Securities and Exchange Commission Historical Society
Interview with Paul Roye
Conducted on June 21, 2016 by William Thomas

WT: This is an interview with Paul Roye for the SEC Historical Society's virtual museum and archive of the history of financial regulation. I'm William Thomas. The date is June 21, 2016, and we're in Norfolk, Virginia. So, thanks very much for agreeing to speak with us. Why don't we start with a little bit of personal background, where you came from, what you studied?

PR: Well, I grew up in Louisville, Kentucky and left Louisville and went away to college in New Hampshire. Studied government, and political science was my major. I always had an interest in public policy, and how the government worked and operated.

WT: You were at Dartmouth?

PR: At Dartmouth, yes, from '71 to '75, and then graduated from Dartmouth and ended up working for a bank in Louisville where I grew up. And I worked for that bank for a year with always the view that I thought I wanted to go to law school. And so, during that year working, I applied to law school and ended up at the University of Michigan, and had a good time in Ann Arbor, saw some good football games. When I graduated from law school the question was do I want to practice law, what area of the law, and the area of the law that most interested me was the corporate securities area.

WT: Was there something that got you interested in that in particular?

PR: It was just fascinating, capital formation and how folks raise money, the regulation of the securities markets.

WT: Yes, most of the people that I talked to say that they ended up in it after law school rather than during, and so I'm also interested in –

PR: Yes it was sort of, you step back and you try to evaluate in law school what classes did you enjoy the most, and some of it could've been a function of my professors as well. I liked the corporate securities professors and took as many of those classes as I could. It was one of those situations where my parents wanted me to come back to Louisville and practice law in Kentucky. I figured if I went back to Louisville I'd probably stay there the rest of my life, so it was an opportunity to maybe do something different. Although frankly I thought I'd go someplace, work for a little while and go back to Louisville and make my family happy.

With the interest in corporate securities, what better place to go than the Securities and Exchange Commission, and I applied to the SEC. I had two offers, one from the Investment Management Division and one from the Enforcement Division. And I was initially more intrigued with the Enforcement Division, but they did not offer me a position in the main office. At that time, they had an office in Rosslyn, Virginia, a satellite, smaller office.

WT: This is in 1979?

PR: This was in 1979, correct, yes. I didn't like the idea of being in a smaller satellite office. I felt, and this was just a gut reaction, that I wanted to be in the main office where all the action was. And so I thought, well, I didn't know anything about investment management, thought, well, I could go there, I could work in the main office and maybe I could work my way around to enforcement. This was back in the days when you had – Stan Sporkin as the head of Enforcement and it was a sexy place to be and all that. And so I said let me try investment management, so I accepted the investment management job and reported on the first day. They took me into the director's office, who was Syd Mendelsohn, I walked in, met Syd, shook his hand, sat down and –

WT: I've heard he's very old school.

PR: Yes, he was an old school guy who had started in the mail room at the Commission and worked his way up. He was a great guy, a great director, and I just remember when I met him the first time. He went in and he said, "You ready to go to work?" And I said, yes, I'm ready. I read the Investment Company Act and I read the Investment Advisors Act and I'm ready to go to work. And he looks at me and he says, "Did you understand any of it?" And I said, there's a lot of it, sir, I didn't understand. He said, "Don't worry about it. Over time you'll come to understand a lot of it." And he said, "I'm still trying to understand aspects of it myself," so he put me at ease.

I went into investment management. I started in the office that handled exemptive applications. A good place to start, because folks were coming in and filing applications to exempt themselves from provisions of the Investment Company Act, and you got to really dig in to understand why the prohibitions were there, did the exemptions make sense. I got a good initial boss, Howie Hallock who was a branch chief. I worked for him, he was very good, very thorough, a good person to learn from. And so, I did that for a couple of years, but after a while, you're doing the same kinds of exemptions over and over again and it felt like I was not learning.

WT: One thing that I would think with exemptions is you learn about, one, not only the different provisions but also the contrasts between them and what's actually going on in the industry.

PR: Yes, it was good. Like I said, to a point that it started to become routine when you do the same type of exemption, and that was back in the days when money market funds were getting exemptions to do amortized cost evaluation and penny rounding to keep their net asset value at a dollar, and I must have done at least twenty of those. After you do so many of those there's nothing to learn anymore.

But the interesting thing was they had a group called the Investment Company Act Study Group. A lot of what their function was after the Commission had experience with issuing the same kind of exemptions, how could we take those and then codify them into a rule. And so, I then moved over to this Investment Company Act Study Group where we did rulemaking. That's a whole different aspect of what the Commission does, and you end up justifying a rule proposal and laying out the rationale for it, the policy reasons underlying the rule proposal, why it makes sense. It was typically granting, again, exemptions by rule and laying all that out.

WT: Who was running that study?

PR: I can see his face. Art Brown was the guy running the Investment Company Act Study Group. So again, Art was another good manager, a good person to work with, and so I worked on a fair number of rules. And then, the problem with the rulemaking is that it took so long. You're working on the proposal, you do the release, you take it to the Commission, the Commission approves the proposal then it goes out for public comment, then you're analyzing all the comments that come in, you know which ones were good comments that you wanted to incorporate into a final rule, which ones made sense to dismiss. And then you prepared a final rule, a rule release, take it to the Commission, and maybe two years later you finally have a rule.

I learned a fair amount in that process as well, but I would learn a lot and hit these plateaus, learn a lot, hit a plateau, and so after about three years I said well, I don't feel as though I'm being challenged enough. So that's when I decided, okay, I've got to make a change. Do I go back to Louisville and do what my parents want me to do and come back there and be a Kentucky lawyer, or do I do something else?

But in the course of those three years, I became intrigued with investment management. A lot of interesting issues, it was the time when the industry was just starting to take off, a lot of money was flowing in the money market funds, and then it was migrating over into other types of investment companies. So, an inflection point for the industry, and from that point the industry just took off.

I then applied to firms in DC. I liked Washington. I applied to law firms in DC that did investment management work, and I ended up going to the Dechert Law Firm in DC. At the Dechert firm was Allan Mostoff, who had been a former director of the Investment Management Division, and at that point they had about, maybe three or four lawyers besides Allan who did investment management work, and their practice was growing and they needed help. I worked for Paul Haaga at Dechert, and then he later left and went to the Capital Group and later became chairman of the ICI. The experience of being a junior associate under Paul and Allan basically taught me how to practice law. And so I did that.

After four years at Dechert I became a partner in the firm and ended up staying at Dechert until 1998, when I got a call from Arthur Leavitt saying that Barry Barbash was going to leave, I need a new division director. Would you be interested in the position? Let's have lunch. I had lunch with him and talked to my wife about it, and went back to Arthur Levitt and said I thought about it, talked it over with my wife, I don't think the time is right and I can't do it. Then I got a call from him about four or five months later, and in between that four or five months my mother passed away and that was a traumatic thing for me.

And Arthur Leavitt calls again and he says, "I've been looking around for a division director, I can't find anybody I'm comfortable with, you're the person for this job. Won't you reconsider?" When your mother passes away; you step back and think about life and what's important to you and what's not important. I reflected on the fact that I was interested in government and public policy and having an impact and that's why I majored in that in undergrad, that's why I went to law school, and here was an opportunity to go back and lead the division where I'd started as a young attorney. So, the second time I said yes. And so I went back to the Commission in 1998, and ended up staying there until I left in 2005, even though I told my wife I'd only stay for two or three years, so it ended up being twice that.

