway before you joined?

MH: That's true. The issue that was thrust in my lap first was this PCAOB internal controls auditing standard, then called Auditing Standard No. 2. He pulled me into his office shortly after I got there. He said, "I want you and Con Hewitt to basically represent the Commission in negotiations with the PCAOB to develop a more cost effective internal controls audit standard."

JS: Did you have any background in accounting issues before this time?

MH: I'm not a trained accountant, but I had spent an awful lot of time preparing public company disclosure documents and working with accountants on those. Over many years I had imbibed a lot of auditing and accounting standards and so forth.

JS: This is basically concerned with what is called Section 404 of the Sarbanes-Oxley Act?

MH: That's right.

JS: What was that section all about and what was the problem with it?

MH: 404(a) and (b) were the two most costly provisions of that act. 404(a) requires that the

company and its internal CFO and accounting staff prepare an assessment of the effectiveness of their internal controls and be prepared to publish that. Then 404(b) says that the accountants then have to look at the management assessment of internal controls effectiveness and attest and report on it in accordance with standards adopted by the PCAOB. That multiplied by a factor of two or three, and in some cases more, the accounting fees that were charged to American businesses.

JS: How much money would we be talking about here for these accounting fees that they were having to pay? Was it in the millions?

MH: Of course, yes. You could have a developing-stage company whose accounting bill might be $1 to $2 million dollars and all of a sudden it would be $4 or $5 million as a result of this.

JS: Some of these were relatively small companies?

MH: Yes. What we learned is that the accounting fees were high during the first two to three years as they were implementing all the controls. Then they would tend to level off a bit, though they were still high after that. What we also learned is that there were many, many things that auditors were looking at that were neither really risk-based nor material. Therefore, they were looking at all sorts of perceived control functions, which even if they got out of control, would not materially affect the financial statements, or were not a material risk. You see what I mean? The mission of our Chairman and us was to try to

get the accounting standard to focus on that which was risky and material, if you will.

JS: To do that, you had to interface with the PCAOB?

MH: Very much so, yes, and all the PCAOB board members and their staff. It became somewhat political or very political in the sense that a number of institutional investors, particular union pension funds, opposed the effort and voiced their views vigorously.

JS: What was their objection? Did they think that it was just undermining internal controls?

MH: Right, that undermining internal controls puts America at risk and puts the financial statements at risk.

JS: Where were the accounting firms on the issue?

MH: They also were in favor of leaving things the way they were. People say it is so the accounting firms could make a lot of money. I actually do not agree with that. I think it was because the accounting firms were trying to protect themselves from liability. Believe me, there had been lawsuits and settlements which were very meaningful to a lot of firms. I think they felt this internal control function was necessary to protect them, which I think is an honorable reason to oppose it. Nevertheless, the overall cost on American business, particularly small business, far outweighed the benefits.

JS: Of course this was just four years after the Enron collapse, so that was very much on everyone’s mind.

MH: Yes, and WorldCom and so forth. We worked on that and I could spend another hour detailing the changes that were made. I might add that we were aided greatly in this effort by the small business committees on both sides of Congress, who supported the effort. They would hold hearings periodically demanding where we were and were we going to solve this problem because they were getting noise from their small business constituency that this was costing too much. What we hope we arrived at, in PCAOB Audit Standard No. 5, which replaced Audit Standard No. 2, was sort of a scaling standard, where if you were smaller, the amount of internal control effort would be scaled down for you.

It is, unfortunately, not 100 percent clear in Audit Standard No. 5, but it is pretty clear that that is what you’re supposed to do. In any event it got adopted in June of 2007. I count that as a major accomplishment. I am told by several people, like my good friend John Olson at Gibson Dunn and others who represent public companies, that the amount of cost savings has far outstripped what was originally predicted at 10-15 percent. It is sometimes as much as 40 percent in terms of the overall costs, without giving up the internal control function. In other words, you are loosening controls by focusing on what is risky and what is material, without losing control. Do you see what I mean? That’s an important concept.

