

Securities and Exchange Commission Historical Society
Interview with Roel Campos
Conducted on April 13, 2015 by William Thomas

WT: This is William Thomas, and this is an interview with Roel Campos for the SEC Historical Society's virtual museum and archive of the history of financial regulation. The date is April 13, 2015, and we are in Washington, D.C. So, thanks very much for agreeing to speak with us. Maybe we should start with a little bit of biographical background. I understand that you're from the very southernmost part of Texas, and that you went to the Air Force Academy?

RC: I did. I'm from a small town called Harlingen, Texas, which is about thirty miles north of the southernmost point in Texas. Brownsville, Texas, is actually right where the Rio Grande River meets the Gulf of Mexico. This is about as far south as Miami. A lot of people are amazed to hear that. Harlingen is just a little bit north of that, and its only other claim to fame are two things: one, it was a former Air Force base site for Navy training and that ended in the late sixties; and then it's on the way to South Padre Island, which is a spring break getaway for many people, and so they pass by Harlingen on the way to South Padre. So for those spring breakers who don't go to Florida, some go to South Padre Island.

But, yes, I grew up in Harlingen. I'm Mexican American. My parents were working-class people, and they spoke Spanish as their first language—actually, as has been in my area for literally hundreds of years. On my mother's side we can trace ancestors back to

1590, well before the Pilgrims arrived. At that point in time, the Spanish colonists were there and they were trying to secure the empire for Spain, given that there was competition from France in particular. And so the idea was they would give out land grants along the Rio Grande River that would have a narrow frontage of water on both sides of the river. The Rio Grande was not a border of any sorts, and they might have a mile on the river and then go inland for ninety miles.

But anyway, I went through elementary school and high school in Harlingen, and I applied to be an Air Force Academy cadet in my junior year. Our Congressman had a very simple approach; he would give people a civil service exam and I fortunately scored the highest and he offered me an appointment, and that was my ticket out of a small town and out of Texas, so I accepted.

WT: You hadn't had any other military people in your family?

RC: No, I did not. One person that influenced me a lot was a ninth grade teacher who was a retired lieutenant colonel in the Air Force, and so he pushed the Air Force Academy versus West Point or Annapolis. I was not exposed to a lot of things in terms of being in a busy city or other parts of the world, but the service academy, and the Air Force in particular, seemed attractive to me. I especially liked that it was a full scholarship, obviously, and being an officer in the Air Force was appealing to me. I, at one point, wanted to be a pilot.

WT: Then after you finished at the academy, you went and got an MBA at UCLA?

RC: I did. During my four-year time at the Air Force Academy, my eyesight took a nosedive. I was qualified for pilot training when I went in, but I'm not totally sure, maybe they just examined my eyes further and they found a defect, at least under the system at that time. I think today you could use eye surgery to probably pass these exams, but there wasn't anything like that available to me. So, fortunately, I did well in my studies, and I got selected to go into this program to get an MBA at UCLA. UCLA at that time had a program where they would give us credit for some of the courses, and so I was able to finish an MBA program in a year. And this was under my obligation, it didn't add to my Air Force obligation.

I graduated in 1971, and then I went directly to UCLA. I got married after I finished in September of that year, went to UCLA with my new bride and attended the MBA program for about a year, and so that would have been 1972. And after that I was assigned to the Boeing plant in Seattle, Washington, for my first assignment in the Air Force.

WT: Could you tell me a little bit about what you did while you were in the Air Force?

RC: Essentially, I was selected to go into what they called special weapons procurement. The idea here, as one might gather, is that the services, and the Air Force in particular, are always in the procurement of high-tech weapons and other equipment that they need. So

Boeing was a major contractor—still is today with the Air Force and the other services as well—and at the time Boeing was involved in the Minuteman Missile program, which is our intercontinental ballistic missiles, which still exist, and they had something called SRAM, which was short-range attack missile. They built some of the cargo planes that the Air Force was using. So there was a lot of procurement going on. Some of the very first, what we call now drones, were being designed at Boeing at the time, this is 1972.

To give you a little perspective, this is Seattle before Microsoft, Bill Gates had not yet appeared and programming as we know it today and software had not yet taken its shape and form, and it was also before Starbucks, right? So those two major icons in Seattle had not yet occurred. Pike Market was a sleepy provincial fishing dock area that was not gentrified at all, unlike today. Mercer Island, where Microsoft now dominates, was a nice neighborhood in Seattle, but nothing much more to distinguish it other than beautiful shores and the lake and water views.

So my job, getting back to my job at the Boeing plant as an Air Force officer, was I was in charge of procurement and I was assigned to various programs. One program that I would mention that I did a lot on was called the AWACS, airborne warning and control system, and what the AWACS was, is if you could imagine a very large, round radar on top of a Boeing 707, that was the original AWACS. Since then, it's progressed to a 747 plane to be the mainstay, much larger. And, of course, the electronics systems have evolved substantially.

But the idea and the mission of the AWACS, which still exists today, is to essentially provide an airborne control system of airplanes that were either attacking in a particular theater, or coordinating other airplanes that might be involved in logistics in other type of missions like that. There's even an AWAC system to enable the President and the staff that he would have with him—or her, we might have a woman President, after all—to be in a place where they're actually above the ground, and, in an emergency type of situation, to still have a command and control center and deal with the U.S. forces and other business of government. Again, this was a scenario in the Cold War where people could imagine that there would be an attack on the U.S. So that capability is still there, by the way, and so I worked on that particular program quite a bit.