WT: So you spent about sixteen years then in private practice, completely in the IM area. What did you take out that? I was talking to somebody, it might have been Marty Lybecker, I'm not sure, but whoever it was, was saying that they didn't view it as being all that discontinuous, being at the SEC and being in private practice because in private practice they were basically helping people to stay out of trouble. It wasn't one of these areas where there was a surfeit of enforcement actions or anything like that.

PR: Yes, I would agree with that characterization. There were things you had to learn about private practice and serving clients and being responsive to clients, but in terms of the legal work and the law, the fact that I was at the SEC was a real advantage. Because I was working with associates in the securities practice who had not had the benefit of working with the SEC, so I knew how things worked at the SEC. I knew how folks there thought. I knew the process and how to get things through the SEC and what they were going to focus on.

For example, when I got into private practice we had a client, E. F. Hutton, I don't know if you're old enough to remember the commercial, "When E. F. Hutton talks, people listen." That was their big commercial thing. But they were going into the mutual fund business and they wanted to get an exemptive relief to be able to – Rule 12b-1 had come out, and to that point in the mutual fund industry there were really two models. Either you were selling no load, going direct to investors, like a Vanguard or Fidelity, or you sold funds with a load, and they had an idea that they would not charge investors up front a sales load, but they would be paid out of a 12b-1 fee, a continuing revenue stream from the fund. But that if you got out of the fund early between one and six years, you had to pay what they call a contingent deferred sales load.

WT: I've heard of that, yes.

PR: And working with Paul Haaga and E. F. Hutton, we got the first exemption to do that. And again, it was very helpful that I had been in the exemptive group to learn how to work that process through. And then, of course, it got copied by almost everybody in the industry after we got that exemption through. So, the SEC experience was valuable in terms of understanding the process and how the agency worked and how to get things done, and how to persuade folks of your position. But then I had to go and learn how to interact with clients and counsel them on how to do it the right way. You can't do this, you can't do that. But the SEC experience was clearly valuable in navigating all of that.

WT: Did you find that a lot of your work was driven by things like new rules and so forth, or was it more routine than that?

PR: Yes, a lot of it was. Obviously, when the SEC comes out with new regulations clients have to figure out how to comply, so that was a lot of what was involved. A lot of it was, again, folks being innovative, and we want to do something, how can we do it, can we get the SEC to concur in our approach or something like that. But the other good thing about private practice, I got to see up close the impact of rulemaking and the rules and regulations.

It made me mindful of the burdens that were being created by regulation, and I would then have to go back and apply some of the rules that I had even worked on. And you'd say, well, we put that in a rule but is that practical? It's hard to comply with. And so I think that kind of perspective, in terms of applying the rules, having to navigate clients through rules, that when I came back I think was very useful in terms of when you're sitting down with the staff and you're trying to craft a rule or deal with a problem, how to do it in a way that is workable. Accomplish the objective, the goal of the rule, but make it workable for folks in the industry. So I think that private practice perspective was useful in terms of going back.

WT: Okay. So you came to the SEC about 1998, Arthur Levitt was interested in this area I think in particular.

PR: Yes.

WT: What were some of the things that were on the agenda when you arrived?

PR: Well, when I got back I could thank Barry Barbash for some of the stuff. One of the big issues when I came back was mutual fund fees. Were mutual fund fees too high, were directors exercising adequate oversight of mutual fund fees? And I think Chairman Levitt had given a speech saying we were going to do this study of mutual fund fees, and of course Barry had left that for me to pick up and carry out. We actually did a study on mutual fund fees, and a lot of work went into that. The other issue we had, under Barry's leadership; they had advanced disclosure reform, so you had the simplified prospectus that had been adopted but hadn't been implemented.

So I came in at the time when all of that had to be plain English, shorter form prospectus, implementing all that and trying to make that work, and so there was a lot of time working with the disclosure staff on that issue. And then, and this is tied back into the mutual fund fee issue, Chairman Levitt was very interested in mutual fund governance and the role of fund directors. They oversaw the fees, they oversaw conflicts between the management companies and the funds, and were there to protect shareholders and then you could always periodically see some article about mutual funds and directors; they weren't watchdogs, they were lapdogs. They weren't doing the job. So that's when we started focusing on mutual fund governance. We had a roundtable on that where we brought in academics, folks from the industry, consumer advocates just to talk about the area in general, and then we eventually proposed some initiatives to strengthen the fund governance framework.

The other area that Arthur, at that time, was very interested in was the whole pay-to-play area. You had situations where actions had been taken, there had been enforcement actions, and predominately the actions had been in the broker-dealer area and rules had been adopted in the broker-dealer area, but not in the investment advisor area. So, you had situations where investment advisors were effectively making payments to get advisory business from public pension plans and other governmental entities, and so then the question was could we do similar rulemaking in the advisors area? So we did a pay-to-play rule in the advisors area and I think, again, that was another kind of signature rulemaking for Chairman Levitt, something he felt very strongly about.

WT: Did that go through fairly easily or no?

PR: No, it was a very controversial. We had a lot of pushback. They asserted we were violating people's First Amendment rights.

WT: Because they had been through this already with municipal securities, right?

PR: Yes, right. Yes, it was not a straightforward rulemaking, but we got it through. We did some after-tax mutual fund disclosure, what are your results like after-tax. We did some improvements in fund advertising rules. Chairman Levitt was always out meeting with investors. He did town hall meetings, and he could hear firsthand from investors what they were concerned about, very instrumental in investor education, launching that effort. And then when that effort got launched, we then tried to feed in educational pieces on the mutual fund area. We put up a cost calculator on the SEC's website, because you could then take different – it's very hard to compare one mutual fund to another in terms of cost, and then – and I think it's still on the Commission's website, where you can take the information out of the prospectuses, plug in the calculator and see what it's going to cost you over time.

WT: Were you worried about the structures of fees and what they were paying for and those sorts of things?

PT: Yes, there were always questions about 12b-1 fees and management fees; were they too high. I think that the basic thrust was, and the federal securities laws are all about disclosure and transparency, so how could we make fees more prominent, how could we get investors to focus on fees? Not so much regulating fees as much as being transparent. The theory would be that if fees were transparent and people had ways to compare funds to each other, they would make intelligent decisions with regard to their investments and funds and the fees. It was borne out, if you looked at the data in terms of where investors were putting their money, the lion's share of the investments were in low cost funds.

They were in Fidelity and Vanguard and the American Funds, which were the low cost providers in the fund industry, and that's where the lion's share of the money was. And so the market seemed to be working, and so I think our thrust was just, let's do what we can to educate investors, let's make the fees transparent and investors will make intelligent decisions.

WT: Were fees a big part of the investor education element?

PR: Yes, I think if you go back during that period of time under Susan Wyderko, I think there was a lot of focus on mutual fund fees, how to think about them, how to look at results, don't focus on short term, and then going from mutual funds to variable products and their fees and cost. Yes, so I think during that time there was a lot of focus on fees and education and transparency.

WT: At the time, you got there in 1998, so this as the tech bubble is reaching its peak. Was that a big concern at that moment?

PR: I think from an investment management standpoint, I don't know if it was all that big a concern. I think that it was similar to the period of the tech bubble, and I just remember somebody saying to me, man, when you joined the Commission the market just took off. Did you have anything to do with that? And I said, of course not.

But it was as though everything was going up. It was in the days of day trading, and the use of the Internet and stuff was just taking off. I think it was just more the exuberance and people thinking that they couldn't lose money. I remember one of my neighbors was retired. His wife would complain because he would just sit on his computer day trading. Ultimately, unfortunately, he lost a lot of their family wealth doing that.