JS: In order to get to this result, in early 2007, the SEC had to vote to repeat the PCAOB's interpretation of Section 404. Now, the SEC stepping in here, what does that say to you? Why was that necessary? Does it indicate that the board is not functioning correctly?

MH: At what point in time is this that you are referring to?

JS: In 2007, when the SEC voted to repeal the PCAOB's interpretation of Section 404, or instructed them to come up with a new interpretation so it changed from two to five.

MH: Yes, I think it is fair to say that the PCAOB did not really want to do this. It is a credit to Chris Cox and to both aisles of Congress that they did want them to do it. After considerable discussion, sometimes heated, we got together and spent untold hours in untold number of conference rooms with leaks in the *Wall Street Journal*, coming up with something which was a compromise between us and the PCAOB, which I think is very workable, and is called Audit Standard No. 5.

JS: Did the Bush administration express an opinion on this issue at all?

MH: The answer is, "I don't recall," which seems funny. You think they would. I just don't recall. We had very little contact with the Bush administration. By the Bush Administration, if you mean the White House, we had very little contact with the White House. They did not call up and give us orders or anything. That by the way is different from Congress, where you get a call from Chuck Schumer or somebody about some issue

with the New York Stock Exchange or some investment banker. The White House was very careful not to try to push the agency around. I'm sure the White House probably made public statements regarding the costliness of Sarbanes-Oxley. We received no instructions, so to speak, on that matter.

JS: Let's talk about a couple of other issues. First of all, the new public offering rules of the SEC. I guess they were not adopted in 2006 but they went into force in 2006. There were a new set of rules governing IPOs that liberalized the rules for shelf-registration statements and things like that. Was this an issue that you worked on?

MH: Yes. One thing we did - there was this Form S-2 for small business issuers. We collapsed all that into Form S-1 and then broadened it to cover more issuers. More small companies could use the reduced effort for disclosure standards of a small business issuer under Form S-1. That was one of the things we accomplished.

JS: The goal with that was just to reduce paperwork and to reduce expenses for businesses?

MH: We adopted a whole package of reforms or proposals for small business, one of which was the changes in Rule 144.

JS: Tell me about that.

MH: Rule 144, as you know, is the rule by which affiliates sell securities into the public

markets, or holders of restricted stock sell securities into public markets after a holding period, and things like that. We reduced the holding period to a year for non-public companies and six months for public companies. In addition - and this is something I take personal credit for - there was a problem with the hoary concept called the integration doctrine.

The integration doctrine says that if you are doing a private placement and a public offering at the same time, you have to register the private placement, too, because you are doing it at the same time, which can be very expensive for the private placement. But the public offering may not be registered yet. It may just be going on in registration, which impeded the ability of companies who are running out of capital to raise capital when they were at the SEC filing process. We got that fixed pretty much. That is something I pushed on very hard, so that companies could actually raise capital from accredited investors during the public offering, without having to go to the expense and delay of registering the private placement too. That interpretation was part of this package of small business releases that we put out.

JS: Let's also talk a little bit about the SEC's role in overseeing investment banks. In 2004 there were some big changes in the regulation of the largest investment banks. There was an agreement that exempted the five largest banks from the net capital rule. At the same time, there was also an agreement that the SEC would oversee at least part of what were called consolidated supervised entities. Where did this issue stand when you joined the SEC?

MH: By the time I joined the SEC, five big investment banks were subject to the consolidated supervised entity regulatory regime. They did this by consenting to be regulated, which meant that they were regulated for the first time at the holding company level and not just at the subsidiary broker-dealer level.

JS: Was the SEC ready to do that? Did it have the staff to do that?

MH: I would say on balance that the SEC definitely needed more staff to do that. It's a big, complex task with big, complex firms. On reflection, the SEC needed more staff. When I came to the SEC, this is not something on which I had worked or knew a whole lot about. I found out about it shortly after I arrived. I said, "That's interesting, you know. Tell me how this works." I had selected a lawyer for my staff, Jim Eastman, who had come out of the Trading and Markets Division and he was one of my counsels.

