

CONNECTLIVE COMMUNICATIONS, INC.

SEC HISTORICAL SOCIETY'S 4TH ANNUAL MEETING  
WITH  
ELIOT SPITZER AND STEPHEN CUTLER

Wednesday, June 4, 2003

## PROCEEDINGS

**MR. RUDER:** My name is David Ruder. I am the Chairman of the Securities and Exchange Commission's Historical Society. Welcome to members of the Society. We're very pleased to have you here.

Before we begin, I'd like to ask us to join in a moment of silence for Alan Levenson, one of the great securities lawyers and great members of the Securities and Exchange Commission staff.

[Moment of silence.]

**MR. RUDER:** Thank you.

The growth of the Historical Society has been, in my opinion, wonderful during the last year. Our Virtual Museum, the ability to share the history of the Society and Wall Street and the financial community has been wonderful. Our programs, including roundtables and oral histories, have been just very progressive, and my thanks go to Ted Levine, our President, and to Carla Rosati, our Executive Director, who has done such a wonderful job. And thanks--yes, thanks. How about--

[Applause.]

**MR. RUDER:** And I want to thank our more than 500 current members and the many institutions that have joined to support us in our work.

To give you the commercial, we need money, and if you give it to us, our programs will prosper. So thank you for that.

It's now my pleasure to introduce to you William Donaldson, the Chairman of the Securities and Exchange Commission, and to thank him for appearing here.

Bill has had a distinguished career which I won't detail in any detail, but he was certainly a wonderful government official, a wonderful Wall Street person in his firm, but, most important to me as a professor, he was the Dean of the Yale School of Management and a professor there. So it's with great pleasure that I introduce Professor William Donaldson.

[Applause.]

**MR. DONALDSON:** Thank you, Dave. I was masquerading as a professor.

You know, it's a great pleasure for me and for all of us on active duty to welcome you all back to the Commission. I understand we're celebrating the 4th Annual Meeting, and we are commemorating the 69th anniversary of the founding of the SEC. And although today's markets are really quite different from those that existed 69 years ago, I think the regulatory principles that prevailed back then are still with us. They're constant. The markets change, but the principles are constant: the essence of full disclosure, just and equitable principles of trade, markets that are fair and open and liquid and vigorous and fair, and evenhanded law enforcement.

We really do appreciate all that the Society has done and is doing to preserve some of the history and background so that it can be passed on to people who are serving today. I've been running around the country talking in many fora about the DNA, if you will, of a well-run corporation, the responsibility of the Board of Directors to infuse the corporation with a philosophy and a DNA that goes on and on and on no matter who's there. And I think this organization reflects that in terms of the deep-seated history and motivation of the people who have served here.

It's interesting to note that back in the 1930s it was really a joint action between state and federal authorities that brought the first major case. I say in sotto voce, that major case in 1938 resulted in the former chief executive of the New York Stock Exchange going to jail.

[Laughter.]

**MR. DONALDSON:** But that notwithstanding, it's interesting to see that once again we've had a cooperation between state and federal authorities.

I want to particularly welcome General Spitzer for being with us today. We're really honored.

The basic thing that I would like to do, in addition to, I hope, sticking around for the cake that I know is coming up--but I hope you'll save a piece of cake for me because I do have to go don a tuxedo and go to some affair tonight. But I really want to recognize four SEC staff members who have been honored in 2002 with a Distinguished Service Award. And I hope that they are here. I suspect they may be in the front row. Regina A. Baker from the Division of

[Applause.]

**MR. DONALDSON:** Meredith Mitchell of the Office of the General Counsel. Meredith, where are you? She's hiding in the back of the room. Okay.

**MR. :** Meredith is ill. She's not here today.

**MR. DONALDSON:** Okay. Ida Mae Wilkins(ph) of the Office of the Secretary. Ida Mae?

[Applause.]

**MR. DONALDSON:** And Robert Burstin(ph) from our Midwest Regional Office, who cannot be with us tonight.

Ladies, congratulations.

[Applause.]

**MR. DONALDSON:** Thanks very much, Dave.

**MR. RUDER:** Thank you, Bill. We understand that you have another meeting and that you're going to be leaving, so we will save some cake for you.

The Securities Committee of the Federal Bar Association has been a staunch supporter of both the Society and the SEC since its--for many years. And for many years, the Securities Committee has sponsored the Manuel F. Cohen Award given to the SEC staff member who best epitomizes the qualities of Chairman Cohen.

Here to recognize the 2002 award recipient is Tom Reisenberg(ph), Chair of the Securities Committee. Tom?

[Applause.]

**MR. REISENBERG:** Thanks, Dave.

As Dave has noted, the FBA has been giving the Manny Cohen Award since 1979, which is two years after former Chairman Cohen's death in 1977. It's given to a staff member who's been with the Commission for less than four years.

For those of you who don't know much about Manny Cohen, he was the SEC's Chairman from 1964 through 1969. And in addition to being a great Chairman, he's really quite unique among the Chairmen who've served here at the SEC because he rose to that position after more than 20 years as a Commission staff member, which, of course, explains also why he was a great Chairman.

[Laughter.]

**MR. REISENBERG:** It should also be noted that after he left the SEC, he chaired the Independent Commission on Auditors' Responsibility, which was set up by the American Institute of Certified Public Accountants and which became known as the Cohen Commission.

