

## ROUNDTABLE OF SEC CHAIRMEN

WEDNESDAY JUNE 2, 2004

**DAVID RUDER:** Good afternoon. My name is David Ruder. I was Chairman of the Securities & Exchange Commission from 1987 to 1989. I'd like to welcome all of you here, both those of you who are here in the William O. Douglas Meeting Room and those who are listening in to the Roundtable at the Historical Society's web site. As you know, this Roundtable has been organized by the Securities & Exchange Commission Historical Society. The Society is a non-profit corporation that is separate from and independent from the SEC. It preserves and shares the history of the SEC and the financial markets. Today's program will be archived in the museum at the conclusion of the broadcast.

I should tell you that the Historical Society started as the result of a memorandum given to me by former Chairman Arthur Levitt and authored in part by current Commissioner Harvey Goldschmid and Paul Gonson, then the Solicitor. They suggested that it would be a good idea if a Historical Society was started, so I undertook to help organize it. I'm proud to say that we are a flourishing and wonderful organization.

Today's program is part of the SEC's Historical Society's activities this year to commemorate the 70<sup>th</sup> Anniversary of the founding of the SEC in 1934. We will proceed today to have presentations initially in the order in which each of the former Chairmen of the SEC were Chairmen. I will introduce them in order without further elaboration about them. You'll hear their own personal elaborations.

The first is Brad Cook, who was Chairman in 1973. Roderick Hills was Chairman from 1975 to 1977. As I said, I was Chairman from 1987 to 1989. Richard Breeden was Chairman from 1989 to 1993, and Arthur Levitt was Chairman from 1993 to 2001. I regret that Harvey Pitt, Chairman from 2001 to 2003, who had been scheduled to be here today could not come because of a personal family emergency. Harold Williams, Chairman from 1997 to 1981, who very much wanted to come, also could not be here today because of some personal matters that he had to attend to on the west coast.

The remarks we make today are solely our own and are not representative of the Society or the SEC. Because of the many topics we will be covering today, we will not be taking questions from the audience. Knowing that this is likely to be an unruly group, I have encouraged each of us to interrupt the others so that we can have good discussion. There are many common topics that each of us dealt with while we were at the Commission. I particularly asked the Chairmen to discuss some of the substantive matters that they dealt with at their time at the Commission, including the regulation of corporations and accountants, including the securities industry, and including the mutual fund industry. You will find that not all of our experiences were the same and that some of the crises that we had were in different areas. We're also at some point going to talk about procedures at the Commission and what it is that we thought at the time and think in the future will benefit the Commission. But again, since we purposely

haven't had a lot of preparation, we will see how it goes. So Brad, I'm going to start with you.

**BRAD COOK:** Thank you, David. I came to the Commission as General Counsel in 1971, appointed by Bill Casey and at least under Bill, being the General Counsel was probably the second best job in the Commission, of course the first being the chairmanship. And Bill convinced me of that and that's why I took the position. Then when he divided Trading and Markets into two bodies, Enforcement and Division of Market Regulation, he made me the division head, and I kind of kept my fingers a little bit in the General Counsel's office at the same time.

In preparing for this program today I was looking back at the budget. In 1973 the Commission had 1500 employees and a budget of \$29 million. Based on the figures I took off the Internet, the current budget request is \$913 million, or a thirty-fold increase, and the Commission now has 3060 employees with an authorization of 3500 employees for fiscal 2004.

Bill's philosophy when I was General Counsel was to regulate rather than enforcement. I think there is always a perception that the staff runs the Commission, but I think that in reality that's not true, at least it wasn't during my tenure. Even though there was an emphasis on regulation, never did I see at the table a disagreement between the staff and the Commissioners that didn't result in actually being worked out and an enforcement action being brought.

Bill also had an interesting trait. He would regulate by speech. He gave 60 speeches in 20 months and during my tenure I had given about six speeches in a short period of time and there was criticism occasionally by people saying, well we have to read the speeches to see what's coming down on the regulatory and the enforcement front.

The major issues that we faced during my tenure were the central market system, the enforcement case we brought against lawyers, directors' responsibility and that's the best my memory serves me on those. But, fixed rates and institutional membership were big issues and of course the institutional membership issue got solved eventually when we eliminated fixed rates.

**DAVID RUDER:** Did you have much interest in mutual funds at that time?

**BRAD COOK:** We had zero. [laughter]

**DAVID RUDER:** And was the industry particularly alarmed about the possibility of eliminating fixed commission rates?

**BRAD COOK:** Well especially the smaller brokerage houses thought that they would lose the ability to perform research and financial analysis, but the momentum was certainly against fixed rates. One of the big issues, in fact the first hearing that I

went to in the Congress as General Counsel was on what jurisdiction did the SEC have over rates. Was it primary jurisdiction? Was it exclusive jurisdiction, or no jurisdiction? And of course we took the position that at minimum we had primary jurisdiction to set rates and we were battling the Justice Department constantly because they wanted to eliminate fixed rates entirely.

**DAVID RUDER:** Did the Gordon case get decided during your period of time? It was a jurisdictional case over fixed rates, or was that in yours, Rod?

**RODERICK HILLS:** It was in Ray's time.

**DAVID RUDER:** Ray Garrett was Chairman between the times of Brad Cook's reign and then Rod Hills' came, so Rod.

**RODERICK HILLS:** My favorite memory, David, is of the people at the Commission. The staff then, there couldn't have been a better staff anytime, I don't think, anytime in its history. I could name too many people and I would leave too many out, but Harvey Pitt was our General Counsel, Stan Sporkin of course was our Enforcement Chief and Ralph Ferrara was my Chief of Staff. But the character and the quality and the collegiality of my fellow commissioners was probably the highlight of my time there. Irv Pollack, the father of enforcement, Phil Loomis, the former General Counsel, Al Sommer, who was one of the really fine corporate lawyers in America, it was a challenging time. I think if it hadn't been for John Evans, God bless him, the economist, I'd have been in real trouble when I came because I'd come from the White House as Counsel to the President, but as Chairman to the White House Counsel on Regulatory Reform, and we had pushed very hard, the President had, in supporting the idea of deregulation. Alan Greenspan had. And in one sense of the word, I came over sort of with Alan Greenspan pushing me to say what you really need over there is more economic analysis. And so as everyone remembered, the first thing I tried to do is get some economists in the place and that's where John kept me from being thrown out on my face. I forget how we cut the budget in those days, but I used to tell Alan Greenspan we got rid of three lawyers and two automatic typewriters in order to get Dick Zecher and Susan Philips and there began the office of economic analysis.

From that we did a lot of things. We began a series of pilot programs and options, trading standardized options. I brought, Irv may remember this, I brought Fisher Black and Myron Scholes over to meet the lawyers on successive weeks and it was an interesting clash of personalities or ideas, but it was, I think it was good. At the end of the time I was there, we were able to begin a pilot program in the trading of standardized put options, which was a major, major challenge. Up until then, we'd only had call options.

I think some of my successors are not all that necessarily pleased with the fact that we have economists amongst the lawyers. My wife thought that maybe we should have some behavioral scientists, but I was not bold enough for that. The biggest challenge we had during the time of course were the questionable payment cases, the Lockheed cases, the United Fruit cases, hundreds of American companies that were

embarrassed to reveal that they made some sort of questionable payment to a foreign official. It's hard to compare the media blitz today of the Enron era cases with those back then, but there was surely a weekly headline and there was surely a weekly blast from Congress. It was a time in which I think we were assailed from the right and the left, the Congress and Ralph Nader thought we weren't doing nearly enough, and the business community and many commentators thought we were doing much too much. We even had a presidential commission chaired by a wonderful man, Elliott Richardson, who basically criticized us for getting out of our field.

There was a great effort in those days to pass an enormous piece of legislation chartering the federal corporations, and we essentially went after it by doing three things. First of all, the Commission for the first time required that we have significant internal controls. There was some doubt in those days as to whether we had the authority to do it and if my memory's correct, the Foreign Corrupt Practice Act some years later established the fact that we did have the authority, but we did establish controls then. We required the audit team profession, AudSEC of the AICPA, to require real auditing standards. We required them, for example, if they saw anything suspicious, they had to bring it to the attention of somebody who was above the suspicion and fortunately we were able to get the New York Stock Exchange to require independent audit committees for the first time.

In many respects, depending on how you look at...

**DAVID RUDER:** How did you go about getting the New York Stock Exchange to require independent audit committees?

**RODERICK HILLS:** It's a wonderful story, if you have time for it. I approached the prior Chairman, Mr. **Needham**, Jim **Needham**, who wasn't wild about the idea at all. But **[unintelligible]** came from J.C. Penney's where he was used to kind of rough and tumble things, and I met with him privately after talking to my fellow commissioners and I asked if he'd be willing to have me write him a public letter, and he said, well, it's going to be a fight, but go ahead. So I wrote him a public letter, and he then had a board meeting. He called me from the board meeting and said we've adjourned the board meeting till tomorrow, can you come up and attend the board meeting. I called Senator Proxmire to say, I wondered if he'd mind if I attended a confidential meeting of the New York Stock Exchange. I explained the reason for it, and he was good. It was a wonderful fight. It lasted for about a month, and the great hero there was Tom Murphy, the General Motors Chairman. Tom just stood up for it. They had an independent audit committee at General Motors and he fought for it and got it. There was, Irv may remember, that the Chairman of Johnson & Johnson sent a telegram to the whole Congress, to us, probably sent one to the Pope, claiming that he would leave the Exchange, and everyone else would leave the Exchange. There were some difficult minutes, but it went down.