He explained it to me how it worked. And he explained that the European regulators had wanted all these investment banks to be regulated by all the European regulators, which they did not want because it resulted in multiple regulation. The European regulators said, "Okay, if you become a consolidated supervised entity under some responsible U.S. regulator, we won't regulate you." They marched into the SEC and asked for regulation and they got it. They consented to it. That's why this happened.

JS: Who within the SEC was in charge of doing that regulation? Was there a specific office

or maybe the Office of Risk Assessment?

MH: No, it is the Division of Trading and Markets. I think at that time it was called Market Regulation, headed up by Erik Sirri. Then he had a division within Market Regulation whose responsibility it was to regulate the consolidated supervised entities, run by a guy named Matt Eichner. Matt Eichner ran that.

JS: We'll come back to this here in a couple of minutes when we talk about the financial crisis. I'd also like to ask you about the creation of FINRA. I don't know if you worked on that issue at all.

MH: Yes. In one sense, FINRA is simply a new name for the NASD. In another sense, it's a new structure, a new organization because it took over the regulatory function from the New York Stock Exchange.

JS: Where was that at when you joined the SEC?

MH: That was in process of being changed over as I joined the SEC. Mary Schapiro, who was head of the NASD/FINRA, in a sense reported through me to the Chairman. She and I had several discussions regarding FINRA and the difficulties they were having getting the small brokers to agree to the whole restructuring of FINRA and the takeover of the market reg function of the New York Stock Exchange. I was impressed by her. I was very impressed. In any event she would often talk to me about things they were

concerned about, like the increasing number of brokers becoming investment advisers with reduced regulation, and no FINRA regulation.

JS: Hedge fund regulation. The hedge funds industry of course has long resisted regulation. In 2006, the courts have struck down a 2004 rule left over from the Donaldson years that would have required the registration of hedge funds that had fifteen or more clients. Under the Cox chairmanship, the SEC did not appeal this decision. Was there any talk of the possibility of trying to pass a new rule that would have required hedge funds to register?

MH: Yes, there was. The decision was made that to try to adopt a new rule would probably be struck down again. We did not want to do that. The registration decision, which is the decision you are talking about, did give us a guideline for how to take care of at least the fraud aspects of hedge fund regulation. The court said that if you go under the Advisers Act Section 204(4), I think it is, which is a rule that is not focused on the word client, so that you could adopt anti-fraud rules that relate to hedge funds, and make then apply to what the funds do to or with their investors. We did. Again, I was given a leadership role on that because I understood it. I have done a lot of fund work over my career. I understood it pretty much implicitly.

I worked extensively with the Division of Investment Management to adopt this hedge fund anti-fraud rule. It applies to a lot more than hedge funds. It applies to all funds in this country who are in a pooled investment form, including venture funds, including

private equity funds.

JS: I understand there was also a hedge fund working group within the Division of Enforcements.

MH: Yes.

JS: Did you bring any suits against hedge funds during these years that you recall?

MH: Yes. They primarily had to do with either insider trading or market manipulation.

JS: Just to bring up information technology, that was also a big issue under the Cox chairmanship. Was this something that you worked on?

MH: Very actively. Again, the Chairman thought I must know something about this, being from Silicon Valley. I was interested in it, as was Con Hewitt. The Chairman was very much an interactive technology Chairman. Pretty soon I became familiar with something called XBRL, Extensible Business Reporting Language, and the idea of being able to go in and actually manipulate the figures on file by a public company to show them the way you want them or to compare them with other companies. It sounded really neat to me. I got very actively involved with an outside agency called XBRL US and their people. We worked over a period of two years very actively promoting this standard and developing the tags.

JS: Is that a private company or a non-profit?

MH: It's a non-profit. It's a private organization. There's a comparable parent organization based in London, I think. I worked with the people in that organization because we were in effect funding a lot of their work. We had a lot to say about how it went. We set goals and timelines and so forth for the adoption of what is called the taxonomy, which is a series of tags that you have to adopt, whether it's income or revenues or expenses or whatever. You have to tag all these items so that you can put the figure in and then manipulate it. It was a lot of work in a short period of time. Then we had to decide how to roll it out on American business.