It is, therefore, really quite fitting that our recipient of the award, of the Manny Cohen Award this year, is Jeffrey Minton(ph), who is with the Division of Corporation Finance. He spent much of his time and his life last year as a member of the team in the CorpFin responsible for drafting the Commission's rules and orders following the indictment and the collapse of the Arthur Andersen accounting firm. And the efforts of Mr. Minton, who is a special counsel in CorpFin, were really quite crucial to preventing disruptions in the capital markets that could have resulted from the demise of one of the Big Five firms.

As an aside, I should just note that I'm an associate general counsel of one of the remaining Big Four firms, and it's my fervent hope that we never have to cite that rule for any precedent ever again, that it's going to be a long forgotten rule.

Finally, Mr. Minton has had a major role in drafting the Commission's rules on accelerated filings of periodic reports, and he really has carried forward the Commission's long tradition of being a dedicated, smart, talented, and fair public servant, a tradition established by Manny Cohen many years ago.

Congratulations, Jeffrey.

[Applause.]

**MR. LEVINE:** Thank you, Tom, and I congratulate all the Distinguished Service Award winners and the other honorees.

My name is Ted Levine, and I am President of the Historical Society. And I would also like to welcome you to the Annual Meeting of the Society on behalf of its Board of Trustees and the two counsel which serve to advise the Board. There's an Advisory Council of distinguished folks, and there is also a Commissioner's Council. The latter is comprised of former Chairmen

Society's efforts. And we're very pleased by the large turnout this evening. I want to take credit that it's because of me, but I don't think so.

I am particularly proud of the efforts of the Society over the past year. From our creation just four years ago, we're a robust, active organization, and as Dave indicated, we're particularly proud of the Virtual Museum, which is a unique way to preserve and share the history of the Commission and the security markets. And I urge everyone, if you haven't looked at it, to go to the website and take a look at the Virtual Museum. It's a collection of historical papers, photos, oral histories, and links to other sites, all of which are designed to bring to you on your screen the history of the Commission and security markets.

During the next year, among other things, we're going to be launching fireside chats, a series of live interactive interviews broadcast on our website on historical investor education topics, another way of trying to bring the historical SEC and security markets views to folks out in the United States.

But what we're here tonight for, and it is my pleasure, is to introduce our principal speakers. Although they need no introduction, I should do it anyway. I'm not going to give the backgrounds of all of them, but I will introduce them by name just in case they get confused.

[Laughter.]

**MR.** : You're being cruel to Steve.

**MR. LEVINE:** We have with us and we're very pleased to have with us the Honorable Eliot Spitzer, who's the Attorney General of the State of New York, and with him is Steve Cutler, Director of the Commission's Division of Enforcement. I welcome both of you and thank you for agreeing to participate at the Annual Meeting.

Eliot and Steve will address several important issues concerning regulation and enforcement, and the format is going to be one where there are some opening statements by each, and then a series of questions that I will pose and interaction. So it will not be a speech but, rather, a dialogue, we hope. And I think we're ready to begin, so maybe--have you chosen who will go first?

**MR.** : No.

**MR. LEVINE:** All right. I'll pick Steve.

[Laughter.]

**MR. LEVINE:** I'll just say one thing. It's an incredible pleasure for me to be on this side of the table, having spent almost a year on the other side of the table with both Steve and Eliot. It's a lot more comforting to be here than the other side.

[Laughter.]

**MR.** : Just wait.

**MR. LEVINE:** So, Steve?

**MR. CUTLER:** Thank you, Ted. It's nice to be here. I'm particularly happy to share the stage or podium with Eliot. He's one of the hardest-working, smartest people I think you'll see anywhere in government. He's a great friend of the investing public, and I'm proud to say he's a good friend of mine.

There's been some speculation over the last several months about my relationship with Eliot, and specifically--

[Laughter.]

**MR. CUTLER:** --whether we consider ourselves to be partners or adversaries. But let me say that there has never been any competitive tension or one-upmanship between us. And I don't believe there will be in the future. I do, however, want to announce today my candidacy for the governorship of New York.

[Laughter.]

**MR. CUTLER:** In 2006.

**MR.** : I'll just call you Andrew.

**MR. CUTLER:** I thought it was only appropriate in connection with a case about e-mails to tell some of the story using some e-mails that I've dug up from my archives. A lot of people are curious about how the analyst investigation started. The truth is that this is something that was kicked around at the highest levels of this agency sometime ago. Date, November 16, 2000, from Arthur Levitt to Dick Walker and Steve Cutler.

"Dear Steve and Dick: I grow increasingly concerned about the improper

like to focus on this, but I would also like to keep it under the radar. Why don't you give it to the states to look at?"

[Laughter.]

**MR. CUTLER:** "They don't seem to be so busy these days. Could you give Eliot Spitzer a call and ask him to look into this matter quietly? He is a master of working unobtrusively behind the scenes."

[Laughter.]

**MR. CUTLER:** Indeed, the New York Attorney General's Office worked tirelessly to investigate the analyst case, so much, in fact, that I started getting some e-mails from some of Eliot's constituents. Date, September 15, 2002, from Walter Krupnick(ph), Saratoga Springs, New York.

"Dear Mr. Cutler: I have information concerning illegal bid rigging on a New York Thruway construction deal."

[Laughter.]

**MR. CUTLER:** "Do you have anyone that could look into this? I called the New York Attorney General's Office, but they hung up when I told them it didn't have to do with something called the '34 Act."

[Laughter.]