It seems to me that if you look at those 28 years and come to Sarbanes-Oxley - in many respects Sarbanes-Oxley is a reaffirmation of those regulatory steps we took those 28 years ago - section 404, like it or not is a reaffirmation or logical extension, or illogical some people say, of the internal audit controls, I'm sorry, of the auditing standards, and the creation of the Public Company Accounting Oversight Board is

really a reaffirmation of the internal controls. That's basically the job at PCAOB to make sure we have good ones and that they're enforced, and of course the third part of Sarbanes-Oxley is the independent audit committee, so in many respects, I hope that Irv and everybody else is as happy and content and proud, if you will, of what we were able to do back then.

We did a couple of things there. We began the first affirmative action program in the Commission's history back there. We created the first office for international operations. We didn't have the budget to send anybody overseas, but we had the office if anybody wanted to check in and we began a program in computerization. We brought Peter Shipman from Wall Street who had such a computer background. I had left a company called Republic Corporation that had terrible accounting problems, and the nice thing about it was the chairman of the company above me was the chairman of equity funding, which was a much worse scandal than what I was dealt with. And I had the notion that you could create a computerized program in which you could have random access, and if you had random access to the insurance industry, the equity funding case would have jumped up. And so that was Peter's effort. We didn't succeed in that, although I do have some hope and some people have told me that what Peter began is part of that today.

**DAVID RUDER:** What was your budget like? Were you affluent or poor?

**RODERICK HILLS:** It depended upon your perspective. We had \$61 million and we were called before Senator Proxmire's committee one time and he wanted us to take a \$5 million cut, and I explained that this just wasn't even possible. My wife was Secretary of HUD then and she'd been in just before me and he was very indignant, saying Mrs. Hills just took a \$200 million cut. And I said her rounding numbers wipe out our budget, she has a \$10 billion budget, we have a \$61 million budget. We didn't lose that \$5 million, but it was a close one.

**DAVID RUDER:** And regarding process, Rod, did either of you have to deal with the Sunshine Act? Did you have to have your meetings in public?

**RODERICK HILLS:** We had a lot of rays coming in. I think we dealt with it with integrity. We had meetings inside the Commission where one or two of the Commissioners would be present. We talked amongst ourselves, but I think that we were very careful to not let anything of substance be discussed with not being in the sunshine.

**DAVID RUDER:** That's not quite responsive, but I'll take it.

**RODERICK HILLS:** It was an honest answer. [laughter]

**DAVID RUDER:** At least for me, I had some problems because we could not decide difficult questions among the five Commissioners. In my conversations with Al Sommer he told me that in prior times many of the difficult issues were resolved by the five Commissioners sitting together, and working out problems. And I know you've all heard the story Milt Freeman used to tell about how Rule 10b-5 was adopted, five Commissioners sitting around the table saying "we're against fraud, aren't we," and adopting Rule 10b-5 that way. But at least for me, the Sunshine Act created a lot of problems in the way that I could operate the Commission.

I guess I just wanted to pick up on one of your other comments. I take it that there were computers at the Commission at the time you were there?

**RODERICK HILLS:** Yes, I saw one. [laughter]

**DAVID RUDER:** They weren't laptops, I take it?

**RODERICK HILLS:** No, they weren't laptops.

**DAVID RUDER:** Well, the interim between the Hills commission and when I came in was handled by two very, very strong individuals, Harold Williams and John Shad. Harold was very influential in the corporate governance area and John Shad was Chairman during a period which was marked in a sense by deregulation. There was a lot of effort as I understand it at the Commission to make things easier and maybe the word deregulation is not right, but to make it easier for the corporate community to file with the Commission and to make things happen in a more reasonable way. John Shad had been responsible for starting EDGAR, which you alluded to. There was not any electronic filing while you were there, I guess.

**RODERICK HILLS:** No, as I said, we were filing papers, all papers.

**DAVID RUDER:** Well I became Chairman in 1987. I was a professor and this was at the beginning of the Reagan Administration's difficulty over Iran-Contra and the Administration wanted somebody who was non-controversial. I came from practically nowhere with no political support or opposition and that was helpful for me in many ways and not so many. The first thing that happened to me was that I found out that my staff was not the 14 people in my office, but the 3,000 employees of the Commission. Second, I found out that John Shad had given a talk at the IOSCO, International Organization of Securities Commissions' 1986 meeting in Versailles and had urged that IOSCO become a more active international organization. When I became Chairman, we did not have a separate international office. Richard, I understand that you reformed the international function after you became Chairman. In my time there was no central place to go for international matters, and there was some slight combat between the Division of Enforcement, which was looking for MOU's, and the Division of Corporation Finance, which was trying to deal with disclosure worldwide. In any event, I found out that there was going to be an IOSCO meeting in

Rio de Janiero. I asked whether I was invited and I was told no, I was not, but that Charles Cox had been invited. So I invited myself and went down to find out what IOSCO was. At least to me this was a very important initiative for the Commission to show that it was interested in fulfilling John Shad's initiative in calling for more staff work and more policy work at IOSCO.

But the most important thing that happened to me was the 1987 market crash. I had been at the Commission for about 10 weeks when on October 19<sup>th</sup> the market dropped 503 points, 22% in one day. I frankly didn't know much about technical market matters. I found out that Rick Ketchum, the director of the Division of Market Regulation had been in New York that morning and had come back as the market was falling. At the end of the day, I received a phone call from Senator Reigle who told me to call the President and tell him to calm the markets. I didn't quite know what to say to that. Senator Reigle was a Democrat and I had been appointed by a Republican, President Reagan. Nevertheless, fearful of offending Senator Reigle, I called the White House. I didn't call the President, but I called the White House and told a person whom I knew there to ask the President to be told what Senator Reigle had told me. In any event, the President did make an announcement trying to calm the markets and for the next year we had a very intense effort trying to deal with the various market matters. Rick later told me that in that first week after the market crash, he had dealt with more difficult market matters each day than he had during the entire time in which he was working with Chairman Shad. So at least for me, the matter of securities markets volatility became the most important matter.

One of the first reports that came out was the Brady Commission Report analyzing the market crash. The Report was supervised by Nicholas Brady at the behest of the White House. The Report described the common market, the derivative index products in the future markets, and our securities markets, and made a recommendation which as I found to be simply astounding. The Report said: "we recognize that there is but one market, and we think there should be a single securities regulator for that market, and we think that the regulator that knows the most and would be the best at regulating that market should be," and I thought that surely the Report would name the SEC, but it said "the Federal Reserve Board," a conclusion I found to be astounding. I knew that we were the right people to handle the integrated markets problems. I was of the opinion that we should have jurisdiction over the derivative index products in the futures market. I said as much in my testimony before the Congress in February, maybe it was January, and I was not totally supported by all the members of the Commission.

In fact, by the time the Commission suggested legislation in the summer of 1988, we had developed a split Commission. There were three of us who favored legislation urging a shift of jurisdiction over the futures derivative index products to the SEC. There were two other Commissioners who were just totally against that shift. Partly as a result of that division, I found myself with substantial division in the Commission on a number of issues. Strangely enough, the two Commissioners who were not seeing things the correct way, that is, my way, were one Democratic and one Republican, so the Commission on its face was not a politicized Commission. But we did have rather strenuous arguments and it was during this period that I became quite unhappy that not only did the two Commissioners that were not in accord vote against me, but they were articulate in the meetings and also articulate outside the Commission in opposing policies that I thought the Commission should adopt. My

conclusion from all of that, finally, was this: (and I've told this to Chairman Donaldson) "three votes are enough." Three to two is a perfectly acceptable way to adopt rules, or to ask for legislation and I surely hope that he follows that advice in the future.

We dealt also with enforcement. The Michael Milken and Drexal Burnham matters came to a head while I was Chairman. At that time I think that we were involved with the single largest penalty imposed against a brokerage firm. I think, as I remember it, that Drexal Burnham paid somewhere in the range of \$600 million in disgorgement and penalties. So enforcement was then as it is now a very important tool for the Commission.