JS: Was that something that American business seemed interested in? Did you have companies contacting you about that, or was it something abstract that they didn't understand?

MH: It was not the most important thing to them, but they were interested in it. We asked for volunteers to come forth and voluntarily file under XBRL just to see how it would work. We got Microsoft and forty other American companies to do the work to voluntarily file, so we could work the bugs out of the system with the big companies.

JS: Was it something that over the long run was probably going to increase costs for them or decrease them? Or would it have any effect on it? I'm just wondering, if it cost so much

money to implement the different accounting measures and auditing measures, how much the -

MH: I think it would increase costs. It also increases disclosure. Don't forget that they still have to file on paper. Now, when I say, "file on paper," that's not really true. They file electronically. They file under the regular EDGAR electronic system. Now, they have to also file under the XBRL system. You would have to agree that it does increase costs. It increases transparency, too.

JS: You just mentioned the EDGAR system, which has been around since the 1980s. In 2008 the SEC also unveiled a successor to the EDGAR system, the IDEA system. Did you work on that also?

MH: Yes.

JS: What was involved in that?

MH: The IDEA System was really a combination of both EDGAR and XBRL. It was supposed to lateral out to a new system of disclosure where we would basically go through all the rules and try to get rid of all the ones that were outdated, update the ones that were outdated, and then try to plug those into the electronic system. As I was leaving, that task force was being set up.

JS: Let's talk a little bit about the enforcement work with the Commission. Tell me about your role in supervising enforcement cases while you were at the SEC. Did every litigated case come through you?

MH: Yes.

JS: That must have been quite a few.

MH: Yes. I'll never forget when the Chairman and Peter Uhlmann, chief of staff, called me into the office. They said, "You're going to be in charge of all the enforcement cases coming through." I looked at them, said, "I am?" They said, "Well, you're the lawyer." I said, "Okay." What would happen is that Linda Thomsen would meet with me once or twice a week along with Peter Bresnan and Walter Ricciardi and her chief people. We would go over the main litigated cases, particularly the cases that might be controversial. We would try to give them some guidance, regarding where we wanted to go and where we did not.

JS: If the enforcement staff wanted to settle a case before taking it to court, did they have to go through the Commission first?

MH: Yes, and still do.

JS: How did that system work? Did they just come to you and make proposals and then you

approved it, giving your thumbs up?

MH: When I got there, they would negotiate with, let's say, the company. Let's say it is a Foreign Corrupt Practices Act violation and they have the company pay forty million dollars as a penalty or disgorgement or something for the violation. They would write it up on a memo and they would present this to the Commission. The Commission could either approve or disapprove. It would come through me. We could say, "We think that's too much or too little or whatever." Theoretically, the Commission could send them back to the negotiating table if they did not like the number.

JS: Are there any major cases from this period that stand out in your mind?

MH: You mean, just generally?

JS: In general, over the years, that you care to talk about.

MH: We were there during the stock option backdating case era. This backdating had taken place before I got there. The cases were mostly brought when I was in there. I would say we brought at least thirty or forty of them while I was there. I very much remember the stock option backdating cases.

JS: You also worked on some Supreme Court briefings during this period, right?

MH: I did. There are two that I remember in particular. There were more, but one was the *Stoneridge* case, which has to do with secondary actor liability under the anti-fraud provisions of the Federal Securities Law.

JS: As in Section 10(b) and Rule 10b-5?

MH: It involved Motorola and a company called Charter Communications, as I recall, where Charter Communications was trying to increase its revenues. It got Motorola to agree to increase the price for the equipment it was selling to Charter Communications. Then that increase was used to buy advertising on those Charter TV stations. You, in effect, were increasing Charter Communication's income because in a capital investment, the equipment, you do not write that off immediately.

JS: What position did the SEC take on this? Did they argue that they should have been liable or should not have been liable?