**MR. CUTLER:** Eliot and I have stayed in touch on a daily basis. In fact, we chat about the issues of the day, pending legislation, whatever. I recently sent him a gift, as I detail in this e-mail. Date, April 20, 2002, from me to Eliot.

"Dear Eliot: How about that legislation in Congress that would preempt regulation of the securities laws by the states? I'm sending you for no particular reason a copy of the Federalist Papers."

[Laughter.]

**MR. CUTLER:** This was supposed to be a serious thing, wasn't it?

**MR. LEVINE:** No, no.

[Laughter.]

**MR. LEVINE:** But, remember, you went first. That gives Eliot a chance to go second.

**MR. CUTLER:** Yeah. You know, I never cease to be amazed by Eliot's tenacity and the range of interests that he has. Eliot's been nice enough to cc me on a number of his e-mails to others in this regard, and I thought I'd share a few with you. Date, May 28, 2003, from Eliot to the FCC.

"Dear Chairman Powell: I believe the FCC's sweeping overhaul of bandwidth ownership is not being handled properly. Our interpretation of the Stamp Act of 1785"--

[Laughter.]

**MR. CUTLER:** --"allows us to tax all products that flow through New York, which obviously includes bandwidth. Please call for my ideas.

"P.S.: Please tell your Dad that some staff in the AG's Office is trying to track down weapons of mass destruction in Baghdad."

[Laughter.]

**MR. CUTLER:** Date, May 29, 2003, from Eliot to the Vatican.

[Laughter.]

**MR. CUTLER:** I don't know if I can do this one.

**MR. :** You may harm your gubernatorial run.

**MR. CUTLER:** "Dear Pontiff: I have"--I'm sorry. "I have some comments on recent papal edicts. While you are and should be the primary regulator of Catholicism, I believe you may be asleep at the switch on this whole business of transubstantiation."

[Laughter.]

**MR. CUTLER:** "As I read the Stamp Act of 1785, I have the authority to tax and regulate all items passing through New York, which we believe includes Catholicism."

[Laughter.]

**MR. CUTLER:** "Please call me for ideas."

And then, finally, June 3, just this week, from Eliot to Heaven.

"Dear God: It's my understanding that you are everywhere, including, apparently, the State of New York."

**MR. CUTLER:** "As I read the Stamp Act of 1785, you are subject to regulation and taxation by the State of New York. While you are and should be the primary regulator of humanity, I have some ideas I'd like to share with you."

[Laughter.]

**MR. CUTLER:** All right. It's your turn.

[Laughter/applause.]

**MR. SPITZER:** Well, I can safely tell you, this is the first time Steve has been unfair to me. And the reason--

[Laughter.]

**MR. SPITZER:** The reason is we do--we do chat with great regularity, and we were chatting the other day, and Ted had been sending us with increasing frequency e-mails about this evening's event, trying to spark some sign of preparation. And so I called Steve the other day, and I said, "I got Ted's e-mail. It looks fine with me." I hadn't read it yet. But I said, "It looks fine with me. We'll figure this out when we get there." And Steve said, "Yeah, yeah, yeah, I'm not going to prepare either."

[Laughter.]

**MR. SPITZER:** I remember in law school there were students like that.

[Laughter.]

**MR. SPITZER:** You went to Yale, right? That's the difference between Yale and Harvard. They work, we don't.

Anyway, let me say this: I actually--I spent two minutes preparing on the way in from the airport.

**MR. CUTLER:** That's more than you ever did during the 12 months we worked together.

**MR. SPITZER:** Here are some true statements.

Ted called in the middle of our negotiations last year, and it was at one of those probably many points where they felt we were being intensely unfair, and we felt they were being intensely unreasonable. And he said, "I have a personal request. Would you and Steve participate in the SEC Historical Society event down in--next June?" And it was impossible to say no.

But what I really said to myself was, "We'll get something back in return."

[Laughter.]

**MR. SPITZER:** Everything is a negotiation. So I said yes immediately. Ted, I don't think we ever got anything back.

**MR. :** Oh, my God.

**MR. SPITZER:** And so you still owe us something, and we're going to--we're going to approach you for it.

Since Steve raised the e-mail issue, I do want to repeat for you what in the entire 18 months or so that this has been going on--and it actually was private for some period of time before--before we acceded to your request that we publicize it, Steve.

**MR. CUTLER:** Oh, I see.

[Laughter.]

**MR. SPITZER:** And reveal those e-mails about the 92nd Street (?). But that was--my favorite moment was when I was invited to give a dinner talk at the Institutional Investor Awards dinner. This was September or October of last year, and it was absolutely mystifying to me why of all the people in the world, when they are handing out their first place awards for analytical work in various sectors, they would invite me to be the dinner speaker. In fact, it was so odd that I believed it was a hoax.

And so I called around to various friends to say, "Did you send this hoping I would show up and thoroughly embarrass myself?"

Well, it turned out it actually was a genuine invitation, and, parenthetically, it's the only time--I mentioned to my wife ahead of time where I was going to be that evening, talking to a dinner audience. And she said, "Are you taking security with you?" It's the only time she's ever been concerned about my actually surviving the evening.

So I got there and I had actually, unlike tonight, prepared some comments, and we had crunched the numbers to prove that really the analytical work product wasn't so hot. They were

in the 40th percentile. But before I could actually deliver this very turgid number-crunching-based speech, I looked out at the audience, and I said, "It is nice to put faces to the e-mails."

[Laughter.]