We also looked at the penny stock fraud area. I gave a speech at the regional office in Denver. It had been my practice at the regional offices to go and shake hands with everybody, but at the Denver regional office Bob Davenport said: "You are not shaking hands with the staff today." I said: "What am I doing?" He said you're coming to my office, and I was then told about penny stock fraud. I had a general idea about penny stock fraud, but I was not totally cognizant of the problems. Following that Denver speech, the Commission started the Penny Stock Task Force. I think we did some good work in reducing the amount of penny stock fraud, penny stocks being defined as a stock under \$5. At that time I began to recognize that there was a conservative wing at the Commission. One of the Commissioners insisted that there be an escape from penny stock jurisdiction if a stock was traded on NASDAQ, even though it was under \$5. In that event it wouldn't be a penny stock and would not be subject to our rules. In any event, I was very much involved in trying to stamp out penny stock fraud.

The accounting area was also of interest. I dealt with the aftermath of the Treadway Report, which was the Fraudulent Financial Reporting Study supervised by former Commissioner Jim Treadway. It was in the context of that report that I finally understood the relationship between Congress and the Commission. We received a letter from Chairman John Dingell of the House Energy and Commerce Committee insisting that we respond item by item to every suggestion that had been made in the Treadway Report. We did so, and left at least our recommendations. Later, I was told by Lynn Turner, Chief Accountant under Arthur Levitt, that his office had gone back to my time at the Commission, had looked at all we had said, and had at least taken our responses as background. So accounting, even at that time, was an important issue, although I must say I don't think that I really understood how important it could be in the long run.

The matter of dealing with mutual funds was something that was on my plate, but not in terms of a scandal. I believe the only matter relating to mutual funds we had was how to deal with the schism between financial planning and financial advisers. David Silver is in the audience and I know even at that time there was some controversy between David and Kathy McGrath, Director of the Division of Investment Management. Kathy used to tell me that once a year she went out to Arizona and gave a speech and then had to listen to David Silver beating up on her. It was all friendly and still involved an industry which was not under suspicion.

I've talked longer than I meant, but I like it. [laughter] Richard, you followed me as Chairman and inherited some of the problems that I left you. I know in the international area in particular you were very active, so could you tell us what went on?

**RICHARD BREEDEN:** Thanks, David. I became Chairman in 1989. I was then serving as an Assistant to the White House, which is, I might, add an Assistant with a capital A, not a little A. I actually took a demotion in governmental terms to come over here. I was a level four when I was in that capacity and was only level three here at the Commission, although I guess Harvey tried to fix that problem. [laughter] I left that one alone. I took that demotion with a smile. I, when the President told me and I had probably a very different background than most coming into the position. I had been at the senior level at the White House. I had worked for the President both on his election campaign and as Vice President and I just finished passing a 1,350 page of legislation known as **FIREA** which was the legislation to restructure the savings and loan industry and put an end to the thrift crisis which was really the most significant threat to the stability of the U.S. financial system since the 1930's. When we finished that legislation, the President decided someone needed to come over here and pick up all of David's pieces and so appointed me, and I must say my reaction at the time, I'd been a securities lawyer before coming to government, though one of little note, nowhere near of the stature of many here in this room, but enough to have a few ideas of some of the problems the Commission dealt with. I must say when the President told me he had decided he wanted to name me to become Chairman of the SEC, they probably just wanted to free up a seat in the White House mess in doing it, but to paraphrase Lou Gehrig, my reaction at the time was 'Gee, I'm the luckiest man alive' because this is an incredible, extraordinary institution. It is a unique national, but more than national, international treasure. There are no other SEC's and the chance to come here and lead this group of men and women and participate in the mission of the agency and try and carry it forward was, I'm sure I would speak for all of us, was absolutely the greatest privilege anyone can have. And I was lucky that it happened to me and I was determined when I came over here to make the most of that opportunity in that time to build the institution, make it stronger. I saw myself in very much as my role as chairman as being the steward of the health of the institution and it was my job to nurture it and to try and help give it direction and focus, make sure that we were making the most of the tools we had and to pass it along to my successor stronger than I found it.

We certainly passed it along bigger. I guess it helps when OMB knows that you can walk into the Oval Office whenever you need to and that you will win in a budget dispute and so we increased the budget 80% in the time I was here. We increased the staff 35% from when I started to when I ended, and those were long overdue. The Commission has been perennially underfunded and understaffed, and that's a condition that we've made some progress on in the intervening time, but I still think the resources in many areas has not kept pace with the growth of the markets, and the SEC is the best investment the American taxpayer has ever made in government and I wasn't embarrassed to say it when I was here, and I haven't stopped saying it since I left, and I don't think I ever will. Now that puts a big burden on all of you to use the resources that the public gives you wisely, to pursue the goals of the agency.

But when you look back, aside from the Congressional issue du jour and the regulatory issue of the day, you look over time, the SEC, when I say it's a unique institution, it's always struck me – this is an agency that more than anything else is about values, and maybe it struck me that way because I worked in the White House and so I worked with almost every agency, certainly involved in domestic policy, and

most agencies build bridges or they subsidize farmers, so they make transfer payments. They do nice things for people. They give away money. The SEC is an agency that's about values, truth, disclosure, transparency, fair markets, not just rich ones and big ones. It's an agency that since the '30's, this unique experiment of can you take American values and can you write them into law and create an agency that over time can try and be the institutional representative of certain values in the marketplace. And, by golly, I think if I had been alive then and looking out, I might have said that that's a tough challenge and maybe wouldn't work, but it has, and I don't know if any of us can explain why, other than the extraordinary good fortune the Commission has had to recruit really top people throughout its history. And it's the people that make the agency and your determination to get up in the morning and come here and not be ordinary, not just kind of go through the day and go through the motions, and kind of just do a little bit and go home, but to make a difference. And this agency has been doing that since the beginning.

Well, as I say, I saw my job as being the steward and kind of nurturing the agency and passing it along in a stronger condition, and I must say, I did not see as purely a question of winning the budgets. It would have been fine if that had been all that was involved because that was the relatively easy part, but I also thought it was that the intellectual strength of the agency was critical and that involves a difficult task of welding a Chairman, the Commissioners and the staff into a successful mix of identifying priorities. What are the big threats, not just the problems we know about, but what problems are growing that we're not worried about? And there is of course always a tendency to fight the last war and it's the problem, the truck that's going to hit you is the one that you don't see coming around the corner, rather than the one you've been watching, approaching for an awful long time. And so stimulating the intellectual resources of the Commission was something that I put a lot of effort into.

Of course part of it is trying to have an attractive place to work and Jim McConnell's here somewhere. He and I did an awful lot of conniving during the time that I was here. We convinced Congress to pass a piece of legislation letting us out, exempting us from the General Services Administration as our leasing agent, one of the best pieces of business I ever did. We promptly went out and replaced places like 500 North Capitol Street and some of the dingy, dismal places GSA had seen fit to confine the agency staff in, and were able to replace every single one of the regional offices and place them in nice facilities. We didn't win pay parity, although I started fighting for it the day I walked in and was still fighting for it the day I left. We did win huge new allocations of SEC slots, 10% across the board pay raise for OBM because they were afraid if they didn't give us anything we might win in Congress. And so we tried to deal with some of the issues of making the SEC a pleasant place to work in the surroundings and to win the compensation that I thought the staff deserved.

Beyond that though, I think one of the most critical things is people like to know you make a difference and I was determined, I was never afraid to break crockery. And I frankly, it would be easier to be SEC Chairman if you just wanted to be popular, but unfortunately, I always saw part of my job with the corporate community and with the people who had a great way to report higher income by just bending the rules a little bit that part of my job was to say no. That there were things that crossed the rules and the agency would stand up for the rules and try to play a constructively forceful role in the markets. And in every single area, Enforcement, Corp Fin, Market Reg, Investment Management, International, a division I created, we tried the accounting area, we tried

to work on not just the day-to-day agenda, but to free up time to think about the issues, to think longer run. We did the Market 2000 study. We did a lot of work in corp fin in rethinking through small business targeted forms to make capital raising easier. We did a lot of things in the mutual fund area, a big study there and so on, where I tried to give the staff an opportunity to both work on the current enforcement calendar and the current issues, as well as to try and think down the road longer run and have an agency that would be able to be respected in Washington and not just respected, but when they were looking around for who ought to be the regulator in charge there would only be one answer. But the agency, I felt, needed to push itself into that position. People weren't just going to give it to us, and we'd do it by the force of our ideas and the force of our energy and our effort.

I did want to just reflect briefly, which is very hard for me to do about anything, on enforcement because I think it is one of the unique characteristics, one of the things that makes this agency unique. I remember working with my colleagues internationally and the different agencies, and they would have inspectors, some of them, and they would have rule-writers and so on, but most of them would never have an enforcement division, or at least not one that we might recognize. And the enforcement program has had the extraordinary good fortune to have a string of tremendous leaders from Irv Pollock and Stan Sporkin. I had the privilege of appointing Bill McLucas to the job. I was fortunate enough to be able to recruit Dick Walker to the agency so that Arthur could end up appointing him and I know Steve Cutler today carries on a very, very proud tradition here.