MH: Clearly, Charter Communications should be liable. It cooked its own books. Clearly its executives should be liable. The question was, "Should Motorola be liable?" The position that I took, and which other people took, was that unless the investing public thought it was relying on Motorola, in other words, its name was in the prospectus or something, as having been involved with the financials, that it could not hold Motorola liable for this. We are talking now about billions of dollars of liability. If it were otherwise, then you would have a situation where banks, investment banks and other

people who are involved in structuring deals could be potentially liable for billions of dollars by virtue of having helped a company structure a deal.

Now, you may not like that answer or like that result, but I did not feel that 10b-5 was built for that kind of secondary liability unless the investor was relying upon the third-party, or unless Motorola is the controlling person over Charter Communications, which it was not. It was just a vendor.

JS: Did the Supreme Court agree with the brief?

MH: The Solicitor General agreed with that position. There was considerable press on this issue that the SEC was not helping investors out. The SEC adopted a compromise position in the briefs before the Supreme Court, which I can get into in some detail. It is a compromise position on the overall issue. The Supreme Court, by and large, adopted our position on the *Stoneridge* decision, which to this day has resulted in relief of secondary actors from 10b-5 liability, where they are not named actors or control persons. They might be liable for common fraud liability, but that is a different issue.

JS: The lawyers out there can go and look at the documents if they want to see that specific argument.

Maybe the biggest criticism of enforcement at the SEC during these years is that they seemed to have missed the Bernie Madoff scandal. Was Bernie Madoff on the radar at

all?

MH: No. I didn't know who Bernie Madoff was. Chris Cox didn't know who Bernie Madoff was. I don't think any of the Commissioners even knew who he was. He never entered the SEC as far as I knew.

JS: He was big at the NASD. I think he was important there.

MH: I guess so. He somehow managed to slip under the radar of five different Chairmen of the SEC. It's just too bad that he turned state's evidence in the last month of Chris's administration. The SEC Inspector General's report is fairly damning of the SEC enforcement staff, particularly in New York, over their failure to pick up on his fraud.

JS: Let's talk about the financial crisis a little bit. Do you remember the first moment when you realized that there was probably going to be a financial crisis, or that it was going to be a big one?

MH: Yes. In November of 2006, some reports from the Fed crossed my desk. These are monthly reports on mortgage foreclosures and other data. Being a former banker, I looked at that stuff. I thought it was interesting. I opened up the mortgage data page. It said subprime foreclosure rates were up over 10 percent for subprime ARMs. Subprime fixed foreclosure rates were up over 5 percent. I reacted almost immediately because I had never seen such percentage default rates when I was with Bank of America. I was

concerned because I knew that people we regulated, such as Bear and Lehman and people like that, had large subprime pool portfolios and things like that.

I talked to various people about this within the SEC. The Chairman told me to talk to Erik Sirri and also Peter Uhlmann, who was the chief of staff, talk to him about it. I took with me, Con Hewitt, who was a former bank auditor and chief superintendent of the banks in California. He and I went in to Peter and to Erik alone or together. I would say the first time we went in was December, 2006. We talked to them again in February-March. By June of 2007, those two Bear Stearns funds went down, which were basically high-yield subprime funds. Then by August of 2007, Bear Stearns reported this big loss due to the subprime markdowns.

JS: What was the SEC doing during that period in the summer of 2007, just staying in touch with Bear?

MH: The SEC Market Regulation staff was in on these investment bankers. It had a staff which basically went up and lived with them. They would audit them, and they would look at records, and they would do this and do that. They would find that they were meeting the Basel II net capital standard, which was the net capital standard that they had adopted, thinking that it was the most up-to-date capital standard there was, that they were well capitalized within the meaning of Basel II. On top of that, they had a $17 billion liquidity and so forth and so on. I remained concerned, and I think Con remained concerned because their leverage was so high.