**MR. SPITZER:** And there was a momentary spasm of agony, after which everybody literally looked right down at their plates. I didn't--I did not see another pair of eyes the entire evening--which may be a comfortable way to deliver a speech, actually, but such is what happened that night.

I do want to make two substantive points, unlike Steve who only made one.

[Laughter.]

**MR. SPITZER:** But it registered. And I will be reasonably brief because I think it will be more interesting to try to dance around Ted's questions or your questions. But here are the points.

First, when it comes to the larger decline in ethical behavior at the board level that we have seen in the private sector, I think we make a serious mistake when we think about the problem and confine it to the private sector. What we have seen is endemic through every sector in our society. It is in our government, both elective and appointive. It is in our not-for-profit sector. It is in our religious institutions. It is in our media. It is in the private sector.

And when we step back and try to critique and figure out what went wrong, therefore, I think we are deluding ourselves a little bit if we think that it is exclusively a matter of greed and money, because money is not the sole motivating factor in several of those other sectors. And, therefore, I think we have a more complicated textured problem to deal with than simply analysts could make more money by putting a buy on a stock that was being underwritten by the company. That is, you know, a critique that fit that one little paradigm, but it does not answer the much more difficult question about what happened in all of these other sectors.

The only thoughtful answer that I have seen to this problem was crafted by somebody who I think is one of the most brilliant elected officials we ever had, and he died, unfortunately, not long ago, and that's Pat Moynihan.

Pat Moynihan, in a very different context, wrote about defining deviancy down. When he was talking about criminal justice and street crime, he said that over a period of years we lost the will to prosecute and pursue small violations. Whether it was graffiti, pickpocketing, whatever it may have been, we lost the will to pursue that.

And what happened over time was that there was a dissipation in standards, a dissipation in our expectation with respect to the behavior that people had to live up to. And that permeated our society and crime exploded.

Now, then from that sort of intellectual nugget, what evolved was the broken window school of prosecution, which went after small crimes to re-establish our basic moral principles. And over time we have beaten back the issue of street crime to a great extent. We have some problems here and there, certainly, but we have made enormous progress.

I think the same thing happened with respect to our governing structures. Small violations that may have been akin to a barnacle on the bottom of a boat, that did not appear to be material, one-off balance sheet partnership, one small indiscretion, began to grow during a decade when things were so good that we lost the will to challenge small violations. And over time it led to a larger dissipation.

And as a result, we woke up a year or two ago when things crashed for a number of other reasons, and because a rising tide washes away a lot of sins, we suddenly had to see what wreckage was there. And it was a consequence of a growing complacency that calls out in many sectors for all of us--and I think that's why--and I hate to pontificate, to use a word derivative of one you just used. But I think all of us who are in positions where we have fiduciary duties have to re-examine how we fulfill them. Because I think it is everybody in every position of some power or governing responsibility who has to examine what happened and why. And I think we all have to sort of pull ourselves up by the bootstraps and think of this in a much larger context.

The second issue I want to address very quickly is: Do they get it? And this emerged, I suppose, very--with some significance on the day we announced the global settlement, and there were some responses from CEOs in various companies that challenged people's judgment about do the CEOs in the investment banking community get it.

But the "they" that I'm referring to right now is not the "they" in the investment banking community. I think they do get it. I really do. And I'm--you have to be an optimist in the business that we're in, and maybe this is a self-delusion and five years from now we'll wake up and say, no, they simply didn't. But I do think they get it, and not necessarily because of the new rules or the new regs, but for a different reason that maybe I'll touch on.

But the "they" that I'm asking about now is Congress. And I think there's a large question about whether Congress, which ultimately enacts the laws that will define the boundaries of financial regulation, whether they have properly understood that after a spasm of deregulation that maybe in certain instances was important and right and necessary, nonetheless, there are problems that have emerged and tensions that have emerged that have not been properly mediated.

And I would give you two examples of ongoing legislative potential enactments that I think suggest to me that perhaps Congress needs to step back and re-examine its role. And those two are: one, the definition of "disinterested party" in the bankruptcy statute in terms of who can give advice in the bankruptcy context, where their--what passed the House would permit the very investment banks that did the underwriting to step back in and garner fees from the very wreckage that they helped create, a change in a statute that for 70 years had served us very well, an issue that passed the House with hardly an inquiry of relevant parties, no inquiry as far as I know to the SEC, and recently when we were up at the Senate Banking Committee, Chairman Donaldson, I was thrilled to see, opposed this move. But the House passed it without that inquiry.

The second measure that they're about to enact or the House passed it--it is before the Senate, I understand--relates to industrial banks where there is about to be created an entire--a possibility for an entire secondary banking system outside the regulatory structure of the Fed. Chairman Greenspan has opposed this, and yet in dark of night, basically, this measure as well has passed.

And so what we are still seeing on the Hill is a willingness to break down those rules and divides and barriers that were, to a great extent, important protectors of investors, depositors, and had some meaning, even though it was very easy for a number of years to malign them and say deregulation is the cure for all.

And I think if you look at the sectors where we have gone through this deregulatory spasm, we now should know there is, in fact, no cure--all called deregulation. So I think that we need to ask do they get it, not just of the investment banks but of our congressional leadership that, through its behavior, may not be serving us terribly well.

Now, I know Ted has a lot of questions, as do you, I hope. Let me just make two very quick final observations.

One is what will ultimately drive this. It is not laws. It is not even necessarily--it is enforcement actions, but in a derivative sort of way. Shame is the greatest public motivator. And I think what has changed out there in the past two years is that individuals who were inviolate, individuals who believed they were beyond reproach, so-called masters of the universe, have now found out that that is a very transitory phase.