My philosophy on enforcement was very simple – that we ought to do everything we could to get rid of all the Mickey Mouse rules and not pay any attention dealing with technical stuff, to focus on what was really important, fraud, market manipulation, and be willing to go to the mat and take down anybody that violated those critical standards because they went to the integrity of the market itself. We used our powers forcefully, the ones we had. We went to Congress and got more, passed legislation to give us things like office and director lifetime bars, which Steve, you ought to start using a little more often. I got that law passed for a reason, and let's start using it. Monetary sanctions and a lot of other things, we tried to be sensible about using our powers judiciously and that's been a tradition of the enforcement division. Not every case warrants the death penalty and not every case warrants the maximum fine, and yet the agency also has to be careful that it doesn't become a settlement factory for relatively meaningless sanctions because if you can steal \$500 million and then agree to an injunction that you won't do it a second time, too many people will take that deal.

I suppose I'd end with just one anecdote about my tenure linked to enforcement because it's a quote some of you might have heard, but I've never really publicly told the story about the origin for those of you who weren't there in those days. We were at a closed Commission meeting room and we were considering a matter that is now known after the final appeal through the Supreme Court as the O'Hagan case, and this case involved a lawyer who had stolen money from his client's trust funds and then gone out and engaged in insider trading. And the staff was at the table, proffering a report that there were settlement discussions underway, and that the gentleman's lawyer had said, well, he was prepared to give in to enter into a settlement and to return most of the funds that were the proceeds of the insider trading, and I emphasize the word most, because the lawyer had said he's willing to turn over all of the money he stole except that he simply needs enough money to maintain his lifestyle. [laughter]

So I'm sitting at the table and the enforcement attorney is describing the situation and said well, we've looked at his financial statement and how many houses he has and many cars and all this, and the lawyers says he needs to maintain his lifestyle, and so we need guidance from the Commission as to what kind of lifestyle you would be willing to allow him to keep his stolen money to finance. And I couldn't restrain myself and burst out, well how about naked, homeless and without wheels? [laughter] Now if I'd thought that that was going to become something noteworthy, I might have phrased that differently, but I was astounded at the hutzpah of somebody to come in and say I need to keep just enough of the money I stole to be able to finance a certain lifestyle. So occasionally, you also need to kind of step back and react as the SEC has been want to do and express the conscience of the country.

So thank you very much for having us here at fossil day at the Commission, and it's a great pleasure to see all of you again.

**DAVID RUDER:** Are you leaving?

**RICHARD BREEDEN:** No, I'm passing the baton to Arthur.

**DAVID RUDER:** All right, I have some questions for you, but I'll wait till we've heard from Arthur. Well, I have one, just before you finish. During the time I was Chairman, when we introduced legislation to transfer jurisdiction from the CFTC to the SEC, I was told when I got back to Chicago by somebody from the futures industry that I had caused him to make 80 plane trips to Washington to lobby Congress against the SEC's legislation. You also were in favor of that jurisdictional transfer. Did you find that there was a lobbying effort going on in Congress to defeat what you and I both saw as the absolutely perfect solution?

**RICHARD BREEDEN:** Well, it was one of the more forgettable periods of my time here in the sense that it was a brutal, vicious fight. I didn't care as much over the CFTC and jurisdiction over enforcement in futures over stock indexes. I didn't, and this was really an issue that legislatively the Treasury was pushing, and in part of the Brady commission report, and I remember that when the then-under Secretary of the Treasury told me that the President had decided that this was going to be a major part of the administration's policy, I knew that meant the Treasury had decided that and that was not coming from the President himself and that they were really going to push this. I remember observing offhandedly that Wendy Gramm then-Chairman of the CFTC coincidentally had the same last name as a prominent member of the Senate and had the Treasury thought about an ambassadorship or a promotion to a cabinet seat or something else, if they were really serious about this and I was told, I needn't worry about that, that the administration had taken care of that. I said, well, good luck. And, you know, it was a fierce fight, frankly not worth the candle of the time that it took away from probably more important work.

What I cared the most about was not the 15 jobs that were involved in directly overseeing the stock index futures trading, although and I don't mean to make light of it, there were obviously a lot of important issues in cross-margining and other things,

but the most important area that I was concerned about was the so-called exclusivity clause of the Commodities Exchange Act, which unlike the securities laws, which are open and allow people to create any kind of instrument and trade it within the limitations of full disclosure, the commodities world is one of licensing of products and this very restrictive provision that said if something is a future which doesn't happen to be the fund, then it's illegal to trade it anywhere other than on the floor of a commodities house, and that was very restrictive, and, I felt, a threat to evolution of new products and new trading systems because instruments that were hybrids that had characteristics of both a securities and a future were the subject of litigation in the Supreme Court to find out whether it was safe enough to offer to let people trade them. Of course London had no such problem and despite all the free market rhetoric that the futures markets were truly expert at, when the chips were down in a recorded vote in the Senate which unfortunately we lost to do nothing rather than repeal the exclusivity clause to allow competition in products and let products be listed on either a securities or a futures exchange, whichever people wanted to list them on and let them compete. The futures industry and the CFTC fought us tooth and nail. Must have been something about what the SEC did every day that made them so passionately afraid of having oversight from the Commission, but it was an unpleasant struggle. It took up a lot of time. It was an issue that was important, but frankly, one that in the end, I do have faith that in the end the markets will find a way to get around things like that, and while we didn't repeal the exclusivity clause, it has receded as a barrier and has not stopped innovation in the marketplace.

**DAVID RUDER:** I think we both came to the conclusion that there were lots of things to do in life and particularly at the SEC, other than to quarrel with another agency and that cooperative regulation was the right solution. Arthur, it's your turn. You were the longest in office of any chairman of the SEC. I think John Shad was the second, so we're going to give you some time.

**ARTHUR LEVITT:** I guess that's part of my name, the longest serving. It's tough to follow a great Chairman. It's a lot easier to follow one that is not so great, so when I came in with a history of Richard Breeden and a staff that he had assembled that was just superb, I decided to follow a practice that my father, who was the first Democratic State Comptroller in about 20 years and kept just about all of the appointees of his predecessor, a Republican Comptroller, I kept all of Richard's division directors and I even kept Paul Atkins as one of my counsels. But it used to gall me when John Dingell, not once but virtually every time I saw him and I saw him a lot, that Richard Breeden was the finest Chairman in the history of the institution. [laughter]

**DAVID RUDER:** I was upset by that as well.

**ARTHUR LEVITT:** And for the nearly eight years that I was here, I would hear that from Dingell. When I came here I guess I'm the only one of this crew that's not a lawyer, and I believe that it takes about four years to begin to understand what you do at this place. So I came here faced with giants of the Commission such as Jim McConnell who had powers that everyone told me about that I didn't quite understand, but he had those powers. Bill McLucas, who would question Bill McLucas? He was too

big. Colleen Mahoney, Linda Quinn. I was going to be a very quiet, laid back Chairman and I'd begin to learn what was going on.

But I did have a history in the industry and that history forced upon me some ideas. Number one, I watched Harold Williams spend nearly all of his term fighting a losing battle on governance and I was absolutely determined that I wasn't going to spend two minutes on governance. I saw Richard Breeden fighting Wendy Gramm and I decided I wasn't going to get involved with any battles with any other agency. Well, what happened? The first thing that happened is the staff began to say, hey, look, the Comptroller of the Currency, he's going to eat you for lunch. You can't trust him. The Treasury Department, they're out to eat your lunch and take your pride. And all kinds of schemes came up about how I had to get into battles with Treasury and the Comptroller's office. The thing that amazed me and surprised me more than anything else was there was an overriding preoccupation at the Commission with two things. How would the media deal with a particular decision and what would our overseers say about it? Coming from the private sector, you cannot possibly understand the power that the Congress, your overseers, have over your emotions, over your judgment. And from the day you walk into that office until the day you step out, you care about Phil Gramm and John Dingell and Mike Oxley. And the moment you quit, the moment you leave this office, you cannot imagine how trivial are the judgments of those people. [laughter] And when you think about the media, it's well and fine to sit back and say who cares, I'm going to do the right thing. But it doesn't work that way in Washington.

Every decision, whether it be an enforcement decision, a market reg decision, a matter of congressional liaison, it all, the question is always asked, how will this read in the *Washington Post*? What will Floyd say about it? What will Gretchen say about it? I tried to steel myself against caring, but I certainly did think a lot about it. And I tried to guide that process as best I could, and having come from a media background, and having come from nearly 40 years of Congressional testimony, I kind of liked the give and take. I liked arguing with the Phil Gramms and the Jack Fields. I even enjoyed Congressional testimony. As far as the media was concerned, I liked reporters, spent a lot of time with them and by and large was fairly treated by them. But my own experience in the securities industry gave me something of an agenda, and while I was determined not to deal in governance and rue that decision during the last year of my term here, I was determined to deal with investor issues and place those above everything else because I was soon faced with the most deregulatory Congress that this country has ever seen when Newt Gingrich came in. And I didn't have the political muscle to deal with that Congress, so I tried to mobilize the best lobbying force I could in terms of America's investors, and develop programs to mobilize them so when Congress would try to stifle some initiative, we could go to them and say that we represented a great many of their constituents, and indeed the town meetings that we engineered throughout the country certainly had a political purpose to them as well since we invited members of our oversight committee to attend town meetings that were attended by many more constituents than they could possibly mobilize for their own town meetings.