The leverage of these big investment banks was well over 30-1, whether your name is Goldman or Lehman or Merrill or Bear, whatever. Some were higher than others. Before Bear collapsed, it was almost 40-1. When I say leverage, I mean the ratio of assets to capital. You take your total assets on your balance sheet and you divide that by the amount of shareholders' equity or Tier 1 capital and you come up with a ratio. That's what we call the leverage ratio. The defense of the investment banks was that you can't include the matched book. Now, the matched book is repos, basically. You have hedge fund X who repos a bunch of securities to Bear Stearns. Bear Stearns buys all these treasuries, and then has an obligation to resell them. The hedge fund has to take them back in a day or three days or a week or month or whatever. Then Bear takes those same securities and sells them to Fidelity under a reverse repo, if you will. Fidelity agrees to buy them, but obligates Bear Stearns to buy them back within a certain amount of time. Basically what it really is is a secured loan, a secured loan with a spread, where you make money on it. Their position was that you match the left-hand hedge fund repo with the right-hand Fidelity repo and that's a matched book and you do not count that for leverage.

The problem with that is several-fold. Number one, this is short-term credit. The credit was getting shorter, that is to say, the term of these repos was getting shorter. The second problem is while the securities covering these repos may be high-grade securities, if there is a lack of confidence in the rest of the firm, namely the subprime activities, then all of a sudden Fidelity will call up one afternoon and say, "We don't want to renew repos with

you anymore." All of a sudden your short-term lending pyramid collapses. The investment banks were excluding the matched book from leverage. They claimed that the leverage ratio was down to 18-1 or 15-1 as a result of this.

I looked at that and I heard that. I never really agreed with it. Then we had a policy discussion, which I thought was a very good discussion, and that is, "What is the role of the SEC in terms of telling these investment banks how to run their business?"

JS: Is this in the summer of 2007 that we are talking about still?

MH: Yes. I would talk to Erik Sirri and I would talk to Matt Eichner. Con Hewitt would be with me often. You have to realize, there were two people in the building who really had private banking experience, me and Con, and that is it. It was good we were there in a sense.

JS: Yet, in principle the SEC was supposed to be overseeing the investment banks?

MH: Yes. But, we had private side experience. Even then, neither one of us had worked at an investment bank. So let's not get carried away with our experience. We had been working on bank banks. But nevertheless, bank banks had investment banks as part of them, so I guess you could say that we had experience.

JS: Did you bring in the Federal Reserve or the Comptroller of the Currency in those

discussions?

MH: No, they did not regulate them. The policy discussion went like this. We would say, "Shouldn't we be reducing the leverage of these entities?" Leverage means your risk. If you've got 40-1 leverage, it does not take a big loss of money before you're bankrupt, right, as distinguished from if you have 15-1. Fifteen-to-one was generally the net capital rule. By the way, people say that the consolidated supervised entity exempted them from the net capital rule. That's not entirely true. It was just a different net capital rule.

JS: What was the ratio?

MH: Obviously, it was a ratio that allowed you to get up to 40-1. It was a different rule. It focused on liquidity and having adequate emergency liquidity and things like that.

JS: As a result of this policy discussion, did you conclude that it might be possible to force them to reduce their leverage?

MH: I had a discussion with Jim Eastman, who was my counsel. We went through 15(a)B-1, Schedule E, which was the consolidated supervised entities rule adopted to regulate the big investment banks at the holding company level on down. I learned from Jim that we had the legal authority to force them to reduce leverage. If we wanted to, we could have. Erik Sirri's position, which he got Chris to adopt, was "They got in voluntarily and they can get out voluntarily." That is true except for one thing - if they asked to get out, you

can delay. They did not have to get our permission to get out. But we can sit there and futz around for a year or two years before letting them out, if we think the public interest or protection of investors so requires.

JS: That also sends a signal to the market if they try to get out.

MH: Right. I never totally with the principle they can just get out. We could simply delay. The point I am making is that the policy discussion was a good one in the sense that Erik Sirri's position was that our obligation is to protect customers' funds, so that the brokerage customers will always get their money back. You can do that by segregating their money in segregated accounts. Erik's position was that our business is not to tell them how to run their overall company as long as we protected customers' funds.