But I think it was just during that point it was more just trying to – I think the perception was, at the SEC, it's not our job to tell people what they should be investing in, it's just to make sure the information is out there, and the risks and the pitfalls are out there for folks to make judgments, informed judgments. I think there were funds that were formed that had very narrow investment focus, this piece of a tech industry, and I'm sure people rode those up and they rode them down.

But the SEC, the federal securities laws that the SEC administers, you're not about saying this is a bad product, this is a good product. It's about describing the product, describing the risks, what investment strategies are you going to pursue, and as long as those risks are out there, investors make their own decision. Now, if somebody was engaging in fraudulent activity or didn't lay out all the risks or had material misstatements or omissions in those documents, then the SEC was there to come after them. It was back in the days when you had Internet advisors like Tokyo Joe. It was more like some guy on the Internet who was giving investment advice over the Internet.

WT: Yes, It really is an early period for the Internet. You talk about people being fascinated with day trading. I actually talked to Susan Wyderko, and we talked about Internet scams and how that was a big part of the Office of Investor Education. But there's also the possibility of using it as a tool for disclosure. Was that something that you were talking about at the time?

PR: It was in its infancy. It wasn't so much – I don't recall anything during Arthur Levitt's – a whole lot of focus on it. We moved to electronic registration for investment advisors. Up until that point the ADVs, the advisor registrations and amendments all had to be filed on paper, and we then launched Investment Advisor Registration. We started under Arthur's regime and then finished it under Harvey Pitt's regime and moved to all electronic registration.

You had EDGAR for the public company filings and investment company filings, but there was nothing for the advisors, so we were stepping up the Commission's use of technology. Then, I remember under Harvey Pitt's regime, somebody came in and wanted to do an all-electronic variable annuity product where all the documents were delivered electronically. That was pretty controversial. That was the first case I remember where it was going to e-delivery and that was something like, we're not there yet. It was before it's time. And by the way, we're still, on the mutual fund area, still trying to get to some more acceptable e-delivery mechanisms.

But yes, so it was an exciting time, a little Wild West, but again, I think the Commission was focused on educating and not getting in the way if somebody wanted do a narrow based technology fund, it's out there, make sure people understand the risks, and then things calmed back down.

WT: In the area of investor education, one of the things that I'm not totally clear on is that a couple of years later, when you had the global settlement from the advisor conflict of interest case.

PR: The analysts.

WT: Yes, the analysts. When the money from that settlement was supposed to go, or it actually did go into what is now the FINRA Foundation, was there a possibility that that was supposed to go to the SEC's office, or am I confused about that?

PR: You got me on that one. That wouldn't have been within the IM space, so I'm not sure what the ultimate plan was for it, how that all sorted itself through. And fortunately, I didn't have to get in the middle of that one.

WT: Right, it doesn't sound like it would be too fun. One thing, you arrived a couple of years after the passage of NSMIA, and so part of that was the preemption of the state regulatory authority. Was that pretty much in place by the time that you arrived?

PR: Yes, that was a good thing, and there wasn't that much to do. It ended up, so basically you had a number of states that actually regulated investment companies and they would impose various requirements, and it ended up having to comply with the most restrictive state requirements. So, once they had a very restrictive requirement, you had to put it in and you had to comply with it, even though it was just a single state request. Unfortunately, the states adopted the requirements decades ago. Some of them were antiquated, out of date, and you would have to go in and file, I know this from private practice, you would go in and file with the SEC, you'd file the registration statements with all the states, and then you would have to go through all the states that had requirements and get cleared through them, and you could be negotiating with the states, and just a costly, burdensome process for, in my view, not a whole lot of benefit.

Most of the states didn't have the resources to follow through and follow up on compliance with the requirements. Quite frankly, for a lot of states I think it was just a revenue issue. And so, I think NSMIA was good in the sense that it preserved the revenue for the states but then preempted these requirements, which I think made a lot of sense, and I think when those restrictions went away you saw it do no damage to the funds or fund shareholders or have any adverse impacts at all.

Then, you also had NSMIA give the regulation of the smaller advisors to the states and the larger advisors to the SEC which was a help. It wasn't the solution, but the SEC I think probably had, maybe at that time, these numbers are probably off, but something like 25,000 registered advisors and it maybe cut it in half. It made sense to divide up the smaller advisors to the states and the larger ones to the SEC. So that was another good development as a result of NSMIA, but it still left resource-constrained SEC with an exam cycle that was still twelve, thirteen years between exams or something like that.

So, there wasn't a whole lot from a post-NSMIA perspective that we had to – I think we had to do some rulemaking to clarify the jurisdiction between the states and the SEC, and how do you treat an Internet advisor – regulate it with the SEC or the states. So there was some work we had to do, but it wasn't dramatic.

WT: And also, I guess it had a big effect on the hedge fund area, insofar as it redefined in terms of the investment level rather than the number of people who could be in a fund, and also the advisors.

PR: Yes. The Advisors Act had an exemption if you had fifteen or fewer clients, and then of course, what we started to see was they had fourteen hedge funds with hundreds of millions of dollars that the hedge fund advisors were managing and the only thing they were subject to were the anti-fraud provisions, so we couldn't go in and examine them, couldn't take a look at what they were doing. You had well before that, before I got there, you had Long-Term Capital Management which was a hedge fund, and maybe it came close to breaking the system down, and the President's working group looking at all that, and I think ultimately it was more let's go at it by decision on folks that are lending to them and control that as a way of dealing with hedge funds.

But I think still, from the SEC perspective, there was always this lingering concern out there, what are they doing, what's going on? We can't really look. We'd have to have somebody basically coming in and complaining, I invested, I got ripped off, and then you could go in for cause basically and go and see if they were committing fraud. And so I think Chairman Pitt may have given a speech and started raising questions about the issue.

I know when Chairman Donaldson came in we did a roundtable on hedge funds, brought in a lot of experts and tried to identify concerns. We asked for public comment, we did a hedge fund report, and then Chairman Donaldson was particularly concerned with what we didn't know on the hedge fund area. We did a Hedge Fund Rule, and then it got challenged and then it got blown up in the DC Circuit. And then guess what, then you have the financial crisis and Dodd-Frank sweeps in hedge funds and private equity funds, all kinds of private funds, and then they end up with more regulation than we proposed in that rule.

I think Chairman Donaldson was vindicated in that effort, because subsequent to the rule getting blown up, if you look at where the SEC was bringing enforcement actions and then subsequent, with registration under Dodd-Frank and the SEC could go in and examine and look at private fund advisors a disproportionate number of cases where the SEC would go in and find problems was in that space. And so I think the impetus to bring in hedge fund advisors under the regulatory regime was the right one, because I think it was an area where, without the sunlight, bad things were happening.

WT: Was there talk of advisor registration as early as Levitt in that period?

PR: I don't recall as early as Levitt. There may have been some rumblings, but I don't think – I think Chairman Pitt started the discussion and had the staff going out trying to learn what it could, and then it picked up steam under Donaldson.

WT: Switching gears to the governance area, I understand that you were centrally involved with the creation of what was then the Mutual Fund Directors Education Council?

PR: Yes. The Mutual Fund Directors Forum, and again, this goes back to Arthur Levitt. One thing Arthur was good at was always thinking about the fact that there were things that the SEC could do from a regulatory standpoint, but he always thought there were initiatives the industry could do to strengthen the governance framework and the regulatory framework. And so, with the focus on his concern about strengthening the mutual fund governance framework, that spurred the ICI to do a best practices report on governance, and the ICI created the Independent Directors Council as a group within the ICI. ICI formed it to get fund directors together, educate fund directors, but I think there was a concern that it was still part of the ICI, the industry group.