WT: Then you went to Harvard Law School after that?

RC: What happened is two things in my personal life. One, my wife became a pre-med student and did very well at the University of Washington, and when she applied for medical school she got into various medical schools. One of those was Harvard Medical. I had a year to go in my Air Force obligation, so I asked, and the Air Force accommodated me, and I was reassigned to Hanscom Air Force Base, in, actually, the MITRE labs, which are MIT research engineers' labs outside of the Boston area, just outside the loop—128 as we know it today—and we were able to stay together and she began her medical studies at Harvard Medical School.

I put another year on the AWACS system and then resigned my commission, and I had applied to law school and got into Harvard Law and I decided to do that. I left the Air Force, I had fulfilled my obligation, I used the GI Bill to help pay for my law school, and my wife and I were two students. We ended up living in Cambridge. She would go her way to Harvard Medical School, which is in the Roxbury area, and I would have the easier of it and I could walk over to the law school.

WT: So did you concentrate or intend to concentrate on any particular area of law, or were you just open-minded at that point?

RC: I began with the idea of being a corporate and transactions lawyer, given that my majors at the Air Force Academy had been economics and engineering management, and that I had an MBA. So it seemed a natural flow to go into business and business transactions, so I took corporate courses at the law school. I took one of the last courses in securities regulation taught by Louis Loss, the famous, well-known writer of the treatise that still exists today, and has been kept up by Joel Seligman and then his protégé, Troy Paredes. So that treatise still remains sort of the go-to treatise in SEC regulation.

I did that, preparing for sort of a corporate law career, but things don't always work out the way you planned. I took a job with Jones, Day, Reavis & Pogue, still a very large firm today—I think they just now dropped the other names and just call themselves Jones Day—and accepted their position in Los Angeles. Now interestingly—and I thought a lot about it—I also had an offer, as a law school graduate, from the SEC and I could have

worked in the General Counsel's Office with Ralph Ferrara, under his time as the General Counsel.

WT: This is 1979?

RC: Yes, this is 1979. I've often thought who knows, if I had done that, would I have ever been a Commissioner? Life has a certain way of getting you where you're intended, I suppose. I've often thought that would have been a better choice, frankly, than going into the private sector, because I would have learned more. But I didn't analyze it that way. Or maybe I wasn't clever and smart enough to have accepted that. It seemed like going to a top rate law firm was the way to go, so I made that choice. My wife agreed and she did her residency in the Los Angeles area under a UCLA program at Harbor General, a large public hospital there in the Los Angeles area, and I went to work for Jones Day out of law school.

WT: And so you were then mainly in the securities area?

RC: Yes, I started in the corporate area, as I had intended. This was 1979, going into 1980, just by the way of sort of letting people know where things were at that time. My starting salary at Jones Day was an impressive \$24,000 a year, and when I showed up they had increased it to be competitive with other law firms to \$28,000 which was, frankly, enough. I felt very well compensated in Los Angeles in 1979-1980, at \$28,000 a year. So, it's interesting how the times change. Today, just by comparison, a new associate at

a major law firm coming out of law school is earning around \$150,000—some law firms pay more.

I started off in the corporate area. I worked with the corporate lawyers in the Jones Day office in Los Angeles. They were very good lawyers, but as time went on we didn't have all the business that would keep an associate fully occupied. And, as you may know in law firms, as a new associate you need to keep very busy, bill a lot of hours to satisfy demands on young lawyers. I found myself, out of necessity, taking assignments in litigation. I found that I was pretty good at that, in particular because most litigation involved corporate or business matters and many litigators in my time at Jones Day didn't have a business background, so they needed to do a little more study and work than I did in terms of understanding the issues.

So that went on for a while, and after doing it for another year or so I determined that if I'm going to be a litigator, and a business litigator, I might as well really learn how to be a trial lawyer as well, and have that full complement of skills. The only way at the time, and even today, to get hands-on trial experience is to go into either a prosecutor's shop or a public defender's situation. I had friends and former Jones Day people at the U.S. Attorney's Office in Los Angeles, and after inquiring they invited me to apply. I applied, and I was very pleased to get an offer from the local office of the U.S. Attorney, and decided that's what I would do next.

WT: Okay, so this usually does turn up in your bio because of the cartel prosecutions and that sort of thing. How much depth would we like to go into here?

RC: I can give you a few highlights maybe, and then we can always follow up if you find it interesting. So, when I began, you're on so-called rookie row, and so as a young prosecutor, whatever age you are, to get you trained you accept what in the U.S. Attorney's Office in L.A. are generally smaller cases. And those tended to be, in Los Angeles at the time, bank robberies. Los Angeles was known as the bank robbery capital of the world, essentially because there are a lot of branches, and a lot of drug addicts decide to rob a branch with a note, often not carrying any weapons, and they can escape quickly onto the freeways if they pick their branches correctly. So, for those reasons, L.A. has a lot of bank robberies. In other cities a bank robbery is a very major crime and involves some of the most senior people. But I got my feet in terms of trial work by doing many bank robberies.

After that you had a choice of what unit you went into. We had fraud units, which involved corporate fraud and government fraud and the like, other types of government fraud. We also had a narcotics unit, and I quickly learned that if you wanted to get trial work the place to go was narcotics. The reason for that was, frankly, most of the cases that would be handled at the U.S. Attorney level, not at the local level, had to do with cartel members, and so cartel cases, large distribution rings essentially, were such where there wasn't much give in making a plea offer. In other words, there was no motivation

if you ended up breaking a ring through the FBI or DEA, Drug Enforcement Agency, or local authorities, to give these drug distributors and ringleaders much of a break.