And I will leave you with two really final brief thoughts. One is the advice that I have given to many folks, which is, if you want to learn the lesson the real way, get "Bonfire of the Vanities" and read it. It is that book more than anything else that shows you how somebody who--Sherman McCoy was the master of the universe. One wrong turn off the Deegan(ph) into the South Bronx, game over. And suddenly your life changes. And I grew up in the Bronx. I can say this. So he did not understand where--what the boundaries were of his power.

And the second thought is that--it was emblazoned on a T-shirt that a friend of mine gave to me that captured up--captured much of this, and it said across the front, "Hubris Is Terminal." And that I think is what befell not only the investment banking sector but also other sectors where we now have seen this governing crisis, where people did feel they were beyond reproach, and hopefully the renewed attention to this will resuscitate feelings of shame, to a lesser extent an obligation that is captured by our notions of fiduciary duty, and population will begin to live up to the mandate that we have invested in them.

If that happens, this entire spasm will have been enormously worthwhile and productive, and at the end of the day will have served investors and the public at large very,

Anyway, thank you for the invitation to be here, Ted. But as I said, we still will get back from you something for our being here.

[Applause.]

**MR. LEVINE:** Thank you, Eliot and Steve.

I'm moved to maybe end it right now because I don't think we can top that, but I think we'll go on.

You know, the context of what they were supposed to speak to, both Steve and Eliot, was--

[Laughter.]

**MR. LEVINE:** --does the integrated broker-dealer model still work? And what's the appropriate regulatory response?

**MR. SPITZER:** Who cares?

[Laughter.]

**MR. LEVINE:** Somehow I didn't get there, but--and I think this is going to be a moment that we'll remember for a long time.

However, there are several questions that I would like to raise and--

**MR. CUTLER:** Before you do that?

**MR. LEVINE:** Yes?

**MR. CUTLER:** Because I love interrupting you. Actually, I want to address something Eliot talked about, which is sort of the Moynihan notion that the will was lost, because I actually see it a little bit differently. And I just--I thought I would say how I see it.

**MR. LEVINE:** Good.

**MR. CUTLER:** Which is not that the will was lost, but maybe the vision was lost or the eyesight was lost. I don't know--I'm reaching for the right metaphor. But the way I really picture this now in my own mind, in trying to sort of understand the cataclysm that we've been through, both on Wall Street and in the markets generally, is that, you know, essentially, you know, we had a--we had a bright line. Maybe it wasn't so bright, but we had a legal line and with--you know, if you go back 10, 15, 20 years, with conduct that was on the right side of it. And slowly and in creeping fashion, and maybe one by one and maybe taking comfort in what someone else was doing and then what maybe everyone was doing, people seemed to move closer and closer and closer to that legal line and then crossed it. And we don't even have to call it a legal line. We can call it an ethical line.

And one day--and you said, you know, we may wake up five years from now and decide that firms didn't get it, CEOs didn't get it. I think what may have happened here is that, you know, as this sort of creeping was going on, everyone was creeping along with those who were involved in the activities. That is, it became harder in the same way that I think, you know, when you're living every day with a person, you don't see that they're beginning to lose hair or getting gray hair or getting older.

**MR. SPITZER:** My wife does.

**MR. CUTLER:** Yeah.

[Laughter.]

**MR. CUTLER:** But, you know, if you haven't seen them for three, four, five years, gee, you notice they have changed a lot.

And I think one of the lessons of the last--the last five years or so is that we don't want to wake up five years from now and that we have to find a way of, you'll excuse the expression, taking a fresh look on a more regular basis and figuring out--you know, trying to step back and not saying to ourselves and industry people not saying to themselves this is the way everyone's doing it. Right? Because that doesn't make it right.

One of the firms--one of the senior managers of one of the firms that we sued has actually told me--I assume he's told you the same thing, Eliot--that, you know, they used to consider themselves better than others. And now when they look back on it, they think of themselves as having been the tallest among Pygmies. And we've got to figure out whether, you know, we're Pygmies or not. And that's a hard thing to do.

**MR. SPITZER:** I agree 100 percent with what you've just said, and I think it actually captures a different way of saying the notion of defining deviancy down. It is that notion of declining standards over time, stretching the envelope, and waiting until it snaps, and it snaps not

completely dispassionate look. And I think one of the phenomenons that we observed was that those who came in early on to discuss with us what we diagnosed to them as being a fundamental problem didn't disagree with our factual recitation, but they responded just as Steve just said, "Everybody's doing it," as though that somehow became a defense. And they said not only is everybody doing it, everybody knows everybody's doing it.

Therefore, how do you--and it was the enforcement action was wrong from their perspective because it lacked horizontal equity to single them out, which is, as I perhaps too pointedly reminded them, wasn't a defense when we were going after bank robbers and, therefore, wasn't going to be a defense in a different context with certainly greater subtlety, but, nonetheless, the lack of horizontal equity doesn't defend against improper activity.

But I agree with you. It was this overarching decline and dissipation that we have to worry about, which makes me wonder--and one of the sort of takeaway thoughts that I've had that has been very troubling to me is that because of this internalization of the wrong values over time, self-regulation didn't necessarily work. And the question I have is, with all the compliance officers out there, compliance personnel who outnumber our combined staffs by several multiples, why wasn't there any greater internal pushback against this behavior? And I think it's because when you're inside you can't see it.