The actions that I think were most significant during my years here again reflected on my experience in the brokerage industry when I would try to get quotes for customers of mine and was confronted with twenty precisely the same quotes from the over the counter market, I knew there was collusion going on. And our landmark case against the NASD I think was one of the Commissions proudest moments. I also reflect

upon the fact that during a six-year period, we brought a case against the NASD, the Philadelphia Stock Exchange. I was able to persuade a very unlikely individual, Sandy Frucher, to take over that Exchange, and he's been uniquely successful in running an institution that many question its existence today.

A case against the American Stock Exchange, the Boston Stock Exchange, the CBOE, the Pacific Stock Exchange and the New York Stock Exchange, and it persuaded me, as it has my predecessors, that the triumvirate of enforcement efforts of the SEC, the self-regulators and private rights of action create the greatest protection for America's investors, and any one leg of that three legged stool is fundamental to that, but self-regulation works only with appropriate oversight. And while we brought cases, I can assure you that my successors will be and have already brought cases against those same institutions and that has got to continue into the future.

Pay to play was an action suggested by a prominent law professor at Columbia University who subsequently became our general counsel and I'm proud to say one of the most distinguished Commissioners in the history of the institution, Harvey Goldschmid. We were able to drive that issue, succeed with it right up to the Supreme Court. Regulation Fair Disclosure, again which was the genius of Harvey Goldschmid, was bitterly opposed by the securities industry and broadly supported by corporate America and has worked in my judgment extremely well.

Ethics in terms of market regulation and the most contentious battle in terms of the accounting issue where we tried vainly over an extended period of time to try to gain acceptance by the accounting industry of their public responsibility. I look back upon that period and say that no industry in the history of America has done a poorer job in terms of public relations than the accounting industry. I blame it upon the leadership at the time and their inability to sense the train that was coming down the tracks when they decided to make war against the United States Government, submit themselves to the kind of public attention which marked them as, unfairly I think, as villains because the vast majority of the industry did an absolutely superb job. And I was obliged to accept a settlement because of the successful lobbying efforts of the industry, a settlement that really didn't go nearly far enough, that set the stage for what happened during succeeding years.

I guess the people that I am proudest of at the Commission and unlike all of you, I have the disadvantage that these people have heard me talk so much they're saying oh God, he's saying it again, but I can't say often enough how valuable I felt the staff was. I often felt like Charlie McCarthy - my best speeches were written for me by the staff. My funniest lines were created by the staff. My best ideas came from the staff. The support in my darkest moments came from the staff. But to deal with McLucas, Walker, and Cutler who really drove home the message in a way that couldn't have been done elsewhere. To have the succession of chief accountants as Walter Shuetze, who was provided by Richard Breeden, Mike Sutton and then Lynn Turner, I don't think any institution in America could possibly have the benefits of the talents and the loyalty and the commitment of people such as those.

Now, recruitment is such an important part of any Chairman, and clearly, even with those talented people, there were issues that I touched on, but didn't drive on. And one of those was the analyst issue. I knew about that issue long before Eliot Spitzer came on the scene. It was not a priority because I had other priorities and I suspect

that everyone at this table could look back upon their term and say I wish I had looked at that rather than this. And then all of a sudden, governance appeared on the scene when again my inspired general counsel decided that we needed to address governance issues by going at it with changes in the way audit committees functioned. And Harvey Goldschmid once more came up with the plan for putting through a blue ribbon commission on audit committees and that began to set the stage for a lot of things that have happened recently. It set the stage for the empowerment, I believe, of institutional America.

I think the Commission today and all of us have got to think in terms of the issues that they face that we faced before them and then successor Commissions will face in the future. The role of the Commission in terms of the Congress, what is the extent of the Commission's political involvement? I think all of us what say that Commissions have been apolitical from the very beginning and it's the job of our successors to see that they are ruthless in terms of committing to a non-political environment, while at the same time trying to fend off a Congress that would clip our wings and mobilize a Congress that can be our main basis of support. Right now we are riding a wave of Congressional support, but I suspect that wave has crested, and we now face powers out there that would trim the sails of Sarbanes-Oxley. And soon I believe you will have Congressional calls for revision of some of the progress made in the legislative arena in recent years and bring pressure on the Commission to deregulate. I think that the relations of the Chairmen with their Commissioners is terribly important, that that relationship be one of cooperation where public bickering or leaks to the press become the exceptions rather than the rule, where talent is recognized and encouraged, where Commissioners feel part of the process, and that's, God knows that's difficult because every Commissioner that I've ever known feels that it's only the Chairman that matters and sometimes the Chairman felt the same way. But Commissioners can make a difference.

And maybe most important I mentioned recruitment, but no Commission can operate without the support of the staff. A staff that is disaffected, a staff that is not respected, a staff that is not championed simply will not do the job, and no Commission can operate in my judgment without being able to deal fairly and openly with the constituents that they regulate. No Commission can take on the united opposition of the corporate community, the markets, the media and the Congress. It simply cannot be done. Fights have to be chosen carefully, and again there must be a sign-on of Commissioners and a mobilization of the staff who view these steps as almost a crusade. So I think we have an extraordinary tradition that has created Chairmen, everyone of whom I think have made significant contributions to investors and to the economy of the country and the issue is now how do we build from here, and I've got to say, David, that in structuring this group, you have crystallized what is great about the Commission and provided a legacy for our successors both as Chairman and as Commissioners to continue the history of excellence that I think has been given to all of us and of which we're so proud of. Thank you.

**DAVID RUDER:** Arthur, thank you. I think all of the Chairmen believe exactly as you do, that the staff is crucial to the success of the Commission and that we have greatly appreciated them in all ways. I like to joke that the only reason I accepted the job as Chairman was so that I could be a member of the SEC alumni group after I left

because the strength of those people while they have been staff members is of such great importance to the Commission and to its function.

We have some time left and I'm going to try to introduce some subject matters and get opinions from the various people around the table and one of them I think is just a bridge from what you said, Arthur. That is what should the Commission and its supporters be doing to keep the political pressures from overwhelming it, to allow the Commission to achieve its goals? Brad, you've been around Washington for a long time. Tell us what it is and what influences can be brought to bear that would help the Commission succeed in its mission.

**BRAD COOK:** Well I think that we don't want to call the Commission political, but as Arthur said in his comments, politics are involved. When I was at the Commission, the Democrats were in office and Bill Casey poisoned the well with Congress in refusing to cooperate in certain areas, and when I came up for my confirmation, I did my dutiful call on various chairmen of various committees and every one of them said we hope we're not going to have the same trouble with you that we had with Bill Casey, and I just think that I don't have a solution for that. I think that you're appointed politically, you have oversight by politicians and politics is what makes this town run.

**DAVID RUDER:** At least you're suggesting that the Commission ought to be sensitive to Congress and the political influences that Congress can have.

**BRAD COOK:** Definitely. I think, you know, you can get more flies with honey than with vinegar.

**RODERICK HILLS:** David, if you look back over the years, I can't think of a Chairman subsequent to the time I was there who hasn't faced some really outrageous criticism from Congress or someplace else. We've all had it, and the answer to your question I think is in this room. It's the tradition of the SEC. I think none of us would want to buckle down if we thought the right thing was to stay on it. [unintelligible] when the President appointed his commission to take a look at why we were bringing cases against all these foreign bribe cases. And it was really devastating one day. Elliott Richardson was a wonderful man. I don't think he'd read the report before it came out, but the report basically criticized us, and I don't think anybody in the room expected anything other than to say baloney, we're going to keep doing it, and the world stayed with us.

**ARTHUR LEVITT:** I think that what's terribly important is to engage. Get up on the Hill even though you may hate the abuse you take from staffers or from members of Congress. Get up there and engage. I think we as Chairmen can't do enough of that and ultimately I think that Congress recognizes the fact that we're wearing the white hat.

**DAVID RUDER:** That was the advice that Al Sommer gave me when I came in. He said that Chairman Shad did not have good relations with Congress and I should make every effort to be right with Congress and to be friends with Congress.

I have one incident that I would like to recount. When I was confirmed as a Republican, Senator Proxmire said to me, I'm not voting for you because Republicans will never be strong regulators. About a year later, I had the privilege of going to Senator Proxmire's office and saying I'm opposing your bill to repeal the Glass-Steagle Act because you do not give the Commission jurisdiction to protect investors against the securities activities of banks. He said you don't mean oppose, do you? I thought to myself, I didn't say this, but I said to myself: "You wanted the strong regulator and I'm going to take a strong position." The answer I said is yes.

Richard, you seemed to have gotten the support of Chairman Dingell. How did you do that?