So, if they wanted a plea, you would have to offer twenty years or more or something, in which case that's prison time. They would say, "Well, let's go to trial. Maybe the prosecutor's team will make a mistake." There were a lot of trials, and one of the trials I did involved a very striking incident involving a DEA agent who was stationed in Guadalajara, Mexico. At the time, the U.S. had DEA agents in various Latin American countries that were trying to help interdict and suppress the drug trafficking.

This agent, whose name was Enrique Camarena, was assigned to Guadalajara, Mexico, and he had the misfortune of doing a great job. He ended up discovering a very large narcotics cartel. Through a lot of persistence, he was able to get Mexican officials to fly over these thousands of acres of fields where marijuana was grown and processed and then taken onto trucks to the border. Also, the operation involved passing cocaine through the border. In essentially breaking the ring, he urged the Mexican government to fly over these particular sites and drop chemicals on the crop and eradicate it essentially, and they rounded up many of the individuals involved.

You have to understand that this is a major multimillion dollar investment on the part of cartel ringleaders. They're essentially business people who happen to be in the drug business. And so this constituted loss of hundreds of millions of dollars when these fields were eradicated, and cocaine was also confiscated, and their whole system, under which

much investment had been made, was thwarted and disbanded. Keep in mind that you have to have power, you have to have trucks and large groups of people, and cooking to provide food to the laborers. Anyway, all of that was disrupted so they were very angry at the DEA, and at this agent in particular.

So, sadly, on the last day of his assignment, as he was walking out of the U.S. Embassy in Guadalajara, two men came up to him, put a gun to his back, pushed him into a car, and that was the last he was ever seen. He was taken, we learned later through evidence, to a mansion owned by one of the ringleaders, a fellow named Rafael Caro Quintero, and taken to a pool house behind there, interrogated, tortured to give information, it was recorded, and he was eventually killed through brutal beatings and trauma to the head.

Many interesting things came out of that. Of course, this was a terrible incident, and at one point the U.S. Customs closed the border, essentially, by making sure that every car was inspected. Well, you can imagine the tie-ups and the long lines for miles of trucks and other commerce trying to get through the borders. And this was because Camarena had disappeared and his body had not turned up. As a result of this, the bad guys ended up exhuming his body and dumping it in a particular ranch, and that had its own complications. Eventually, FBI agents went and obtained forensics evidence.

But, just very quickly, one of the interesting aspects of this case was that there was this tape that was procured and in evidence, or at least in the government's possession, that had to do with the interview. It was a recording of the interview of the agent, and it

became a huge challenge of how to get that particular tape into evidence. There was an informant that no one wanted to blow or to compromise, and so the chain of custody as to how that tape had been obtained couldn't be made.

It was a big challenge, and it fell on me to devise a legal theory of how to bring that into evidence. Good student that I was, I studied the Evidence Code, and I determined that there was a way to introduce it through self-authentication, because the content was so unique and we could identify the agent's voice and the voice of several of the cartel members, and let it in on its own weight of the evidence. The judge wouldn't declare that it was authentic, but we would argue that it was, allowing the other side to argue against it if they could make a case that it had been fabricated in some way.

This was a very publicized case. I was part of a team, I was one of the co-prosecutors, and we ended up winning, in other words convicting the three individuals. There were many more who were involved, but these three were the only ones we had in custody at the time, and we ended up having them sentenced to 240 years. The death penalty, at the time, wasn't available. It was a very dramatic trial. I was under U.S. Marshal protection because of a death threat at the time, and my family and I were being escorted by deputy federal marshals, home and back to the U.S. Courthouse for a period of six months. So it was a lot of adrenaline that was flowing in my body at the time.

But, fortunately, it all ended well. We weren't hurt, we didn't have any incidents to report, but it was a very involved system of protecting me and my family, and even the

L.A. County Sheriff's Department was involved in a potential rescue if my home at the time—I lived in Glendale—would have been attacked by narcotic hitmen of some sort.

WT: It's a very different story from what we usually get in these SEC Historical Society interviews.

RC: (Laughter) I imagine, yes.

WT: So how long were you then with the U.S. Attorney's Office?

RC: For about five years. I left essentially just thinking that it wasn't fair to my family to keep giving them these kinds of adrenaline experiences, as exciting as it was for me personally. I left the U.S. Attorney's Office and returned to private practice. I decided to do something different. I became a partner with a longtime Hollywood lawyer, a well-known lawyer who had represented Frank Sinatra, for example, for thirty-three years, had been Frank Sinatra's do-everything person. He had one of the best arrangements I think a lawyer ever had with a client. He would take 10 percent off the top of everything Frank Sinatra made, and he would book him in Las Vegas, deal with the studios in terms of any movies. Along the way, this particular partner, whose name was Mickey Rudin, ended up also establishing record companies, which became Warner Records and other evolutions since then, on behalf of Frank Sinatra who maintained ownership. So it was quite a very interesting set of assignments.

At that time, I wanted to keep doing trial work, courtroom work if necessary, but also go back to doing some business transactions, so I did that for a few years and it went well, I had a good practice in Beverly Hills. Then I did something very different. Again, you gather that I haven't had the typical career. I chose to accept the invitation of a client of mine, who at that moment was raising capital and building a company to own radio stations, and his business premise I felt was very strong. The idea was that the radio industry at that moment in time—we're talking now late '80s, early '90s—was still not consolidated, and it's not the radio industry that exists today. Many radio stations in major cities were owned by private individuals.