And in spite of the fact that I think it's now called the IDC, Independent Directors Council exists today, they do a lot of good work and a lot of good programs for directors, programs to educate mutual fund directors and get them focused on their responsibilities, and so Chairman Levitt sent me off to think about it and come up with some ideas.

So one thing that I had been aware of was Stanford had done a – they had a directors college or directors institute and they would bring public company directors in for a three-, four-day session on corporate governance issues. And I said, "Wow, it would be neat if we could do something like that for mutual fund directors" – a directors' college for mutual fund directors. And the great thing about that was, we had David Ruder, who had been a former Chairman of the SEC, who was a professor at Northwestern Law School, and I thought Dave would be great for doing this directors college. So, I called up David Ruder and said, "We have this idea about maybe doing some form of directors college program focused on mutual fund directors and wonder if you'd be interested and if we could do something through Northwestern." I can't remember exactly, but I think we may have done an initial program at Northwestern, I can't remember exactly, but David Ruder was very interested in it.

I then called Allan Mostoff, who had been my former partner at Dechert, who I knew was interested in governance issues and I said, "There's an opportunity to create a directors' group that's an independent directors' group that's not part of the ICI, would you be interested?" And I think David Ruder had said, "Look, I know there are mutual fund directors, and I have a sense of what they do, but I'm not an investment management lawyer. I really need some help, to help shape this."

And so that's when I put him together with Allan Mostoff. They then started working, and it didn't turn out to be a directors' college, but it ended up being basically a trade group for mutual fund directors. And then they got fund groups to join, they started doing policy conferences, they started doing regional meetings, they started putting out educational papers for directors, and then they started writing comments on SEC rules from a director's perspective and it just took off.

It exists today and going strong, and as I said, we've got basically two groups, the ICI group and the Mutual Fund Directors Forum. And again, I think it was a way to get mutual fund directors together as a group, talk about common issues, common concerns, share ideas, what are the best practices in fund governance and I think it has worked to strengthen the governance framework overall.

WT: I think it was Susan Wyderko who was mentioning that Paul Haaga, who you mentioned earlier, was involved in this whole effort too, is that right?

PR: Well, as I said, Arthur was good at trying to get industry groups to come in and develop best practices, so as I mentioned pay-to-play. I think the investment advisers Association or Council Association, whatever they called it then, they did a best practice paper on pay-to-play, even though we were doing pay-to-play rules. ICI did best practice on fund governance issues.

And so there were gaps in the regulatory framework, so the statute provided that you have a certain percentage of independent directors on a fund board, and you could have a former executive of the mutual fund company retire, and as long as they had been two years away from working for the advisor, could come back on the board and be an independent director, and they might still be getting a pension or something from the management company, the advisor. And that was okay under the statute the way it was drafted, but clearly, can that director in that kind of situation truly be independent? So their best practices highlighted things like that as no-noes, as a best practice you shouldn't do this.

Of course, in this whole governance, strengthening the governance framework effort, it was a continuum. Levitt was focused on it, we did a package of governance reforms, and then we get to Donaldson and then we get to late trading/ market timing scandal, and then the question becomes, again, was the governance framework strong enough to head off some of the late-trading market-timing abuse issues. So the issue comes back again, and then Bill Donaldson is in ratcheting pressure up on the governance frameworks more.

WT: So you did the first rule concerning that under Levitt, right?

PR: Right.

WT: So that made it majority –

PR: Had to have a majority of independent directors, that independent directors had to be self-nominating, so that it wasn't the management company that solely picked who the new directors were when there was a vacancy. It was solely within the control of the group of independent directors. So things like that, again, to strengthen the governance framework, and then you had the best practice and then you had the Mutual Fund Directors Forum, all focused on education and that was Levitt.

WT: In the rule you used the exemptive authority as the way to push that through. Was that something that was novel then?

PR: Yes, that was. Yes, the SEC Chairman comes to you and says we've got to do something to strengthen the mutual fund framework, and guess what? You're not Congress (Laughs). Obviously, Congress could go in and amend the Investment Company Act and impose whatever requirements they want to on the definition of what an independent director is, but the Congress didn't directly give the SEC the authority to define what an independent director is. Then the question becomes, you get this charge from the chairman of the SEC saying I want these frameworks strengthened, figure out how to do it.

It's funny how some of the stuff comes back. I worked in the exemptive group when I first started at the SEC, so for me coming in and having to deal with it, it wasn't as a novel as one might think, because when Joe Goldberg, who was the director at the time – and they put in Rule 12b-1. Rule 12b-1 was an exemption to allow funds to pay out of their assets the cost of distribution, and as a condition of that, Rule 12b-1 said well, if you're going to have a 12b-1 plan to charge 12b-1 fees, then, you have to have a majority of independent directors and the directors have to be self-nominating.

But that was only for funds that had 12b-1 fees, and so what we did was then latch onto that and tied the independence requirement and the self-nominating requirement to other exemptive rules that basically every fund group had to rely on, so it was just extending that concept from 12b-1 to fund groups across the board.

WT: Was this something that you remembered from your previous time at the SEC?

PR: Yes, I mean it was just, you know –

WT: It was known within the Division as well?

PR: Yes. Fortunately, it was there for us to latch onto, and it was a back door way, I admit, of getting the requirement in but it worked.

WT: Was there a thought of going further, or did that have to await Donaldson's interest in this?

PR: Well, I think we probably pushed it as far as we could push it at that point. There's nothing like a good scandal that gives you the cover to take it further and of course then we had a good scandal.

WT: I want to come back to that, of course, because there's so many things that you do in the aftermath of those scandals. So, just sticking chronologically with the time frame that we're in, there's also Gramm-Leach-Bliley here in 1999. What are your memories of that? Of course, the differences between the bank regulatory areas had already been pretty well eroded by that time.

PR: Yes, I think it was, we were stepping back and we were looking at some of the disparities that existed. So, for example, if you were a bank you were exempted from registration as an investment advisor, and that didn't seem to make a lot of sense. It was, oh, the bank regulators are going to worry about any issues over there. And then you have non-bank advisors who are registered with the SEC, so it wasn't as though you could go in and examine. They could be managing assets and you couldn't go in and look at them, but there was nothing we could do about that. That later got addressed.

Then you had some issues like where a savings and loan wasn't a bank as defined, so there was disparity there. The bank regulators didn't want us encroaching on their turf. I think we recognized that we'd like to be able to look more, pull the covers back, but the bank regulators, they didn't want us to look, and of course they never got over the fact that back in the late seventies money market funds were dis-intermediating the banks. That's probably when – they probably weren't using the term but the shadow banking industry, that's when the mutual fund industry started eating the banks' lunch at that point. But there was some tension there, but it didn't manifest itself so much publicly, it was just behind the scenes tensions.

And part of the problem is the difference in our regulatory regimes. The bank regulators were all about safety and soundness. Whatever you do, we don't publicly announce bad things that the banks have done because we're worried about the safety and soundness of the banks, and runs on banks. And the SEC's philosophy is, if you commit fraud we're coming after you and everybody's going to know about it. It may cost you some business. It may even put you out of business, but so what, that's our mission, that's our mandate. And the bank regulators, they have a different mindset.

WT: Was there ever any contact between you or the SEC and the comptroller of the currency or the FDIC, or the Fed for that matter?

PR: Sometimes, but it was pretty siloed for the most part when I was there. There could have been more contact from – the GC folks might have been talking to them, or Enforcement, but just from an IM perspective there wasn't a whole lot of interaction with them.