As a former banker, I didn't agree with that. As a former banker, I believe in countervailing force. The countervailing force of intelligent regulation is an important thing to have in the American system and that we should do that. Nevertheless, Erik did his argument. I did my argument, and Erik was head of the division and that was his position.

You can argue if you want to that Erik was right in the sense that had we greatly reduced the capital or the leverage of these entities, it might have led to its own market collapse problem. Do you see what I mean? It was too late or something. On the other hand, that is the history of what happened. I would say that by August or September of 2007, it was

too late. At that point the die was cast pretty much. Bear probably could not raise more capital. Before then it was not too late, based on the subprime default data we had in hand, in my view, for regulatory action, but I am not talking about the SEC. I am talking about all the financial regulators.

JS: In the case of Bear Stearns, it did not actually hit until about eight months later.

MH: It hit on March 14 of 2008, when certain institutions, Fidelity maybe, decided to stop doing repos with Bear.

JS: Let's talk a little bit about that period. I guess at the end of February, beginning of March was there any sense that maybe the crisis had passed or was there still a concern?

MH: I'm sorry, February-March of –

JS: Of 2008. You were still at the SEC then. This is when Bear Stearns actually collapsed in mid-March. Tell me a little bit about how that played out from the perspective of the SEC.

MH: Well, it collapsed in a week, very fast. It was as much a surprise to the SEC as it was everybody else. As the Chairman described it, it was like a run on a bank. When you have a bank built on short-term credit relationships, once somebody calls up one afternoon and says, "I'm not renewing the rollover of the credit," you can go bankrupt

pretty fast. That's what Basel II failed to pick up. It failed to pick up anything having to do with secured credit. It was not built into the Basel II calculations. It was not built into the mindset of the SEC Division of Trading and Markets. Basically while the SEC was certainly involved during that famous week, it could not be the decision maker because it did not have a checkbook.

The SEC has no checkbook. The Fed has a checkbook. The Treasury has a checkbook. At the end of the day the US Treasury put up fifty-two billion dollars to keep Bear Stearns alive. People say it's twenty-five billion dollars, but they forget to count in the additional money that came out of the primary dealer credit facility created by the Fed the week after Bear failed to get JPMorgan to acquire Bear. But for that checkbook, Bear Stearns would not have been saved. That is something the SEC does not have. In a sense the SEC was at the table as a regulator, but it was not in any way a decision-maker because it could not facilitate. What it could do is it could create exemptions to permit the acquisition by J.P. Morgan to take place and that sort of thing.

JS: Tell me a little bit about how the SEC handled the public relations aspect of the crisis, particularly during this period with Bear Stearns. Was there a conscious decision to stay back from the spotlight?

MH: To the contrary. I thought that Chris was very much in the spotlight. There were several press releases that came out from the SEC during that period. At the end of the day it is really hard to be a CEO. It really is. And Chris was CEO and I was the advisor, or one

of the advisors. I was trying to advise Chris caution regarding saying anything that says, "It's going to be all right." On the other hand, there's a natural tendency, whether your name is Greenspan or Bernanke, to say, "Everything's going to be all right." You see what I mean? You are there to calm the markets.

JS: Do you think that's what happened when Christopher Cox said on March 11 that he had "a good deal of comfort" about the capital reserves of the banks?

MH: He did. He thought that Basel II was a good standard, that Bear had seventeen billion dollars of liquidity, that they were well capitalized, even though they had a high leverage ratio. Under all those standards that we were using at the SEC, he was right. The problem was it was the matched book – the leverage - that brought them down and the inability of Basel II to deal with short-term funding facilities that are secured. When he explained this later, the Chairman said, "Basel II missed that." I thought the Chairman was very candid about what happened afterwards. But when he was making the statements on, what did you say, March 11, that is true.

JS: Do you have any other thoughts about the SEC's role during the financial crisis before we move on?