You might have in L.A. several radio stations owned by a large car dealer, for example. Gene Autry, former star and singing cowboy, owned various very strong, very well-known radio stations in Orange County and the L.A. area. In other cities, you had funeral directors owning radio stations. So, it was sort of the local businessman's media, that they would find it interesting. Some of these individuals would actually even be on-air personalities, they would do stuff at lunchtime. I remember one director who would come on lunchtime for an hour and play his guitar and sing, and he wasn't considered to be very good.

So the idea was twofold: one was that we would have consolidation in the industry, and that essentially we would end up having a change of laws. The laws at that time only allowed a large company to own two major signals in a city, and therefore, it was called a duopoly, where that allowed the smaller businesses and individuals to own radio stations.

WT: Those are FCC rules?

RC: FCC. We were thinking that there might be a deregulation of the industry, much like the airlines and so forth, and that was Newt Gingrich in that particular Congress working on that. There were other industries, like the airline industry, that were also looking at being deregulated. So we thought we had this great idea that if we could grab these stations at the current prices, then their price might jump up in the future if deregulation did indeed occur by Congress. We also thought that we could provide a manner and a system of management of these radio stations, take it away from kind of a frills and a hobby approach that these local people did.

So, anyway, we went out and raised capital, bought radio stations. It still required a lot of capital to buy a major signal in a city like L.A., many millions of dollars, so we brought in investors like Goldman Sachs and others. I did that for about five years. Actually, more like seven years, and we built a company, we had major investors—Goldman became our major investor over time—and I ended up in Houston, Texas, essentially because we were able to make more deals in Houston and in Texas than we were anywhere else, and so most of our properties ended up being there. So we ran our course—

WT: And this is El Dorado Communications?

RC: Yes, the company was what's called El Dorado Communications, exactly, and I was one of the owners, founders—I wore many hats—general counsel, and I also was a general manager for a while of our operation in Houston. It came to the point where our investors wanted us to sell our properties and return money at a major profit to them instead of just keep building. We had harbored the idea, and had thought that we might continue to build our company into a major radio owner and operator, but your investors control those kinds of strategic plans, and they wanted us to sell, so we did.

WT: And a deregulation had taken place during this period?

RC: It did, which was another temptation. Our prices jumped way high, and so we bought stations, for example, at \$20 million that were now worth \$100 million or \$120 million, so we had big profit margins that, again, our investors wanted to cash in on. So that's what you do when you're in that type of world. We had kept a little ownership, so we made a little money for ourselves—not as much as we'd hoped, but we did okay.

As far as my situation went, an interesting turn of events occurred. I was asked by people that were very active in the Democratic Party whether I would consider being an SEC Commissioner. At the time, Tom Daschle was the Senate Majority Leader for the Democrats. Actually, he was a leader of the minority. The Democrats were in the minority as 2002 came in and George W. Bush was elected president, so the Republicans had the control. I found it intriguing, and after discussions with them they pointed out that, well, I would be a different type of Commissioner in terms of my background. I

hadn't devoted my life exclusively to SEC regulation, which was a concern of mine. I said, "Well, do you think this is something that would make sense?"

WT: Had you been active in the party, or how did they come to select you for the nomination?

RC: I had not been particularly active. I was a Democrat, I register as a Democrat. I had given to some Democratic candidates, but being in business, I had also given to Republican candidates. I think they chose me because my particular sponsor liked me and thought I would bring kind of an interesting set of background and experiences to the SEC. Anyway, he persuaded Tom Daschle to interview me, who was having to make that decision, and I interviewed with him and his chief of staff, who at the time was a fellow named Pete Rouse, and there were other very qualified people, and they decided that I was going to be their choice.

And so it was a bit of a surprise to me. So, in speaking it over with my family, they decided it was a good opportunity. At that time I was looking at finding another business opportunity, taking my winnings in terms of our return for the investment we had had in El Dorado into another business, or possibly going back into law practice. But being Commissioner sounded interesting, I thought it would be an interesting opportunity, so I accepted their offer. I was vetted by the George W. Bush White House at the time, and eventually nominated to be a Commissioner.

It was an interesting point in time, because we had had the Enron situation, Enron/WorldCom, so we had this sudden explosion of essentially fictitious numbers on financial returns that were for public companies. That was, I think, another reason that they found me attractive. Given my prosecutorial background, suddenly the SEC was going to be in a situation, unlike other eras, where it was going to busily enforcing fraud issues. Enron was there, and then suddenly WorldCom also became an issue shortly thereafter. You had Adelphia and many others.

WT: All very prominent cases, as well, in the spotlight.

RC: Exactly. Right, and so, someone who's been a prosecutor, businessman, corporate lawyer at one point in his life, and a military officer, seemed interesting. I know that the Bush White House had no issues with me. They thought I was very qualified. So, anyway, my confirmation went smoothly, I met many of the senators beforehand, including Phil Gramm, and it all went very well. I was confirmed for my nomination in August of 2002 on the same day as Sarbanes-Oxley was passed, so I'm a brother of Sarbanes-Oxley, or son of.

WT: So when you got there actually, this was almost an entirely new commission. I think Harvey Pitt had been there for about a year, and then there were a couple of other people coming in more or less within months of you. Could you tell me a little bit about that dynamic?