WT: Okay, completely different topic. Sarbanes-Oxley was in 2002. It wasn't principally concerned with IM, but I understand there was some application.

PR: Yes. Yes, we had to go and implement Sarbanes-Oxley certifications, the whole process, certifying reports, putting in forms where the CEOs and chief financial officers would certify the financials of the funds, and for us it was just following all on everything that had been in the public company space. So yes, there was a rulemaking that we had to follow through, but it was fairly straightforward. We just did what the Congress asked us to do.

And I can't remember whether or not the more frequent reporting – the more frequent reporting may have come in, may have been something we did on our own, because at one point funds only had to report their holdings twice a year. We moved it up to four times a year, quarterly reporting, and then those reports to shareholders in the Sarbanes-Oxley have to be certified with criminal liability. But we did work that through, but it wasn't controversial, it was mandated by Congress and it's in there today.

WT: Right. Am I correct that there was a fairly large backlog of applications for exemptive relief in the same period?

PR: Yes, that was one of my failings as a division director. I was looking for ways to speed up the application process. The late trading/market timing scandal got in the way of focus on that. Again, the goal was to, you do exemptions, once you've done a fair number of them codify it in the Rules, and that was going pretty well for a while. But then you get these other issues that get in the way, and it inhibits your ability to codify the exemptions into a rule so folks don't have to come in individually to file for applications.

I had floated an idea with the staff where you could, once we had done a certain number of applications of a certain type, that couldn't we just rely on outside counsel to certify in a filing to us that this exemption is just like the prior seven exemptions you granted in this area with the same conditions, and then couldn't we expedite the processing.

Certainly, there should have been no reason why routine applications, where we were just doing them over and over again, and again this goes back to my experience first as a young staff attorney where you're just cranking out the same ones over and over again, wasn't there some sort of expedited way we could do that. And I had the staff looking at it, working on it, and I think there were some staff members who weren't intrigued by my idea, and so when the late trading/market timing scandal kicked in, then I had to focus on other things.

The difficulty is, the opportunity is, to certainly speed up the routine applications, but you get novel applications that you're going to have to step back and take some time and it's something new and different, and you want to make sure you understand all of the ramifications of it. With novel stuff, you're going to have to take it to the Commission, and they're going to have to agree to grant the exemption. With the routine things the

Commission gives the staff delegated authority to issue those exemptions, so I think they've speeded the processing up today, probably still not as fast as it could be, but they're doing a better job than I did.

WT: Was that one of the things of that Chairman Donaldson would have been focusing on as far as his managerial approach is concerned? I've heard a little bit about this here and there.

PR: I don't recall that being a big deal on his radar. What I remember with Chairman Donaldson was action plans. It was, okay, we've got a late trading/market timing scandal, what's our action plan. Give me the layout of the things that we're going to do to attack this problem, address the problem, and I want it done. Give me a timetable. And he was definitely action oriented. But again, I think had we not had a late trading/market timing scandal, speeding up the exemptive applications probably would have been something we would have focused on, but I think it was more the events got in the way.

WT: So moving more towards the scandals now. Let's talk about just the general area of enforcement, but also inspection and examination. Going back to Arthur Levitt, it's my understanding that one of his preferred strategies was to do message cases, to pick an area that would have an effect on the law or to clarify the law and to do cases in that area. Was that your experience?

PR: Yes. That's probably right. Again, in IM our role was more, if there was an enforcement case in our area, in the asset management area, what was our view, was this a case that should be brought, does it make sense, appropriate enforcement case, and for me it was always, I didn't think we should be making up law in enforcement cases. The question was, was the law clear and is this something that folks should have known better what they were doing was wrong and yes, let's come after them. And a lot of the cases did send messages to folks in the industry that this is not something that's going to be tolerated.

I think, and this may just be my own bias, but I'm just trying to think, I can't recall any cases the whole time I was there where I felt like they were inappropriate. Subsequently, I've seen cases where I scratch my head and say, "Well, was the SEC really clear that this was a problem, was there guidance, was it clear that this was a violation of the rule?" I think while there were message cases I can't recall any offhand where I just thought that there was not a strong basis for the cases.

WT: Okay. One of the things that Barry Barbash mentioned is that he regretted the creation of OC because, even though the Division had a good relationship with OC, there was still a certain distance between the people who were on the ground and what was going on and the Division. What was your experience of working with OC?

PR: Yes, so I came in, essentially OC was still pretty young, and Lori Richards was the first head of OC and Lori and I had a great relationship. I think she was a great director, a good person to head up and start the group and get it off the ground. I do agree with Barry to the extent that there was something lost because with the exam staff and the IM staff together. The exam staff would go out and see things it was as though there was almost the instant communication to the IM folks which would translate into your rulemaking and policy calls that you would have to make in investment management.

Now, that being said, I can't ever recall where I picked up the phone to Lori and said, "Lori, we're working on this rulemaking. I need to understand what the industry is doing in this area; can you send some folks out on an exam and gather information on this so it can inform our rulemaking?" And I don't ever recall Lori saying, "No, I can't do that." Now the problem, again, is I think some communication was lost. Information flow got lost because of the separation.

But I never felt like I had a hand behind my back except when I had to take the blame for what could be perceived as an OC failing. Again, I'm going back to the late trading/market timing thing where that issue gets surfaced because somebody whistle blows to Eliot Spitzer, and that's something that our exam staff did not pick up in exams, and then having to be one of the people that has to testify on Capitol Hill as to why it got missed, and why didn't you guys catch this.

WT: With the existence of OC, did the IM division have much contact with the regional offices? Was there occasion for that?

PR: Yes, we had periodic get-togethers. At least once a year we'd get together with the Washington office – all the regional offices. It was usually a whole week where the IM, key IM folks, we'd sit down with all the OC folks, including the regional offices, go over priorities, issues, concerns, share perspectives on what ought to be focused on in the exam program. They'd share perspectives on examining for compliance with the rules, and so they would be able to come to us and say we're seeing this. We're looking at this rule and looking at folk's compliance, here's something that folks are missing, or, here's something that's problematic in the rule that doesn't seem to make sense. You guys ought to do something about that.

So, there was that interchange and there were mechanisms set up to share information but probably, again going back to Barry's point, there probably was something lost in separating the two. Now, on the other hand I think Lori was able to professionalize the exam staff in a way that hadn't existed before, because she was able to put in training, focused training, develop expertise in areas, and formalize the exam program in a way that it hadn't been structured or formalized before. So, there are pros and cons, but I never felt as though it was a big disadvantage. As I said, in some respects it worked well, and I think from an exam-staff morale, again professionalizing the group, I think it added some real benefits.

WT: Most of the action, the scandals in 2003 happens with the enforcement staff, of course, but tell me about this from the experience of the scandals from the perspective of the Division.

PR: Yes. Again, I think that you see the late trading and market timing issue come to light by Eliot Spitzer, and then first you're saying well, maybe this is just an isolated event. But then as things gear up and ramp up, and then the exam staff and Enforcement starts going around and looking across the industry, and you see that it's too many people in the industry engaging in late trading, market timing, basically taking advantage of investors in their own funds, in some cases installing systems to facilitate the late trading and market timing, I mean just outrageous.

So OC and Enforcement then get focused on ferreting it all out, and you see a whole series of fines and settlements and enforcement actions by the SEC and Eliot Spitzer. And then from the standpoint in IM, again it becomes a question of what do we do? What do we do to put things in place so that this doesn't happen again?