So then people say, well, what's the response, what is the alternative to self-regulation? I throw up my hands and say, "I don't know," because I'm not sure there is one that can really fill that enormous void where we have to presume on the ethics and propriety of those we're after.

**MR. CUTLER:** I guess from my perspective, I'm not ready to throw out self-regulation yet.

**MR. SPITZER:** I'm not throwing it out. But I'm saying we have to somehow reconstruct it so it works.

**MR. CUTLER:** Well, then there are lots of benefits to it, of course, and, you know, I think when it was conceived back--Harvey, you'll tell me when. Was it in the '30s? It was in '34, really.

**MR. :** '37.

**MR. CUTLER:** '37, '38?

**MR. :** Yeah.

**MR. SPITZER:** I thought it was in '21 in the Martin Act.

[Laughter.]

**MR. CUTLER:** Everything is--

**MR. SPITZER:** Not the Stamp Act but the Martin Act.

**MR. CUTLER:** You know, the rationale was, you know, let's put people in place that understand what's a very complicated set of processes better than someone sitting in Washington or even someone sitting in Albany or Manhattan would. And, you know, I think that has great merit, but I think you've got to balance that with this phenomenon, that it is--you know, the closer you are to a problem--and we've all read about it in law school, right? The administrative process itself is subject to that. You know, the more susceptible you are to being drawn into something that isn't right and that you can't see isn't right.

And I think that's the challenge of self-regulation, is to--

**MR. LEVINE:** Could I--

**MR. CUTLER:** Yeah, go ahead.

**MR. LEVINE:** I worry about--

**MR. SPITZER:** We never let Ted interrupt us when we're negotiating.

**MR. LEVINE:** That's true. Why don't you go ahead?

[Laughter.]

**MR. LEVINE:** No, I was just going to say two things. The theory of self-regulation, when the Chairman, Chairman Douglas, espoused it in '37, was you would regulate yourself, but you'd have vigorous enforcement by the government, particularly in the circumstance where the self-regulation broke down, the point that you're both making. But the theory that you should be able to move faster as a self-regulator, because after all--well, I shouldn't say this, but after all, the government is bound by due process concerns--is something which sometimes limits them, but--not in all cases, I might add.

**MR. LEVINE:** But so the theory was you should have a strong enforcement effort.

One thing I would ask your view on, though, is I think you're absolutely right in the sense of the breakdown. It's a complicated reason for it. I think the disciplines among the lawyers, the accountants, the world broke down--Eliot's point--and the government. But to the extent you don't have the pressure from a regulatory point of view, people tend to look to a slippery slope. It's the way people work.

But I also think in part--and one of the problems that we've had is that the line also moved in the course of the response. And that's--part of it is what people thought was okay behavior, not where we clearly agree was not, has now become possibly not okay behavior. And the problem people are having is unless there are clear lines with the obligation to have them, then you end up in a circumstance where it's very hard to do business because people, particularly with strong enforcement, tend to run away from the line as far as they can go because they don't want to get caught up in it.

And so I guess one of the things that that raises--and maybe I can segue into a question--is how do you draw a balance between using enforcement actions or rulemaking to effectuate change in terms of prescriptive relief. Essentially where is the balance? When do you--do you redo an industry through rulemaking with all the benefits of that, or do you use an enforcement process to change behavior? And when is it appropriate to do either?

**MR. SPITZER:** Let me take a shot at it because I think it's probably a harder question for me. Steve has the capacity to issue rules, we don't, even though that may surprise people. We know we don't and, therefore, we are only left with the option of sort of crafting changes in the form of injunctive relief in the form of settlements. And we've thought about this. And when is it proper to impose change out of an isolated enforcement action?

But I sort of analogize this to the tension between common law evolution and statutory evolution. There are a series of statutes out there, both federal and state, which don't have that much ambiguity. They use words like "fraud" that are always somewhat elusive, necessarily, but it's clear what the statutes mean. But we lend meaning and texture to those words through individual enforcement actions, and those enforcement actions, to the extent they do anything more than say you're guilty, pay a fine, to the extent that there is any prospective injunctive relief will begin to redefine behavior, whether it's a no-action letter, whether it's a settlement.

And I think that, therefore, when you see behavior in the context of wrongdoing that you want to end prospectively and you articulate what it is and say from henceforth you will act in this following manner, it's no different than common law evolution with respect to the thousands of statutes out there. And so I feel very comfortable using that capacity to try to change industry behavior.

**MR. LEVINE:** Could I just ask you a follow-up? And then Steve--and we give the Academy Award after this. How do you deal with the fact that you different standards for people who are subject to the enforcement action and those who are not, meaning that the same conduct engaged in by folks who are now subject to the change is going to be different than those--that conduct because they're not under that relief.

**MR. SPITZER:** Two rationalizations--and I think they're more than rationalizations. One is that those who acted improperly necessarily should pay some price, and the price may take the form of limitations upon future behavior. And the predicate for this is what we believe to have been wrongdoing. And, therefore, the balance is you acted improperly; therefore, your future behavior will be bounded in a way that perhaps somebody who did not act improperly will not be bounded.

The second response is that--take the global--the settlement. I'm not saying anything new. My firm expectation is that even though there are a limited number of signatories right now, in due course there will be rulemaking by the SEC that will promulgate for the entire industry standards of behavior that will not differentiate merely between those whom we on the back of a napkin one day decided, hey, let's drop subpoenas on these folks and left some off. I think that that sort of irrational distinction will disappear when there is broad-based regulatory action that covers everybody.