RC: Yes. Harvey Pitt, who is a friend of mine today, had been appointed Chair early, as the George W. Bush Administration took over. Harvey Pitt was, of course, a well-known litigator, SEC regulatory expert, and was a lawyer, had been a lawyer at Fried Frank where he had a very preeminent practice in securities regulation. So, he was Chair, and for a moment in time after he took over I think there were only two other Commissioners, if memory serves me right. You had Cindy Glassman, who was nominated, but she had not yet been appointed and so I think she was serving, nonetheless, actively on the Commission. She ended up being confirmed at the same time that I did, but she had already begun as a Commissioner.

And you had an African-American Commissioner, Isaac Hunt, and his term had expired but was on sort of a tail situation, which happens to Commissioners. They don't always have to leave immediately when their term ends. Often, they can continue to serve until Congress adjourns, so Isaac Hunt, a very fine individual whom I met later, was one of the Commissioners at the time. I think one of the things that Congress wanted to do—and this was a different era—there was a lot of mutual work and compromise in putting Sarbanes-Oxley together, i.e. the name, Senator Sarbanes and Mike Oxley, the leader of the House [Committee on Financial Services] at that time, put together this bill that was dubbed Sarbanes-Oxley. And this was in response, as you know, to these huge frauds that suddenly erupted and upset the public very much, given the losses that many people took with Enron, and then later with WorldCom. Suddenly, the stock markets and owning public company stock seemed to be a hazardous thing. And so there was a big

desire to calm the waters and make the world seem safe again for investors in public company stock.

I was nominated along with Harvey Goldschmid. We were both Democratic nominees. And on the Republican side—and this was done together so that there would be balance and neither the Republicans nor the Democrats would pick on the opposite party's nominees—on the opposite side, also being confirmed at the same moment, were Paul Atkins—an individual who had served at the SEC in prior times, had been at PwC, a very experienced fellow and very capable—and Cindy Glassman. So this maybe began the idea of having both the Democratic nominees and the Republican nominees for the SEC be confirmed together, sort of as a package. That way, nobody would sit on the others. And it was deemed very important to put all of this on and confirmed on the Commission, rather than having a commission that was—

WT: Temporarily out of balance?

RC: Yes, out of balance and had vacant spots. This gave the full complement and allowed the Commission to work as intended, statutorily. The idea here, just to maybe say the obvious is that the Commission works with five Commissioners, one is the Chair, the Chair is appointed by the President's party, usually with a lot to say by the President and his immediate staff; and two others when their nominations come up. So the idea is that the President's party appoints three of the serving Commissioners, so they have a

majority of the five. The other two are nominated by the party that doesn't have the presidency.

So in my time, obviously, I was serving under George W. Bush, a Republican, I was a minority in terms of the two Democrats initially, with Harvey Goldschmid and myself. Later, Harvey returned to academics—he was a well-known law professor at Columbia—and Annette Nazareth took his place while he was serving. And the three Commissioners initially that were Republican were Harvey Pitt, the Chair, Paul Atkins, and Cindy Glassman.

WT: So you arrived there and you pretty much immediately fell into the problems surrounding the nomination for the Public Company Accounting Oversight Board. I know that you gave a speech in support of John Biggs, and then there was the events that ultimately led to Harvey Pitt having to resign. Could you tell me a little bit about what it was like to just kind of walk into that situation, your own perception of what was going on?

RC: Yes, it was an unfortunate situation, just to put that out there. Just for a little background, one of the signature items of Sarbanes-Oxley was that the act established a new government entity. It's not quite an agency, and this is what's called the Public Company Accounting Oversight Board. So, essentially, Congress, through the Sarbanes-Oxley Act, determined that the accounting profession and the auditors in particular of public companies needed oversight. This is because the accountants and the auditors at Enron and WorldCom had totally missed these frauds, and in reviewing the situation these cases

indicated that there had been some sort of lax behavior on the part of the public company auditors, and that there had been some lack of diligence in some respects. Now, all that's controversial. I think some would argue today that frauds are very difficult to unravel or to discover, and that the mistakes made were mistakes that could be made at any time.

Nonetheless, Congress felt that the public needed some reassurance, and the audit industry was essentially at a low point in terms of its reputation with the public. The PCAOB was intended to bring up the level of practice, and to assure that the right practices were followed, and that, indeed, investors could rely on the annual reports in the financials that were being audited by certified auditors, and that these had a level of diligence and reliability. The PCAOB, the Public Company Accounting Oversight Board, would make sure by examining the auditors, examining what they did. This was the idea for the board, and it was going to be built from scratch: a staff had to be hired, board members had to be appointed.

WT: And it was a very short timeframe on getting all this set up, too, if I recall.

RC: Yes. Right, exactly right. Congress gave the SEC that I was on, the Commission, a very short period to implement Sarbanes-Oxley. We had very tight deadlines, and we took them very seriously. And our Chairman, Harvey Pitt, pushed very hard the staff, pushed very hard the Commissioners, quite appropriately, to implement, to get the rules out that were involved, and so we were facing a short time period in getting the PCAOB established. And remember—just a little bit more background—Arthur Andersen had

been a very famous, very well-known with a high reputation, audit firm that happened to be the firm that was auditing Enron when Enron unraveled. Enron, of course, ultimately had to declare bankruptcy, Arthur Andersen became an item of scrutiny, and some of its auditors who were involved in Enron were essentially prosecuted. One auditor, in fact, pleaded guilty.