That's where you get into Donaldson saying I want an action plan. There was a lot of Congressional interest in what's going on and the problems and so it's Steve Cutler, the head of Enforcement, myself and I think Lori may have been in some of the hearings, but going over to Capitol Hill and getting beat up about why didn't you do this, and Eliot Spitzer taking shots at the SEC, just trying to answer congressional questions. For me, I viewed my piece of it as what are we going to do to fix the problem so that it doesn't happen again.

WT: Did it look at any point like there was going to be a legislative response?

PR: Yes. It was a financial crisis for the mutual fund industry. It was like we were looking at potentially a Dodd-Frank for the mutual fund industry. There were all kinds of legislative proposals, and I think I said it earlier, never let a good scandal go to waste. So then you had folks who had their laundry list of things they wanted to do to the mutual fund industry all of a sudden coming out of the woodwork with things they wanted in legislation. And a lot of it had nothing to do with the scandal. It was just things that they wanted to somehow get in some legislation to impact the mutual fund industry.

Again, I think that's why Chairman Donaldson was so focused on we've got to have a strong response to this scandal, because otherwise we're going to end up with legislation that doesn't make a lot of sense. So we put together an action plan, and it had a number of different components to it, and we took ideas and things that were in the works, that go back to Chairman Pitt.

I think one of the great things that Harvey Pitt initiated that I don't think he has ever gotten appropriate credit for was the chief compliance officer requirement for funds and advisers, and the requirement that funds and advisers have comprehensive compliance policies and procedures, which, by the way, has gotten copied in other parts of the regulatory regime. Because at that point there was no requirement, believe it or not, that you have someone responsible for compliance, or that you have policies and procedures reasonably designed to comply with the federal securities laws.

And so I think Harvey was looking for ways to strengthen the framework, and we proposed it under Harvey's regime, and we adopted it under Donaldson's regime as part of the action plan in terms of dealing with these late trading/market timing scandals. So we used that, and also as we discussed earlier the fund governance issues.

WT: Let me ask for a bit of clarification on the chief compliance officer role. The understanding that I managed to cobble together of this is that sometime in the early nineties, the ICI had put forward a proposal along these lines, but that it asked for protection against liability and that ultimately, in the wake of the scandals, they just didn't get that. Nobody's ever going to get that.

PR: Yes, so let me give you a little bit of background on this. Chairman Pitt may or may not recall this, but he wanted to take action to really strengthen the whole mutual fund regulatory framework, so he calls me into his office and tells me that. And then he says, "I want to do a self-regulatory organization for the mutual fund industry like FINRA is for the broker/dealer industry." I said, "Well, Mister Chairman I'll go look at that, but offhand I don't think we have the authority to create a self-regulatory organization for the mutual fund industry." He said, "Oh, we can do it, we can do it."

Harvey's one of the great federal securities lawyers of all time. He had been General Counsel to the Commission, so I wasn't going to sit right there and say no we couldn't do it. I said, "Well, let me go back and look at it." So I went back and looked at it and looked all through the '40 Act, the Exchange Act, couldn't see how we had any authority to do it. I wasn't so bold as to use the exemptive rulemaking to create a self-regulatory organization like we did with increasing the percentage of independent directors.

So I went back and started thinking about what could we do. I concluded we couldn't do a self-regulatory organization, but the ICI had floated a CCO type proposal. I can't remember the context, but yes, they wanted some exemption from liability. So I looked at that and said, "The concept of having somebody responsible and accountable for compliance with the federal securities laws makes a lot of sense, but then, they have to have something to administer and so they administer the policies and procedures that the fund and the advisor have adopted."

I went back to Harvey, I had that concept. I'm trying to think of what else. We looked at maybe having the auditors do more in connection with fund audits, served up some alternatives, and then Harvey said, "Let's go with the CCO. Okay, you're right, don't have the authority to do the self-regulatory organization." So we proposed the CCO Rule, and I think it's – and I can see this from my vantage point now – I think it's one of the greatest regulatory actions the SEC has taken in terms of strengthening the overall framework. Because they had to force everybody to think about how you comply, writing those procedures down, conforming to those procedures, having somebody responsible and accountable for administering those procedures, reporting to the fund boards so they can oversee how the compliance is working.

I think you can't measure the effect because you don't know what would have gone wrong but for those procedures. But I think it's been a good prophylactic for the industry, and I think Chairman Pitt should get credit for doing that, and Chairman Donaldson for carrying it across the goal line.

WT: Another thing that Harvey Pitt was involved with was the proxy vote disclosure, and that was another thing that came in this series of rules, right?

PR: Yes. Harvey just felt, on the heels of the Enrons, the WorldComs and a lot of questions about governance, where were the directors of these public companies? Institutional investors who vote on the directors of these public companies and vote on issues have a lot of influence over public company governance issues. And he felt like one way to get at those concerns was to force institutional investors to actually think about and focus on how you vote your proxies, disclosure process, disclosure procedures, what kind of guidelines do you have in place, and then actually disclose how you voted.

And that that transparency, again, the federal securities laws are all about sunlight is the best disinfectant and disclosure transparency, and that through that you would influence behavior. If there were excessive executive compensation issues and issues like that you could see how large institutional investors, asset managers in the fund area were voting those proxies. If there was something to call out, somebody probably would call it out. Maybe managers would think more carefully if they knew their votes were going to be publicly disclosed – how they would approach proxy voting, how they thought about it.

It was all part of addressing some of the bigger issues that were around at the time, and just the importance of institutional investors in terms of governance of public companies.

WT: Before we get back to fund governance, there were also rules specifically addressed to the late trading and market timing activities as well? Or, what happened there?

PR: Yes, so on that front we adopted rules that forced funds effectively to basically adopt procedures that outlawed that, barred it.

WT: In some cases there was some ambiguity as to whether or not what they were doing was even illegal, per se, or whether it was just against their own stated investment strategies.

PR: Yes, well in some cases, the late trading I think was clear. The law was clear about when you have to price and effect orders. The market timing in my mind was clear, but you had managers in some cases themselves trading, allowing favored clients to arbitrage the funds, and they knew they were benefiting from it at the disadvantage of the remaining shareholders. And so, it's hard to look at a practice like that and say that's okay. At the very least you would have to disclose to your fund shareholders that, hey, we advantage certain shareholders and let them rip the fund off in effect, right. But obviously nobody was going to disclose that. So to say that it wasn't clear –

WT: It was a defense tactic, essentially?

PR: Yes I think so. I don't think anybody looking back on that would conclude that, as I said earlier, I couldn't recall - maybe there were some, but these were certainly not the cases where I thought it was inappropriate to bring those cases. Now I can look at some of the things that in particular Eliot Spitzer extracted in settlements that had nothing to do with late trading and market timing. They were just things that he added on because he wanted to add them on. They had no relation to the actual crime. But in terms of the SEC sanctions and what the SEC's actions were, I think it was all appropriate.

WT: Okay, so now, the governance rules. These were very prominent, very controversial, so tell me about how these came about.

PR: Well again, part of the plan was strengthening the compliance framework, attacking the late trading/market timing issues head on so they wouldn't occur again, and then another component of it was oversight. And again, you had folks asking questions, while all this late trading/market timing was going on where were the directors. Again, could we strengthen the mutual fund governance framework so that directors had more power, more ability to oversee what was going on? So again, that was a component of it, and then increasing the percentage of independent directors up to 75 percent and then, perhaps more importantly, having an independent board chair.