And, moreover, I would suggest that anybody who is not a signatory, who nonetheless continues to act in a way that would violate the spirit and intent of the global

prudent general counsel of any investment bank out there who's saying, Ahh, well, we didn't sign it, forget about it, we don't need to comply. I think they're all going to live up to it.

**MR. LEVINE:** I think--Steve, I'll give you a chance to respond to both. The only other thing that you haven't addressed, Eliot, is the input issue in rulemaking where you get other interested parties contributing to the process. And if the--if the format is the government determines it without that input, I mean, the negotiation is one obviously between you and us.

**MR. SPITZER:** Right.

**MR. LEVINE:** Sometimes the rulemaking process is too late because then you're going to be in a situation where it's after the fact, you're going to start changing the rules again when you get that input. And how do you deal with that element of it?

**MR. SPITZER:** Let me--not to monopolize this, Steve, but you're right. There was a bilateral negotiation that included the investment banks that signed and government that I thought--think produced a very wise document to deal with the problems at those banks. Those precise rules may not be applicable to the sort of hypothetical investment bank that has five people and where the distinctions and dividing lines that we crafted for much larger institutions don't have direct applicability.

When rules are finally crafted, no doubt that differentiation will be made. Nonetheless, I think the principles that guide behavior and what has to drive analytical work will be applicable, and so people can still see what they're supposed to be doing.

**MR. LEVINE:** I agree with that.

Steve, how do you feel about all this?

**MR. CUTLER:** Well, I guess when I hear regulation by enforcement, I actually think of two things, one of which is more difficult, I think, for us to do and probably something we ought to shy away from more than the other.

The first form of regulation by enforcement is--involves sort of reinterpretations of the law, of existing statutes to try to reach conduct that's never been reached before--novel theories, et cetera. And it strikes me that's a different kind of regulation by enforcement. That's what I think--when you talked about sort of moving the line--right?--where people thought it existed, you know, on day one, now you get to day 100 and the regulatory line has moved via an enforcement action. And, you know, that raises in my mind some due process concerns that are legitimate and valid.

The other type of regulation by enforcement is, I think, the one that you guys were really addressing, which is what kind of relief is appropriate as a result of a finding that someone has violated the law or allegations that someone has violated the law. And I guess there I feel a lot more comfortable because, you know, I think what we're trying to do in those cases--and it's not any different than the notion of the structural injunction, you know, that my law professors taught me about 20 years ago. You know, I think of the prison reform litigation in the South in the '60s and '70s.

And it seems to me that there is room, and appropriately so, in an enforcement action to say let's craft some relief here to ensure that it doesn't happen again. And that's why we call it prophylactic relief. And I do think it's appropriate to do that.

And, again, what's strange about the global settlement, and I think what makes you shudder in this regard, is that we had enforcement actions against so many firms in the industry. And that's not an ordinary, everyday occurrence. And that's why it seemed to a lot of people, including you, that we were trying to accomplish regulation through enforcement actions. But that really is just a byproduct of the fact that we were suing ten firms, and ten firms that occupy a lot of the landscape in the investment banking industry.

But I don't think that there's anything particularly novel or wrong about insisting upon prophylactic relief to make sure that bad conduct doesn't recur.

**MR. SPITZER:** I can't argue with either one of you, and particularly the circumstances I'm in.

[Laughter.]

**MR. LEVINE:** But the one thing I'd like you to address, the distinction between the public and Congress, God bless them, sometimes get confused between what you're saying was illegal and what you're saying you want to change and to improve business practice. I'll give you an example, not so much to comment on, but one would have never thought but for this

not good practice and it leads to bigger problems and the whole reason you don't want to do it. But no one has said that was illegal. In fact, I think any lawyer in the country would have said there's on thing illegal about that.

When it's put in the context of a settlement, a relief, unless you're very careful the public gets confused as to what you've done to improve the standards and what you've said is a violation, and the people jump to the conclusion that it all violated the law as opposed to obviously you were much more careful in doing that.

So I think that is an issue maybe that you should think about because at least when I read the press--and they haven't distinguished that. It's been, you know, this conduct violated the law and this was imposed. And as you know, the addendum and all that is much bigger than simply that fact.

**MR. SPITZER:** Clearly you're right. There was nothing illegal about sending--on its own about an analyst going with an investment banker to pitch business. On the other hand, we all began with the premise that an analyst issuing a report that he or she did not believe in, misleading investors, was illegal and the rest of it was the framework to prevent the deterioration of the quality of analytical work. That is a distinction, you're right, that will get lost in the mix.

On the other hand, if the fundamental question is have we approached this the right way from a governmental enforcement perspective, I think that that debit--that element of confusion does not weigh the necessity of doing more than simply issuing an injunctive statement that says thou shalt not issue false analytical reports.

We need it to clearly do more to take apart a business model that had led to the very product at the end of the tunnel.

**MR. LEVINE:** And I think I agree with you. Having been in enforcement at one point in my life, I certainly respect that. I think the only thing that one has to be careful about and why the rulemaking model is important also is from a competitive point of view, unless you're going to say--you're in the penalty box. I hear, to be sure, the ten firms, they happen to be 95 percent of the capital raising for the country, maybe in the world--is don't--should you use--you got to be careful how far you use the enforcement stick in order to effect competition and way of--to improve conduct, but competition where you don't have everyone subject to the same rules. And you're right, Eliot--

**MR. SPITZER:** Let me say something that may surprise you. You're right. It's suboptimal. But to say it's suboptimal doesn't mean you don't do it. In other words, if you were to say to me you have a choice between broad--sweeping regulations that will resolve this issue or enforcement actions as a means of remedying behavior, I'd take the regulations.