**RICHARD BREEDEN:** I perhaps had the advantage of working in the White House for four years so I had dealt pretty extensively with Congress. We had just been through the searing experience of the savings and loan trauma for the country, and had passed a revolutionary piece of legislation that eliminated the FSLIC, merged it in with the FDIC, got rid of various regulatory bodies, created new ones, enhanced criminal penalties, in many ways a precursor for Sarbanes-Oxley, but focused on the insured institutions. And so I knew the committee chairman, I knew leading members of the committees on both sides of the aisle.

**DAVID RUDER:** And you knew that you should be friends with them.

**RICHARD BREEDEN:** Yes, but it's more than friendship. To state the obvious, this is not a monarchy, this is a democracy and Congress represents as much as sometimes we don't like it, the institutional voice of the public. And so I actually never found, and I testified on 55 occasions, we passed I think three major pieces of legislation. I had during my era, both houses of Congress were controlled by the Democrats, so I had John Dingell in the House and Ed Markey in our subcommittee and Chris Dodd in the Senate, and I must say, and Mike Oxley over on the House side, and you know we had a wonderful set of relationships there was party lines were never an issue. The SEC isn't about politics. There was nothing we were doing that was political. There was nothing that really needed to fragment on partisan lines. I did have a lot of problems with criticism from Senator Gramm for a variety of reasons, and there was a real, I think, period of time in which there was an animus toward the SEC as an institution that I tried my best to just work around, but no, I found dealing with Congress to be a critical part of the Chairman's job. It's difficult for the Commissioners individually to, the Commission needs to speak with one voice as much as possible with Congress, and it's the best forum available for explaining the Commission's views on policy issues. Testimony is a wonderful opportunity. Now the staff always thought it would be nice if our testimony in my era could get there more than five minutes before the time I was scheduled to testify, and I will confess to having a problem with ever thinking we couldn't improve the testimony, but or at least improve the parts I had written, the parts the staff had written usually needed no improvement, but testimony is a wonderful

opportunity to present your case to Congress and persuade them that you're right. And I think in the end, the best way of dealing with Congress and to have good relations with Congress is to do your homework and think through the issues and be engaged.

And it's not a matter of lobbying your position through. The opponents can use donations and can use the force of lobbying and so on. The Commission has a precious currency and that is its positions are motivated by a view of what's right for the country, and people will respect our process and will respect our views, but they won't give it blind deference and they shouldn't. And so if the Commission has good answers for good questions, then it will win tremendous support on the Hill. If you try and go up there and say well you should do it that way because we say so, well then you won't get so far. And you have to recognize that in Congress, I mean John Dingell is an excellent example. I consider myself privileged to work with John. His father had been directly involved in the drafting of the securities laws, and he had from a career of 40 years in the Congress watched Chairmen come and go, and watched the evolution of the securities programs and so it was not entirely clear who had more experience and more, certainly no one can say that his stake in the health of the Commission and its programs was not as great as ours. And so, and I think that across the Congress when you get committee chairmen who have been on a given committee and worked with the government programs sometimes for decades, they have tremendous institutional knowledge too, and so I always approached it as an opportunity, not as a challenge, to persuade them we were right and they were a vital source of information to me of where there were areas we hadn't though through the issues well enough, that was where I was going to find out about it. And the goal wasn't just to fix bayonets and charge the Hill, but to take what their questions were and go back and really think through our positions and hopefully come up with something would command support.

**DAVID RUDER:** I want to switch grounds a little bit. Arthur, you talked a little bit about your relationship with the accounting profession and Rod, you'd just been chairman of a commission that made a report about accounting and what it should be like. I think it was called The Future of the Accounting Profession?

**RODERICK HILLS:** Without a question mark.

**DAVID RUDER:** Without a question mark, yes, and my own background has been not only with the Treadway commission. but as the result of Arthur's work in reforming the governance of the Financial Accounting Standards Board, service as a member of the Board of Trustees of the Financial Accounting Foundation. This background has led me to become very much aware of the fact that accounting is an incredibly important aspect of the way our society is run in terms of disclosure, certainly, and now in terms of international convergence matters. But I'm just curious, and I know we have the PCAOB, but I'm just curious as to what role the Commission should play in dealing with accounting matters. Where should it's focus be? How can it help to create the kind of disclosures we'd like worldwide? Rod, do you have some comments on that? You now know what the future of the accounting profession should be.

**RODERICK HILLS:** I think the role of the Commission right now is to recognize that the accounting industry is caught in a time warp. It's doing what it's always done, the same way. It's terrified of doing anything different. It's afraid of being sued. They stick to these rules, the Financial Accounting Standard Board rules. They stick to the interpretations of it. I think it's fair to say that the financial statement today has become a relatively unimportant thing. It's very important to the trial lawyers, but in terms of trying to understand the value of a company, the notion that there's a number, an earnings per share number, that's just not right anymore. We need to break out of that time warp, and so I think the Commission with PCAOB as a help, needs to create the climate for a major change in the way in which a financial statement is prepared.

**DAVID RUDER:** How would it do that? Would it force the FASB to change its approach?

**RODERICK HILLS:** Well, I think that the so-called bully pulpit works along with it. I think you have remarkably good people and I think the Financial Accounting Standards Board was willing to break out of it. I think the International Accounting Standards Board is trying to lead the way. I think the question is how can you challenge the accountants to create a different kind of financial statement without exposing them to undue liability for doing that.

**ARTHUR LEVITT:** I think the PCAOB was created largely because the profession abdicated its responsibilities to self-regulate itself. And ideally, the PCAOB will restore public confidence in the profession, and over a period of time, hopefully a short period of time, the industry may embrace the characteristics of self-regulatory responsibility. In the best of all possible worlds, in four or five years we wouldn't need a PCAOB because the industry would have developed those self-regulatory characteristics. I think the danger that we run in now is that all of these efforts and the enormous litigation that is directed at the profession, both from the government and private rites of action, may place the industry in great jeopardy.

**DAVID RUDER:** I agree with that.

**ARTHUR LEVITT:** And the alternative to that I think is unacceptable in terms of government taking on the audit responsibility.

**RICHARD BREEDEN:** So, I've got to jump in here, I'm sorry.

**DAVID RUDER:** You are a former Chairman. You are entitled to do that.

**RICHARD BREEDEN:** Thank you. First of all, I agree with Rod. We need a different kind of financial statement. The accounting profession needs to finally figure

out how to get it right, and you know the number of times where we have had blown audits. (drops paper) There we go.

**DAVID RUDER:** It's all right. You're still on the air.

**RICHARD BREEDEN:** Where we have had financial statements in WorldCom, the last published balance sheet of WorldCom prior to the announcement of fraud showed assets of \$104 billion. When we finished one of the most intensive forensic reviews ever done at a colossal cost both in new fees and \$200 billion in losses to shareholders, it turned out that the assets at that time were worth about \$20 billion. So they were close. 75% of the reporting assets didn't exist, and the accounting firm didn't notice and neither did the analysts, a separate problem. And I think we have had, we struggled during my era with accounting principles that I think have gotten worse and worse and worse, and the FASB needs independence but we have had more and more and more theoretical and complex accounting standards and the last statement now has more things being accrued into it and then accrued back out of it than you can shake a stick at.

**DAVID RUDER:** Doesn't the Commission have some responsibility here? Hasn't the Commission been overseeing the profession, overseeing the Financial Accounting Standards Board, reviewing the complex financial statements? And so aren't we in a position where we should tell the Chairman to take steps to accomplish this?

**RICHARD BREEDEN:** That wasn't what I was arguing for. I think what I was trying to say, perhaps inartfully, was we have a tremendous need. The markets depend on information and we have had, and Arthur and I think it was one of the many highlights of his tenure that he took the tough actions that he took in trying to confront an industry as large and as powerful as the accounting industry is and have forced them to face up to certain issues, and for 20 years they had evolved in the direction that their job was to find ways to grow their consulting business rather than to get their audits right. And the market depends, we've given a quasi monopoly to accounting firms. We know have four firms in the world who do it. We are in a very dangerous position of how in the world are you going to hold people accountable for major problems when you get down to there's only a few firms and the consequences to investors and the markets when they get it wrong badly are immense. And so there needs to be a consistent effort, I don't think it should stop with either Arthur's rules or with Sarbanes-Oxley or with the creation of PCAOB. There needs to be sustained effort between the accounting firms, the Commission itself, the PCAOB and interested people in Congress to try and figure out how to put the quality back into auditing and try to have financial statements that are really meaningful. My own personal view is that the most important thing the Commission could do would be to require vastly greater use of cash flow statements because the problem is as pieces evolved the P&L into something that is such a theoretical construct now and it diverges so greatly from real cash flow, I think we'd do investors a real favor to provide a little better information on the reality of cash flows.