The thinking there was that in most fund groups at the time you had an inside board chair. The inside board chair ran the meeting, dictated the agenda, led the directors by the nose, independent directors. Could we strengthen the framework if you had an independent board chair? Who would control the meeting, control discussions, control what's on the agenda, and that we'd presumably get to more effective oversight through that? Now, that proved to be fairly controversial. You were disrupting a long-standing construct within the mutual fund governance framework, and it was viewed by some as the SEC overstepping its grounds and pushing too far, inter-meddling in the boardroom.

But Chair Donaldson, he felt as though it was time for it and that we should push forward as part of a comprehensive way of heading off problems in the future, strengthening oversight of advisers, overseeing conflicts between the management company and the fund, protecting fund shareholders, and so we proposed it, got a lot of negative comment, and –

WT: Is this the rule where they got all the former chairs to line up behind the rule with a statement or something?

PR: Yes. It was a group of former SEC Chairmen lined up behind the rule, then we had industry leaders writing op eds in the *Wall Street Journal* against it, and to me it was a lesson in how – I think on some level there was an overreaction on the part of folks in the industry. At some point this became an issue of whether Chairman Donaldson was going to stand up to the fund industry. The fund industry made a big issue out of it. Had they not made such a big issue out of it and argued on the merits – because I had in my own mind a sort of compromise, which was a lead independent director, requiring that you could have either an independent board chair or a lead independent director, and with the lead independent director being able to work with the independent directors to help shape the agenda of the board meeting. Now, the lead independent director wouldn't necessarily run the meeting, but you could define the role of a lead independent director in such a way that they would have a lot of influence over what the meeting covers, what the subject matter was, and what the issues were they were going to focus on.

Even though I recognized that running the meeting is a fair amount of power, I thought we could maybe get there, 90 percent of the way there, with a lead independent director. But the industry made such a big deal out of it, and I think they put Chairman Donaldson in a bad position where if he had caved he would have looked weak. And this is just my own take. I don't want to speak for Chair Donaldson, but I think it put him in a position where he just had to stand strong, and he did. Of course we got sued and it got blown up, but again, I think it's another one of those issues where I think history vindicated the actions.

Independent chair is probably the dominant structure now in the industry. And I know from the standpoint of our own mutual funds, I think it works very well. I think it gives our independent directors control, they can demand what they want on the agenda, and we have an independent board chair that runs the meetings, and it can work, and it can work well. So I think that if you look around at the two pieces that got blown up, 75 percent independent director requirement, I think you'll see that that, to me that was the best practice that the ICI came out with, and I think if you look around the industry, predominant funds in the industry have 75 percent independent directors and they have independent board chairs.

WT: There seem to be the two perspectives. The industry was heading there anyway so why do the rule. Well the industry is heading there anyway, so what's the problem?

PR: Right. So again, I just think that from an industry standpoint you can overplay the hand in a way that you back the agency into a corner, and I think this was a circumstance where it did. But I reflect back on all these things and things that the Commission did when I was there. Like the Hedge Fund Initiative, these governance requirements, and the test of time has shown that these things probably were the right thing to do and investors and the industry are better off as a result of it.

WT: So you do have these high profile showdowns in the courts, the Chamber of Commerce case, and you mentioned the hedge fund registration, advisor registration as well. And I understand that they challenged on the basis, a couple of different bases, one where the SEC prevailed concerning the use of the exemptive authority in this way, but then of course notoriously the cost-benefit analysis basis.

PR: Yes, and it was unfortunate. I think when I was there we had economists, didn't have as many as they have today, and now I think it's an area where the SEC has beefed up much more significantly. It's given much more importance, and so I think you take that, you learn from it as an agency and you go on. Maybe this is self-serving, but I think in the final analysis on all those rules we were ultimately right.

I think there were problems in the hedge fund area and they've come to light, and now they're dealing with being pulled into the regulatory framework, they're probably having to contend with a lot more than they would had they not challenged the rule. I think on the governance issues, the debate continues on separation of chair and CEO in the public company area, and I think in most cases, even when I step back and look at our own, how we vote proxies in public companies, our bias is toward separation of chair and CEO unless there's a good reason to have the same person in both roles. Because I think that we view it generally as a best governance practice to have an independent person in that chair position. So, I think we're moving everything toward the right direction, and I think from a standpoint of what's in the best interest of investors in these funds, I think you end up with a better framework.

WT: We've covered quite a lot of territory in your time at the SEC and I want to move towards the time after you left, but is there anything that we missed that you feel we should address?

PR: When I reflect on it, I was fortunate to work with three really good SEC chairmen. I think investors were better off because we had Arthur Levitt, Harvey Pitt, and Bill Donaldson in those jobs.

Levitt was just great with investors. He wanted to be in touch with investors, he did the town halls, he was big on investor education; he was big on strengthening the governance framework and attacking issues like pay-to-play. As I said, Harvey, that CCO rule, very significant. One thing that Harvey, I don't think got enough credit for, and it just get's sloughed over, but Harvey was the chairman during 9/11. I just remember that day in Washington and all the panic, and people crying in my office and people not knowing what to do, and rumors; there's the plane coming for the Pentagon, going into the Pentagon, there's a plane coming to the Capitol, we're right around the block from the Capitol. Somebody was saying there's a bomb at the subway stop near us, just chaos.

And then of course the New York Stock Exchange shuts down, and Harvey Pitt just pulled everybody together, pulled all the heads of the major firms together and got everything up and running. We took emergency actions that people probably don't remember. You've got things like in the Investment Company Act, where you can only renew advisory contracts at an in-person meeting, and 9/11, after that people were afraid to fly anywhere, once the airlines even got up and going. So we issued emergency relief facilitating borrowing, we initiated relief so you could renew contracts without in-person meetings. He just, from a comprehensive standpoint, got everybody together and said, what do we need to do in terms of emergency actions to make sure everything continues to work and function, get the New York Stock Exchange back up and going?

And just the ultimate crisis. We do these desktop exercises, in an emergency, who's got to be at the SEC, if there's something really bad where are we going to go outside DC.

And this was real, this was not a drill, and it was, one, good to see the dedication of the employees at the SEC and that kind of thing. I don't know, a lot of people don't realize this, but 3 World Trade Center came down after the other two buildings came down. That's where all the SEC employees were, and everybody got out, and folks had to work in another location for a long period of time. But Harvey, just in managing that whole process, was cool under fire. I don't think he ever got full credit for that.

And then Donaldson, during the late trading/market timing scandal, we were faced with what could have been a Dodd-Frank for the mutual fund industry there were a lot of bad things in some of the legislative proposals they were kicking around, and because of strong action it never happened.

So, different kinds of tenures, different issues, different environments, different context, but for me it's why I ended up staying that six and a half years as opposed to the two or three that I told my wife; because it was just, for me it was just a great experience, even though at times it was pretty painful.

WT: You hear it bandied about sometimes, it was in this period, that among the Commissioners that it became more divisive, if not political, then more ideological or philosophical. Was that your experience?

PR: Yes, unfortunately. I think under Levitt it was a pretty collegial Commission; all were pretty much on the same page. With Harvey it became a little more contentious. And so the disagreements did, over my tenure, as I got longer in tenure, there were more philosophical differences on things. But I have to say all the Commissioners that were there during my time, I always felt like I got a fair hearing. They didn't always agree with the approach I was taking or the approach that the Chairman was taking, but at least they were willing to listen and they explained why they disagreed and you'd try to talk them out of it.

As a division director you really work for the Chairman and it's your job to carry out the Chairman's wishes and their approach to dealing with issues, so you're pretty much an advocate for the Chairman with the other Commissioners. But I felt like everybody was respectful, and there wasn't always agreement, but I would say under the Levitt regime everybody was pretty much on the same page. As it got longer in my tenure, we were getting into more contentious issues where, depending on your philosophy, you could disagree with approaches.