What was involved was Arthur Andersen facing a criminal conviction as a corporate entity, and so that essentially destroyed its ability to continue. An audit firm with a conviction would no longer have its reputation sufficient to attract clients, and so Arthur Andersen unraveled. And again, that was not a great moment in our financial history because a lot of people were put out of work. Many people within Arthur Andersen, who suffered, were innocent. Retirement plans and so forth had to be abandoned, given the bankruptcy unwinding and all that sort of thing, so, there was a lot of chaos going on.

So, one of the things we had to do was not only appoint members but also appoint the chair, and we undertook a process where we interviewed different nominees for board membership, as well as potential chairs. At one point the Commission, with Harvey Pitt in agreement, had agreed on John Biggs—that's my recollection—as the choice, and everything was going to be fine, so I thought. Uncontroversial, we were going to have a clear endorsement and nomination by acclamation, essentially. Somewhere along the way that changed, and Harvey Pitt decided to go with Judge Webster who had been, of course, a federal judge, and he had been appointed at one point as head of the FBI—a very, very high profile, well-regarded personality and individual.

When that occurred, it was a surprise to me. I did not have a discussion with any of the other Commissioners about the change and the pivot to Judge Webster, and I don't know how that happened, even now looking back on it. I've had the opportunity to talk to Harvey Pitt about it, but it's a delicate area and I've never really asked for clarification. But I found myself in New York doing a commitment that I had made, the open Commission meeting had been scheduled, and then suddenly I'm becoming aware that Judge Webster is going to be the nominee and is being supported by Harvey Pitt and the two Republican Commissioners.

I had already made a commitment to John Biggs, because I felt he had the financial, the broader corporate background, and I felt that we didn't need a strictly law and order background person, which I felt was the background that Judge Webster brought. Now, that didn't disqualify him, but I just felt that John Biggs at the time, who was the chair of TIAA-CREF, was more appropriate, given the moment, given what was needed, and his understanding of corporate matters, business and auditing. I found myself in an awkward situation.

WT: And he'd also been appointed a public representative of FASB, I think.

RC: Yes. You're right, so that was another item of his qualifications that I found very strong. And what may have happened is that there was a leak earlier, and a few days before our meeting, in which we were to make the decision, that John Biggs was going to be the

choice. And there was commentary by some political people that, gee, it's too bad that there couldn't be a Republican. There are so many Republicans who are qualified. Well, I had never intended, and I don't think other Commissioners had certainly intended that this be a political decision. Biggs was a Democrat, but he wasn't an active Democrat in terms of being a political person. He was not a fundraiser, had not served any particular administration, and that sort of thing.

I don't know if that influenced my colleagues on the Republican side to then leave the decision we had earlier made, or the understanding we had, to support Biggs to going and supporting Judge Webster. No one came to me in advance and discussed it with me and tried to persuade me that Judge Webster was, indeed, the right choice. I found myself at this open meeting in an awkward situation, and I knew that Harvey Goldschmid also felt very strongly about John Biggs, and so I determined to prepare my statement in support of Biggs, Harvey Goldschmid decided to do that as well, and so every Commissioner went down and gave their reasons. And again, it was hugely awkward, unfortunate, because you don't discuss people's qualifications in public, right? I mean, when you're making a major hire, these are things that should be kept private, because it's about subtleties. Again, one set of qualifications versus another, it's a judgment as to which one is better.

So anyway, that's what transpired. There was 3-2 vote, the three Republican Commissioners, with Chairman Pitt, voted 3-2 against us, and Judge Webster was indeed voted as the chair. Now, what I did was I let it be known that I would—I talked to Judge

Webster I think in advance of the meeting and told him, “Look, obviously, I admire you. I think you’re an icon and you’re one of the people that I’ve respected. I’m also, obviously, in law enforcement and have been a federal prosecutor, so I totally appreciate where you’re coming from. Nonetheless,” I said to him, “I’m in a position where I feel your qualifications—I mean you should be in another position to utilize your expertise, and not this one.” This was a very dangerous one in terms of the corporate world, fraud, auditing. “Without having the substantial background there, I just don’t think you’re ideal—not that you couldn’t do the job, that you couldn’t learn it.”

And, given that we have John Biggs, as a hirer I told him, “If my colleagues vote you in, I will support you in every way possible.” And in fact, when that happened, I wrote him afterwards, congratulated him and told him he could count on my support going forward, and I think we even made plans to meet further and discuss how I could be helpful in any way he thought in transitioning into his job.

So that’s what occurred. The press ran with it and thought it was a bit of a sensational story and went forward with it. Sadly, a few days after that it was revealed—I don’t know if the press did it or how exactly it was—but that Judge Webster had served on a board of a company whose chair and CEO was being investigated for some type of fraud, and that fact had not been disclosed to the entire Commission. Apparently—again I learned this third hand—it was known or should have been known by the Chief Accountant at the time, who was aiding Chairman Pitt. I don’t know if it was just a mistake or why this bit of information wasn’t shared with the rest of the Commission, but

at that point I think two things happened: Judge Webster resigned his appointment, given that that was, indeed, embarrassing and an item that was not known to the Commission, and Harvey Pitt followed up by offering his resignation to the President.

There had been a series of things that had happened under Harvey's watch that had brought him bad press, all things that maybe under other circumstances would not have been items to cause a resignation, but had added up. And so the President accepted his resignation, which again was an unfortunate situation all around. The Commission didn't look good. Harvey was immensely qualified. He was probably one of the best qualified Chairs ever in the Commission's history. I still think it's a shame and I regret it didn't work out and the Commission didn't have a way of benefitting from Harvey Pitt's immense background and experience.