**ARTHUR LEVITT:** I said before that I think the real threat that investors and the Commission face at this point in time is that the lessons of the past I sense are rapidly being forgotten, and the efforts to dilute Sarbanes-Oxley are being heard all over America – Op-Ed pieces and speeches and news columns, and I think the Commission has got to be vigilant in terms of protecting the principles that lie behind Sarbanes-Oxley and the PCAOB. That's not to say that there aren't unintended consequences of any legislation or regulation. Nevertheless, if we begin to allow political pressure to play out in terms of Congressional pressure on the Commission, to step back, to be permissive, to water down the actions with respect to investment companies, the accounting profession, the analyst situation, and all of those issues I think we would move backwards very, very quickly.

**DAVID RUDER:** Well I think you are addressing one of the questions that I put. That is, how does the SEC Commission behave as an institution? Your conclusion, I take it, and I don't know anyone here that would disagree, is that the Commission must be firm about the policies that it thinks are proper.

You mentioned mutual funds and we haven't talked about them. I don't know any of us that really thought that mutual funds were a great problem when we were in office, and today we find a scandal and suggested ways of overcoming the problems in that scandal and they tend to be in the governance area. Although we have been a governance agency involved in governance matters, we haven't looked at the mutual fund industry and I wonder if our, in our collective views we would instruct or tell Chairman Donaldson to stand firm on the proposals the Commission now has made regarding an independent chairman and 75% of the independent directors or any other governance matters. You want to talk about that, Brad? Do you have any views? And if you have any conflicts you can announce them.

**BRAD COOK:** What are mutual funds? No, I don't have any view on that, but I have a question to ask you on a lighter plain.

**DAVID RUDER:** Sure.

**BRAD COOK:** When Proxmire voted against you was it because you were using the SEC limousine? [laughter]

**DAVID RUDER:** No, someone in the history of the SEC was seen by Proxmire using the limousine when that limousine was supposed to be off-limits. Now, do you know who that was, Brad?

**BRAD COOK:** Do you want to hear the right side of the story?

**DAVID RUDER:** Sure.

**BRAD COOK:** My car was locked up in the agency and I was going to a Chamber of Commerce dinner and Willy, who is the driver, had driven Bill Casey everywhere - I don't think Bill Casey ever drove his own car in his life - came and picked me up the next morning, I think because my car was at the agency, I had to have him pick me up at my house and drive me to work. I was sitting reading the *Wall Street Journal* and I hear this tap on the window, and there's Senator Proxmire running to work. And he says 'A good morning, isn't it, Brad?' and I said 'Yeah, it's a great morning, Senator' and I got back to my office, or when I got in to my office, Sandy Whitman who was then my executive assistant came in and said there's something on the wire about you using the SEC's limousine. So that's my side of the story.

**DAVID RUDER:** Okay.

**RODERICK HILLS:** David, I was, in trying to get ready today, I went back and tried to read some old speeches and statements, and I was astonished to find that there was a period that mutual funds did come to our attention.

**DAVID RUDER:** Okay.

**RODERICK HILLS:** And it was a time when fund regulation was a big thing in those days, investment management regulation, and we were trying to re-examine that and Dick Zecher and others who were quite concerned about the fact that we had all these rules but we had no transparency and we did not have any independents on the mutual fund boards. And so there is one little speech that I made at the request of Dick Zecher and the staff was very concerned about the fact that we regulated everything, we even said that the arrow can't point up, if you have an arrow, anything that's pointed on a financial statement, mutual fund, the advertising, it can't point up. There's all kind of rules like that. But we did not have simple things like transparency and how they did their business, and we had no requirements for independents on the board. So the need for independents in mutual fund boards, I think is critical.

**DAVID RUDER:** And how do you relate to the question of whether the chairman should be independent? That is a proposal that is not being made in the industrial area today in the United States. That is, there is not a strong lobby for independent chairs in industrial corporations.

**RICHARD BREEDEN:** I disagree with that. It's fast becoming best practice. It is what the direction we should be going. It, the best companies, whether you call it lead director because you don't want to offend the ego of the CEO or whether you call it chairman, we are moving in the direction of having a little better balance of power at the top of industrial companies, and it's high time we did.

**DAVID RUDER:** Balance of power, right, but the formal separation, at least in Britain that has been the approach.

**RICHARD BREEDEN:** I think five years from now you'll find it a very common thing here in the U.S. We're getting there. It's not something we're going to get to overnight, but...

**DAVID RUDER:** Without that caveat, Richard, where are we with mutual funds? Should we be moving today to have the mutual fund chairman be independent?

**RICHARD BREEDEN:** Well, I personally, since it's something the Commission's grappling with, I don't wish to express an opinion on that. I'll leave to the people who have the responsibility here and they don't need my views complicating that. Mutual funds are a very difficult issue. You have an entity that is created in many respects by the sponsoring organization. It has no employees. It is a creature of the fund complex. There is an obvious tendency to take all of the things that represent good governance in the corporate world and slide it over and say well that automatically would be good in mutual funds, and some of them are. But it isn't automatically true that everything that might be good for a widely-traded public company is necessarily the right answer for a mutual fund and I think the Commission, there are some tough issues there the Commission has to struggle with and so I don't think it's as simple a fix as that. I certainly have been watching some of what's gone on, agonized over whether in my time we did enough, whether any of us have done enough as mutual funds evolved. I think we, during my era we certainly had a view that mutual funds were very clean, had had a long history of being not involved other than Cornfeld, there had been a few issues, but by and large you didn't have the bad loan problems, fraud problems and so on that the act could work very well by not allowing sponsors to buy or sell anything with funds. We didn't think about in my time, and funds were a bit smaller then, we didn't think about the risks in the trading dynamics that that might be a different route to improper enrichment of the people running the funds. And you look at the situation now and I think the Commission is doing what it needs to do, which is to try and step back and think across the board of where did we go wrong and where can we make this system better.

**DAVID RUDER:** But it is doing or suggesting in the mutual fund area exactly what you said will be practiced in the industrial area in the next five years and I have to tell you where I'm coming from. I've already testified before Congress that an independent chairman is exactly the right way to go and that 75% of the board being independent is exactly the right way to go. I believe that because the separation of the management from the true representatives of the owners, the boards, is much more complete in mutual funds, we need to empower the overseers in that area.

**RICHARD BREEDEN:** Arthur and I jointly wrote an article in the *Wall Street Journal* saying exactly that some time ago and so I was just being gracious with the Commission in not wanting to comment on a matter that they are struggling with here.

**DAVID RUDER:** Well I think it's important to have the support of all its former Chairmen, if we give it to them.

**RODERICK HILLS:** I think, David, let's go back to industrial corporations for a minute. One of the great things that's happened as a combination of Sarbanes-Oxley and the New York Stock Exchange crisis is the creation of the nominating committee, nominating slash governance committee. In the years ahead, it seems to me that that's going to be the single most important thing in corporate governance, and so the capacity to select directors, the number of boards that are going out have a nominating committee to hire a headhunter to look for a really qualified director not just people that are independent of the chairman, but people that are quality and that compete for those jobs. And how you can transpose that, I suppose I'll associate myself with Richard, how you create that capacity in a mutual fund board, certainly the independent chairman is a way of doing that, and I have no objection to that, but the important thing is how do you create the quality on the mutual fund boards that is beginning to be created on the boards of industrial companies?

**DAVID RUDER:** And how do you motivate the directors to act as though they are independent?

**RODERICK HILLS:** Well, that's Steve Cutler's job.

**DAVID RUDER:** The velvet glove, I mean the velvet glove over the iron fist.

**RICHARD BREEDEN:** I mean there are limits. You can lead a horse to water but sometimes you have to whack him over the head with a two-by-four.

**RODERICK HILLS:** Well we've certainly done it in the industrial field. Nominating committee chairman, I think you can look at this year's annual reports or proxies. I've seen ten companies where the nominating committee hired the headhunter without any interplay with the CEO, selected the candidates, interviewed them and selected three from say a number of eight or nine and had other directors meet those three, including the CEO, and then after getting the response from all of them, then they selected the director. And I saw ten. I think you're going to see a hundred next year doing it that way. And how you create that initiative, I'm not positive how to do that.

**DAVID RUDER:** Arthur, do you have a comment on that? You and Richard have already written an article saying that the independent chairman is a good idea.

**ARTHUR LEVITT:** Well once again this an area where industry pressure has become very aggressive. This is an election year. What to many people is a sure thing

in terms of this initiative going through as recently as several months ago feels to me just slightly less sure, and I think it's terribly important that the Commission stay the course and push through the proposal. Today's *FT* –

**DAVID RUDER:** *Financial Times?*

**ARTHUR LEVITT:** Yes, the head of TIAA, Herb Allison comes out full square in favor of the recommendation, but is largely opposed by other heads of investment companies, so I think this is terribly important for the Commission to win this one.