MH: I was asked by the Hoover Institute at Stanford to participate in a conference called, "The Future of the Fed." I would say that conference was in the spring of 2009. They had all these luminaries on there. I don't know why I was there. I guess they brought me in

because I was a real-life former regulator.

JS: A token regulator then?

MH: I thought they were going to throw darts at me. They asked me to talk about the Bear Stearns crisis. Then they asked me to write a chapter of a book about it, produced by all the speakers, which I did. The chapter is called *Systemic Risks and the Bear Stearns Crisis*. We went through this heavy editorial process. That book is now on Amazon. It's called *The Road Ahead for the Fed*, by the Hoover Institution of Stanford University. My chapter is in there, along with a chapter by Schultz and all these other thinkers about where we go from here.

JS: Did your experience at the SEC change any of your views about financial regulation or about the role of the organization?

MH: Yes, it did because I did not come to the SEC with views on that subject. Over the somewhat less than two years I was there, I had formed some very definite views on that subject, because it was a day and night operation. I would live up there in Connecticut Avenue in the Kennedy Warren Apartments. I would take the train down in the morning and I would work until midnight and take the train back. It was a full-time job for that period. I came to the conclusion, number one, that we needed systemic regulation. Systemic regulation means that you are regulating the overall American economy from the standpoint of preventing the kind of crisis that occurred, which is a systemic crisis.

You have got to be careful you do not overdo it or you will wind up with a Soviet-style managed economy. But we need to do better than we did. I came to the conclusion that the SEC is not set up to do that. For the SEC, when it first announced the consolidated supervised entity program, it said that it would look at systemic effects. The SEC Inspector General criticized it for not doing that job. My comment is the SEC never should have said it would do that. It does not have the facilities to do that. For example, the SEC does not have a total global picture of the repo market. It does not know who all the counterparties are. It does not know the total credit and debit and the net position of repos and so forth.

The Fed has a better idea of that than the SEC. I became of the view that we needed an overall Financial Stability Oversight Council, which is in Title I of the Dodd-Frank Act. Again, you can challenge me, saying, "I thought you were Republican." I'm a realistic, practical one in the sense that I think that we need to instill confidence in investors and the public. This overall council would be an answer to that. As a matter of fact, some Republicans started filing bills. Susan Collins from Maine filed a bill, S.664, calling for exactly that. In that chapter I reviewed her bill and gave it some kudos.

JS: Did you have an opportunity to provide any input into the regulation that came out of this period, into the Dodd-Frank Act or anything else?

MH: Yes. I talked with people on the Hill regarding it. I was out of the SEC by then. Don't

forget, we lost the election – paid the financial crisis price. I had a one-year recusal period. I was not allowed to talk to anybody in the SEC for a year. I got involved in some of the Dodd-Frank Hill stuff. The Financial Stability Oversight Council, it was not adopted in the form I would have wished. If you read my chapter, you will see the form I would have wished, which is very similar to what Susan Collins proposed. The Financial Stability Oversight Council is basically a collection of regulators. All the major financial regulators are the members of the Council.

What does that remind you of? It reminds you of the President's Working Group. It's basically a reincarnation of the President's Working Group. What group failed to pick up on the crisis? The President's Working Group. It would seem to me that if you wanted to really give everybody confidence, you would have a majority of the commission be from the outside. You would have the likes of some pretty esteemed people out there, like Charles Bowsher and people that are not regulators as such, that are sitting on the Council.

The regulators are members of the Council. Nevertheless, it is better than not having it. We now have the Financial Stability Oversight Council. We have enhanced supervisory regulation for big banks and things like that. That is one conclusion I reached at the Commission. I do not believe the SEC is set up to be a system regulator.

JS: I think we have covered just about everything. Did you have any final thoughts before we wrap up?

MH: Gosh, it was a great run at the Commission. It was a night and day job. Nobody told me there was going to be a financial crisis until shortly after I got there. I would do it again. I believe in public service. I would encourage anybody who has a chance to do it.

JS: All right, Mike. Thank you very much for taking time to talk with us today.

MH: You're welcome.

[End of Interview]