WT: So let's talk a little bit about the implementation of Sarbanes-Oxley, then. I know you spoke about it a little bit, but were there any particular areas or rules that proved particularly difficult or notable that you recall?

RC: Sarbanes-Oxley, by comparison to Dodd-Frank, was very small, and maybe today we would even use the word quaint. But it had very significant items, and I'm glad to say that today the items of Sarbanes-Oxley have become almost a part of the DNA of corporate governance, of auditing and so forth. So, implementing and selecting the board chair of the PCAOB and the other board members was a major task, we had to do that. That involved discussions among ourselves and voting and so forth, and I think we got a

pretty good representation. You needed some accounting expertise, but the thought was, and Congress had baked this in, that the accountants not overwhelm the board so that it wouldn't be viewed as an industry association at some point. So we did that, and ultimately Bob McDonough, who had been head of the New York Bank of the Fed Reserve, was appointed and he did a very commendable job as chair of the PCAOB, as its first chair after Judge Webster.

So that was difficult, and it involved its own sort of politicking and finessing. Sarbanes-Oxley, if I can break it down, involved some governance rules, essentially the idea of independent board committees, and the independent audit committee of the board of directors of public companies being in charge of the relationship with auditors, in other words not by the management. It had been the practice in the past that management would select the outside auditors, so there was this natural my boss and who I have to please is the manager, the CEO, the CFO, and that group. And the idea was to break that and, for the most part, make sure that the auditors understood that it was instead the board of directors through its audit committee that controlled the relationship. Obviously they worked with the management team—that was never intended to go away—but that they understood there was an independence there that was involved.

So that was interesting and that involved a lot of lobbying. I think many corporate interests were worried about losing the ability to select the outside auditors, but that was the law and they all came to live with it. We had to meet with many, many corporate groups of public companies and reassure them that we weren't looking to displace them,

but instead create better governance. There were limitations on loans to executives that Sarbanes-Oxley provided, and that went pretty smoothly. It wasn't too terribly difficult to work that out, because I think their CEOs understood the value and the bad appearances that could cause if they were getting so-called sweetheart loans from the company, or if the public might view them that way.

The other independent committees were established, nominations, for example, compensation, and all of that became part of what exists today, and I'm very happy to see that it's part of good governance today. We did this through influencing the NYSC and the NASDAQ to have listing requirements that established the independence of directors, and so the rule is that you have to have a majority of independent directors now on public companies, and so that's fully established.

One of the audit rules caused a lot of problems and required several iterations, and that was Rule 404(b). It's a very technical item, but let me just summarize it. Essentially, the rule required that management, at some point, of a public company set up internal controls, and they had to document the internal controls. The idea here being is that a public company has its own set of finances and risks, and the internal controls systems need to be very defined, thought about carefully, revised as appropriate, and documented. In this way a public company would provide more comfort to investors and not be likely to go off the rails, as it were, in having both the board and the existing managerial staff, in particular in the accounting and finance area, have controls that, again, gave reliability,

hopefully. It certainly provided more reliability to the numbers that were being produced.

Then the auditors were supposed to audit at some point—there was a period of time—the internal controls. The auditors' effort is what caused, initially, a big brouhaha because it was a new work and it expanded the scope of work of the auditors. There were new costs involved in the management group providing the new 404 internal controls, and, thereafter, having the auditors confirm that those particular controls and the management job had been done—additional audit work, which then increased the audit costs.

So, at least for one year, it was a big issue because it was additional cost, and the corporate community, public companies, Business Roundtable and others, squawked mightily about it. It was an issue for them for about a year and a half. Once they did it, once the internal controls and the documentation, which was costly internally, they had to expend resources to do these documentations, which weren't done in many large companies. You can imagine a large company that has foreign operations, all the different procedures and internal controls that would have to be in place. But once that got done, they became less concerned.

However, the smaller issuer community that was mostly domestic continued to lobby and continued to get extensions on their compliance with 404(b), the argument being that you're discouraging small companies from becoming public because this is an additional expense that doesn't necessarily produce a better bottom line, and it's not going to

produce better returns to investors. So therefore you're discouraging companies, essentially, small companies, in particular new companies, from becoming public, and therefore, you're reducing the IPOs, which is not a good thing overall in the financial community.

So the SEC continued to extend the time, and they have now decided—I haven't visited this area in a while—but they have now decided, as I understand, to give exemptions for smaller issuers from the full 404(b), and there are certain elements to that. So that occupied a lot of my speeches and time immediately for the first two years or so of implementing Sarbanes-Oxley, so that was one area that was fought very strenuously.

WT: I wanted to ask very generally, Gramm-Leach-Bliley had been passed in 1999, I believe. Were there still jurisdictional questions being worked out at this time as to how the SEC would operate within that versus the Fed, the FDIC, the OCC, and some of the bank regulatory organizations, or was that not something that came up?

RC: Yes, that was a major issue, and the staff felt very strongly that they didn't want to cede any authority to the other regulators. And not for bad purposes, not for obstinance or anything, but the idea of the regulatory agencies like the Securities and Exchange Commission is that an expertise had developed, and was developing and maintained in the areas that the SEC touched and oversaw. And the idea of letting securities activities within a bank go to the Fed or FDIC or the other bank regulators seemed to us to be an abandonment of the intent of Congress through the '33/'34 Acts and so forth.

And so, even today a lot of the jurisdictional areas and overlaps of securities work inside a traditional bank—and what is a traditional bank?—has blurred because of the '08 crisis, a subject for another day, but during my time we had five or so independent broker-dealers, independent investment banks. These investment banks would not take deposits; they used their own capital and they underwrote securities offerings and did mergers and acquisitions, and maintained securities accounts, they traded bonds and all of that.