**RICHARD BREEDEN:** I know you all know this, but for the record I think the lesson in history is fairly clear. If you are being criticized in the press and in Congress, the agency should take comfort that you're on the right track. If no one is criticizing you, wake up. There's something you're missing, and look, the Commission's role is as I said, is sometimes to say no. It is to stand up to people who want to do things that are not necessarily in the interest of the markets or the tens of millions of investors and so that doesn't mean that the critics are always wrong. Certainly you can learn a lot from people who point out the flaws in your thinking and you should, but and the Commission, and Arthur's point on Sarbanes-Oxley, I was strongly in favor of Sarbanes-Oxley, but I think there are things in the law that are more costly than they have to be and that we need to work with the business community to find a way to preserve as Arthur described, the principles that lie behind it, but make it workable. Nobody wins when we have a law that achieves a regulatory objective in a more costly way than it needs to and so, but I think you have to listen to criticism and you have to be responsive to it, but in the end, the Commission has a long history of having to be willing to sometimes stand up and push something through even though there's criticism. And it's kind of funny, some of the things Rod was mentioning earlier and some of the things we take as absolutely accepted practice today that were the subject of the same kind of tub thumping from the corporate community 20 years ago and so sometimes you just have to take the criticism and stick to your guns.

**RODERICK HILLS:** It's interesting, Arthur, that the ferocity with which the New York Stock Exchange was met when it proposed independent audit committees is absolutely quiet. Sarbanes-Oxley and audit committees has been supported every place. I think the PCAOB has been supported every place. Rule 404 is in question, and I'm with Richard on this thing, I don't think it needs new legislation. I think the PCAOB and the SEC can work together to deal with that in an effective fashion, and I hope they will.

**DAVID RUDER:** I think the Commission has always been sensitive to the needs of the business community as long as the regulatory environment is not compromised, and that's what you're suggesting, Richard.

**RICHARD BREEDEN:** We went through, and it's actually interesting because Arthur mentioned he sort of stayed out of the governance area, we did a very wide

ranging overall of proxy reform, or proxy disclosure and the proxy process when I was there with Linda Quinn and who, who I know we would all say contributed so much to this Commission in so many ways in our work and I was certainly one of them. I must say all my Commissioners at the time, we all spent a huge amount of time and effort and focus and everybody made a contribution to that, what I think was a very significant update. We put in place the short slate rules, so that instead of replacing an entire board of directors, it was possible for dissidents to replace one or two or three members of a board, and I think that was a critical reform that has led to some real progress in corporate governance. We got rid of some of the provisions of law that could be used to try and intimidate people, shareholders, from communicating their views about corporate performance with one another, which was a healthy step.

The area that I in looking back and just, this is perhaps changing the subject, but the area that has vexed me the most is we thought we could, we thought then that executive compensation was a terrible problem in the country. It was growing and we had sort of two sorts of problems - one, compensation that wasn't linked to performance in too many companies, and two, the performance that wasn't, was done in secret and wasn't out in the open and three, that performance that may have been linked to performance but was so large it was unreasonable and shocked the conscience. We thought the solution to it was good disclosure. We put everything out in the open. We put these nice rules in place that required the comp committees to write rules, or put in the proxy and analysis the factors they looked at in awarding the compensation, to sign their names to it. We required very, very thorough disclosure to all the components of compensation, particularly all the equity pieces. We hoped that that would lead to good transparency and market disciplines and the market would function and everything would be fine, and instead what it did was to arm the compensation consultants with all kinds of new data on how much everybody was being paid, and ten years later the average compensation package is probably 300 or 400% what it was ten years ago.

The Spitzer suit against Grasso, using a statute unlike the federal statute, the New York not-for-profit law, but basically bringing an action saying that compensation that is unreasonable is unlawful is an interesting development. It will be interesting to see how it plays out. I don't think as a society we have solved the problem yet of dealing with executive compensation, having reasonable decisions. People who are great CEOs and lead companies that are doing well can create tremendous value and should make very large compensation, reflecting their achievements, but I think too many times the outcome is huge packages whether there are achievements or not and sometimes beyond what is at all reasonable. And I've been fascinated over all the pressure we put on audit committees to do a good job and the Commission and the PCAOB and the private bar and everyone else pounds the heck out of audit committees, such that I must say as someone who has chaired a couple of them, I keep thinking every year I need to get off these audit committees because this is just going to be too hazardous. And we haven't put very much pressure on people running compensation committees to do a little better job. And I must say again and again in my era and I think down to the present time, some of the worst frauds are tied in with the worst abuses of the compensation practice. It's certainly an issue that I'd point out as one for the future for the Commission to do a better job than we did in my time to finding a solution to this problem.

**DAVID RUDER:** Here as you know, the Commission has in this area thought of itself as a disclosure agency, so in some way the Commission needs to fashion a disclosure rule to force conduct, which it thought it was doing originally with the compensation rules. Other than that, I think we are probably looking for greater powers, for some Congressional initiative, but before you speak to that, I'd like to change horses just a little bit more. Arthur, the initiatives that you took regarding market structure I think were the most far reaching that the Commission has taken in some time, and we are now looking at a major Commission initiative in the market structure area which will, depending on its result, cause change. I wonder if you could comment a little bit on your reflections on whether the Commission should be a leader or a follower in the market structure area. Should it be concerned about interfering with the freedom of the markets if it attempts to interfere with the way in which markets work, or should it be concerned about its regulation lagging markets and injuries that are caused by unfortunate activities in the market without SEC regulation? I've always thought that was a really tough dilemma for the Commission.

**ARTHUR LEVITT:** I think the Commission has it just about right. What the Commission is trying to do in the simplest form is to see to it that natural market forces, which have changed dramatically in recent months and years, operate fairly from the standpoint of investors, represent the minimum number of systemic risks, nurture competition that is fierce, but fair, to drive down costs, to see to it that the various participants are nudged, are encouraged, are motivated to move in that direction, and that direction means clearly moving toward globalized electronic markets, step by step by step. The recent Commission action with respect to the trade-through rules which is so controversial, criticism coming from the ECNs that the Commission has not gone far enough, from the auction markets that the Commission has gone too far. I think that the Commission has done it in the same way that it's always done it – constantly put pressure on all players to move toward what was, has been long regarded as a national market system, only today, electronics is more of a factor than ever, and if the Commission failed to recognize it, markets either here or more likely away from here would force us into that. We no longer have the luxury of saying that we are the primary capital market in the world and we can rest on that and other countries are going to have to embrace our standards and our system. That's simply not the case any longer, and I think the Division of Market Regulation understands that full well and I think their proposals are appropriate as motivators rather than structurers of the market of the future. I don't think it's the role of the Commission to say this is the structure that shall exist, but rather to see to it that they describe the boundaries of what's being considered and what's being done, seeing to it that disclosure is complete, seeing to it that no one market is favored over another and that nudging process continue.

**RICHARD BREEDEN:** I agree with that, I think Arthur put it very well. Some people value cars with a lot of horsepower and other people value cars with high fuel economy and it's kind of hard for the government to say what's the best choice. You have to let, at some point, the market decide. Now all the cars that are sold have to have a certain level of safety and in this case we have certain overriding principles of best execution and so on, but you know, the Commission has to try and help set the boundaries and set minimum characteristics, but also has to be determined to let competition flourish, even if it is unpopular with certain very large institutions.

**RODERICK HILLS:** I agree with everything that's been said, I think the trick is to figure out what is obstructing the free market. I'd see Don Weeden in the office and I remember way back when the Rule 394 of the New York Stock Exchange, we were trying to figure out how to create a market structure, and I'm not sure we've always done it right, whether we've always identified the obstructions to the competition.

**BRAD COOK:** This issue's been moving about as fast as a two-legged elephant. In 1973, we issued the white paper on market structure, central market system, and how much progress have we made since then?

**DAVID RUDER:** We've made a lot of progress, and we've made progress in the face of technological change that is very hard to anticipate. I think the way you posed it, Arthur, was where I was when I was at the Commission, that the Division of Market Regulation had to watch the markets very carefully, regulate it when it seemed that matters were going to turn to the disadvantage of investors, but be careful not to interfere with the technological innovations which are so natural and which today are coming along at even fiercer paces.

**ARTHUR LEVITT:** Look at the speed of executions, and look at the volume we're able to handle and look at the Commission. The Commission enabled the first new market in nearly 30 years that rapidly catapulted from the bottom position to the leading position in terms of the New York Stock Exchange being one of the principal options markets in the world and the Commission made that possible, so I think market regulation has done a superb job.

**DAVID RUDER:** We are almost at the end of our time. Any last minute comments from any of you? I participated with Alan Levenson in many programs and his last comment for questions was this: what do you think the most important issue facing the Commission in the future? And I'm going to give each of you five seconds to answer that. Richard?

**RICHARD BREEDEN:** I think it's preserving the institution, keeping the ideals married to the power of great ideas as you confront the challenges of the futures.

**DAVID RUDER:** Rod?

**RODERICK HILLS:** Stay the course.

**BRAD COOK:** Protect the investor.

**ARTHUR LEVITT:** Recruiting and motivating and compensating staff.

**DAVID RUDER:** Well I thank you all for coming. We've had what I found very stimulating and challenging. It's certainly wonderful to know that our former Chairmen are alive and well and full of thought. [applause]