WT: I suppose in the wake of Enron and the scandals in the mutual funds there was probably a lot more pressure to be active in the Commission. So some of these issues that might have been there before come to a head as the SEC has to take action.

PR: Yes, I think that when you have scandals or issues, that people want a response, and as a regulator at least I always tried to think about not engaging in overkill. Because it could be in the Congress or long-standing folks in the agency waiting for the right time to dust off all the things that they want done, and they use a good crisis or scandal to resurrect all those things. And again, I think this is where the private practice experience came in, that there's a problem, you want to solve it, deal with it, but deal with it in a way that you're not killing the patient on the operating table. You're exacting the cancer, but you don't want to kill the patient with overkill in terms of the rulemaking.

That was my mindset, and I'm sure there were people when I was the director who said, "Well, he wasn't taking it far enough." And then on the other side people who would say, "Well, we probably did more regulation than anybody had done in the shortest period of time during that late trading/market timing scandal, so I'm sure there were people who would say it was overkill."

WT: You had a very long tenure, and of course very active in terms of all the issues that you had to deal with so it's not surprising that you left, but was there anything in particular that prompted you say it was time?

PR: It was as I said. I had taken a pay sacrifice. I had kids that had to go to college, I had to pay for that, and my wife had been good about it, and I told her I'd do this for two or three years and go back to private law practice, and did double the time, and I felt like we had really dealt with the late trading/market timing thing, and so I think it was time to let somebody else step in and for me to honor my commitment to my wife.

WT: I understand completely. Then you came here to Capital Funds Group, is it?

PR: Yes, the American Funds, Capital. So I resigned from the SEC, and I had taken very little vacation in that six and a half years when I was there, so I had something like three or four months' vacation time, so I said I'm going to just take it. It was probably the most relaxed time in my life. So I just took that three or four months and just took off and reflected on what's next.

And then I could have gone back to my old law firm, and I had some other offers from law firms. I had, in private practice, done work for Capital and I knew the folks well and knew the reputation of the firm and, one, I wanted to go to a place where it was focused on doing the right things and meeting the needs of investors and delivering value for investors. I don't know if you saw the sign when you came in, but Capital has been around for eighty-five years, and you don't have a firm that endures that long without doing some right things.

The biggest challenge was I had lived in DC for a very long time, never made it back to Kentucky, and then the question was would I moved to LA, which is where the firm is headquartered, which again, had that other conversation with my wife about how would you like to move to California. And again, she was open to another adventure, so that was eleven years ago.

WT: I was looking at your bio for what you do here, and it looks like there has been a legal role, but you've been actually involved with the fund governance.

PR: Yes. We have forty-plus independent directors. We have essentially eight different mutual fund boards, and we have very smart, very experienced directors and they take their oversight roles seriously, and part of my job is to make sure they get all the information they need to make informed judgments with regard to the funds and everything the rules require them to do. All that fund governance work I did at the SEC I'm having to apply and live with, and when I see it working as it does here and seeing the compliance procedures in the CCO role and responsibilities put on fund directors and see it work, you can step back and feel good about what we did when we were there.

WT: I'd like to just end by asking about some of the more recent developments. Of course, we've had the financial crisis and the series of rulemakings that have followed from that. One of the most prominent has been with the money market funds. Was that something that you had thought about much during your time at the SEC? And what do you think of that protracted series of rulemaking?

PR: I think that if you focus on the environment today, Dodd-Frank created the Financial Stability Oversight Council, which is the SEC and mostly bank regulators, and so it's a dynamic that is there that I didn't have to deal with when I was at the SEC. And so the question is what ultimate influence will that have. You look at the money market fund rules that ultimately came out, and there was disagreement among commissioners about how to do them, how to craft them. But I think it was almost the threat of the FSOC that, well, if you're not going to do something, we'll figure out some way that we can do something as this broader regulatory body which held a gun to the Commission's head.

And the question is what does that mean going down the road in terms of their job to focus on systemic risk. And they first started out saying well, we're going to focus on large asset managers and applying requirements to large asset managers is the way to deal with systemic risk. And we said look, that's the wrong answer. If there are risks in the asset management industry, you need to look at activities and practices that introduce risk to the system, and you're not going to solve that problem by just focusing on a Capital Research or Vanguard or Fidelity, because the rest of the industry, they can engage in those. Just by regulating us you're not going to get at the problem.

And they seem to be listening to that, that you have to focus on activities that may be problematic, and then you need to defer to the primary regulator who regulates the industry, understands the industry, and has the expertise to deal with the issues. So, for me it's more of a worry that the SEC will always have a gun to its head, and again, it's a largely bank regulators who have a different mindset than the SEC.

WT: Seems like it's an echo from that post late trading/market timing scandal period, wherein the SEC was really trying to run – I didn't realize until I got into this series of interviews that money markets were not covered under Dodd-Frank, that the rulemaking was Mary Schapiro trying to take action on that to avoid having that incorporated into this massive legislative process.

PR: Right. Yes, you had the Reserve Fund breaking a buck as a result of holding Lehman commercial paper, which got in trouble over the financial crisis. On one hand you can argue, in the reserve fund situation, ultimately folks may have lost two or three cents on the dollar. You can say maybe that was an isolated situation, but I think the rules that have been put in place have caused people to adjust in the money market fund space, and I think ultimately the industry can live with them.

But again, for me the changing landscape, just where you have basically largely a group of bank regulators who are out there to second-guess what the SEC does, we'll have to see how it plays out, but it could be troubling.

WT: There have been attempts to apply the systematically important financial institutions criteria, SIFI –

PR: Apply the SIFI designation to asset managers. And then, you saw that they designated Met Life as a SIFI and that got challenged, and they're appealing that and we'll see how the process plays out. But, it's a different dynamic and I'm glad I didn't have to deal with it when I was at the SEC.

WT: And the last detail question I have to ask is about this floating NAV proposal that ultimately got at least partially implemented into the 2014 Rules. What are we likely to see when that comes into effect?

PR: Well, I'm not sure what the impact will be. From our own perspective, we did some things well in advance of these rules coming out altogether. We had two different money funds. We had a tax exempt money fund that we converted into a short-term tax-exempt bond fund, it has a floating NAV but you get tax-exempt interest off of that. We had a generalized money market fund that invested in commercial paper, and we basically converted that into a government-only money fund, and under the rules a government-only money fund doesn't have to have a floating NAV.

We're long term money managers. We view the money funds as a safe haven for an investor. If they want to park money on a short-term basis we have a money fund available, but our focus is long-term active management, so we don't specialize in money funds. For us it's an accommodation as opposed to a primary investment strategy. We conform to the rules in a way that worked for us, worked for our investors, and I think you'll have maybe some floating NAV funds out there. A lot of fund groups have done what we've done, they converted their money funds into government funds, so they don't have to float, and then the only thing you have to worry about is are there enough government securities for all the funds.

WT: So it's definitely had its effect, then?

PR: Yes, no question.

WT: Terrific. Well, is there anything in general that you'd like to say to wrap up?

PR: The only thing I would say is my experience at the SEC has been one of the highlights of my career in the asset management area. Worked with great people, the great folks of the staff, great commissioners. Three great individuals as SEC chairs, learned a lot from them, learned a lot from my colleagues at the SEC, and it was a great experience.

WT: All right, well thank you very much. We appreciate your time.

PR: All right, thank you Will.

[End of Interview]