Having said that, in the context in which we found ourselves--you know, life is a matter of second-best choices--we did what I think was the wisest thing and proceeded to put a tourniquet on a major problem, and in due course there will be perhaps the optimal resolution through, you know, the wise regulation from the SEC.

**MR. LEVINE:** Could I just say one other thing? There's been a fair amount of criticism of the government about the settlement, which--and our industry really, because of the circumstances we're in, hasn't been able to really respond. Maybe I'm getting a call now.

[Laughter.]

**MR. LEVINE:** I can only say, having watched the reaction from the 10, 11 firms, that it was an enormous--an enormous enforcement action. I mean, I don't think there's been any action taken that I am aware of in my professional career which impacted an industry some--not only the sum of money, but I'm talking about the totality of the case. So anyone who is critical of the action, either because of the size of the money or speculating nothing was done, really is misunderstanding how dramatic a change this has been.

I can see internally the conduct has been changed. I mean, we go--I spent hours trying to figure out what the addendum means so people can actually implement it, which is strange since I was involved in negotiating it. But the commitment and the senior--

**MR. SPITZER:** You could always call us. We'll clarify it immediately.

[Laughter.]

**MR. LEVINE:** Yes, you're right. And I think that--I think that's--that's--we have five minutes left. Could I ask one other question?

**MR. LEVINE:** How do you--our industry, with its faults, is probably the most highly regulated industry in the country, if not the world. The SEC, the states, the SROs, Attorney Generals, bank regulators, foreign regulators, U.S. Attorneys--you name it. We have--it's like open season.

How does--what is the right balance between the federal, state, and SRO regulation going forward? Should it be in all cases all three? Should it be--how do you articulate a philosophy or the sort of coordination of that regulation in this time?

**MR. CUTLER:** First, I guess as much as I like to spend time with Eliot, I think it's got to be the exception rather than the rule when you'd have three sets of regulators working together. It's just--in most cases, it's not going to be an efficient use of government resources.

Now, this was such a massive undertaking and so critical, I think, to the regulatory function of all of us that I think it was important that we all be there. But I think to see that, to see this case as a model for future cases is probably not right.

I think in the securities area there has to be a dominant national regulator. You know, we've got a national market system, and Congress has--Congress' vision is that we have a single national market system. And there needs to be a strong, aggressive SEC in order to make that work.

Having said that, the notion that states should be displaced from this landscape of enforcement strikes me as wrong. You know, there are a thousand people in the Enforcement Division of the Securities and Exchange Commission, and that sounds like a lot of people to some. But--and Eliot alluded to this before. You could go to a single firm on Wall Street, and it will have more compliance and legal personnel than we have in our Enforcement Division.

And so from my perspective, it makes sense that you have other people--and I don't know why we'd want to sort of turn away the help that can be offered by state prosecutors and state securities regulators and, for that matter, the SROs. I think, you know, unless you want an Enforcement Division that's 20 times the size, you've got to have states as part of the mix, and you've got to have SROs as part of the mix.

**MR. SPITZER:** Let me just throw in a final thought, because I agree with everything that Steve just said about the primacy of the SEC, which is inevitably the case. I would put a slightly different spin on one aspect of what you said.

I think once the SEC has acted, there is almost without exception no reason for states to then intercede. On the other hand, where the states initiate action that will have the sort of injunctive rulemaking consequences that this action did, then I think we have an obligation to go to the SEC to get the SEC involved to ensure that there is that uniformity in the capital markets. The SEC doesn't need to worry about that looking down the hierarchy of enforcement entities. We looking up, you know, viewing this structurally or hierarchically as the SEC, then the SROs, and then the states in terms of fragmentation, we I think have to look up and be very conscious of not permitting the Balkanization, which some people fear, to result.

Having said that that's a possibility, I think we can handle that responsibility and bring in the SEC, which I think the track record is quite good on that, to ensure that uniformity. And, consequently, I agree with Steve's point. Preemption would be an enormous mistake because you would be sacrificing tremendous enforcement capacity because of a downside risk that has not yet been seen to be real.

**MR. CUTLER:** What I do think is incumbent upon both of us--and I don't mean to personalize this, but really the federal and the state regulators--is to have a dialogue. And there does--there is a responsibility, I think, on the part of states when they are delving into areas of national significance to put us on notice. And, likewise, I think when we've got--when we're delving into areas of particular significance to a particular state, I think it's incumbent upon us to call up that state regulator.

But, you know, one of the, I think, nice things of the experience that we've had in the last 18 months is I think we've proved that we can work together and that we can talk to each other. You know, Eliot described this as a bilateral negotiation, which is the first time I've heard it described that way. I really thought of it as a 64-party negotiation. And yet somehow, at the end of the day, we made it work.

**MR. LEVINE:** Well, for what it's worth, I think--I've been a strong advocate for state regulation, not preemption. I think it would be a terrible mistake. But I think we're out of time, so

[Applause.]

**MR. LEVINE:** Thank you very much.

Now that we're going off the air, we can really have a dialogue. But there's a birthday cake celebrating the 69th birthday of the SEC in the back.

Thank you.

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