So now they have all become banks because they've all accepted the Fed window option to provide cheap money almost at no cost, with the zero interest rates that have been prevailing, and so there are no longer any independent investment bank broker-dealers. They're all part of a bank organization, which is also subject to bank jurisdiction, either the Fed, if it's structured under a bank holding company, or the FDIC for those others, and even the OCC, the Office of the Comptroller of the Currency.

So these are fights and discussions that continue today. We have further complication with FSOC, which is a strange animal that Dodd-Frank created. It's not exactly an agency, but it's an entity in which all of the major regulators, chaired by Treasury, part of the executive branch of the federal government—the Secretary of Treasury, in fact, is the chair—it bring in the chairs of all of these other agencies and there are other members. It's a complicated formula as to who sits on there. But the idea here is to be able to assess where there are large systemic risks to the entire financial system. Roughly \$50

billion of assets under management has been the rough threshold. That's been changing. It depends on—I'm not as up to date as I might be.

But questions such as should insurance companies be viewed as systemically risky—and those questions exist today—and the lines of SEC securities regulations in terms of a broker-dealer inside a bank versus the Fed requirements and versus reserves that are required are all areas that are still very active and being debated. I think the SEC continues to maintain its jurisdictional rights there.

WT: Maybe we should talk a little bit about enforcement strategy. Of course, there was a lot of public pressure at this time to clean up all the various messes and to ensure that they would not recur. I'm wondering about some of the discussions within the Commission among the staff. You have to, of course, bring cases that you have a hope of winning and so forth. What was that like? Was there agreement? Was there disagreement on these issues?

RC: So enforcement was an area that, of course, I had a lot of background in, and I brought my experience in enforcement through federal prosecution. I may have been the first former Assistant United States Attorney who had been a federal prosecutor to serve as a Commissioner. I think the Commission felt obligated to restore trust in the system, as it were, say '02—and I served from '02 to '07—but in particular based on the scandals that we had just been involved in, which were Enron, WorldCom, Adelphia, and others.

And those frauds were simple by today's standards. They simply were making up numbers essentially, if I can put it that way, and these fictitious returns on financial statements led to very bad consequences. Companies had to go out of business, investors lost money, and they wondered whether other companies were doing the same thing. So, I believed it was appropriate when fraud was discovered and there was actually an effort to defraud shareholders and invent numbers, as it were, to the benefit of managers or senior executives, that those folks, if there was a case there, should be punished appropriately.

Now remember, the SEC only has civil authority, it is not a criminal agency, so the cases that the SEC brings are civil lawsuits. The SEC, in filing an enforcement action, would file a civil lawsuit typically, if it hadn't been settled, or even if it was settled, it's with a federal complaint alleging wrongdoing and violation of SEC rules. Some type of fraud was committed, and the idea would be to extract—there are various types of penalties and sanctions—disgorgement of unlawful profits, for example, if they were in the company or individuals were part of what was looked at. I felt very strongly that in these cases of fraud you should extract as much as possible of any wrongful gains, and the idea that you also needed deterrents. A penalty on top of that sometimes was appropriate, just to show that there wasn't a way of going forward.

What I found as time went on was that Harvey Goldschmid and I usually agreed on the deterrents and the penalties and the sanctions. And remember, what we have in front of us are cases that the staff is bringing for approval. We would often see eye to eye on

these items, and by the way, I would not discuss this in advance with Harvey Goldschmid, it just turned out that we had similar views. After Harvey Pitt left, Bill Donaldson became the Chair, and I found that Bill Donaldson also tended to agree with the presentations that the staff were making, in particular when we had questions and we wanted to adjust or even ask for more, which we sometimes did, more in sanctions to increase the deterrents and make it appropriate based on the severity of the fraud. I found that Bill Donaldson agreed as well.

Often, as it turned out, there was disagreement between us, among all the Commissioners, and the two other Republican Commissioners, Paul Atkins and Cindy Glassman, would—not always but sometimes—feel differently in that the penalties and the sanctions might be a little lighter to accomplish the same things. They had good intentions; they were just coming from a place that was different at times. And they often agreed with us, we often had unanimity, but at times there was difference of opinions.

WT: I noticed that in certain cases that Chairman Donaldson did tend to agree with you and Harvey Goldschmid, I think, over mutual fund governance as well, which I wanted to bring up a little bit later.

RC: Yes. Well see, in that situation we're out of enforcement cases into rulemaking, which would be new rules involving different industries. So, the SEC, besides bringing enforcement actions, also does rulemaking. Like Sarbanes-Oxley, it was implemented through a rulemaking. And these rules become essentially law, statutory law that is

followed by the affected industries. So the SEC, for example, has jurisdiction directly over broker-dealers, which it exercises through FINRA and the Advisers Act, and it has jurisdiction over mutual funds, which is exercised through the Investment Company Act, acting through one of its divisions called Investment Management.

So in that situation we had a proposal from the staff, and the staff at IM, Investment Management, after much study had come to believe that investment companies, which are mutual funds, have their own boards, and it's an odd creature in terms of these investment companies because you have an advisor—an investment advisor creates a mutual fund and often appoint the boards themselves, so it's a little bit incestuous in one respect.

And the idea is that the board then is supposed to oversee the advisor and make sure that the advisor performs adequately for the mutual fund investors that end up buying shares of a mutual fund, and that the fee, in particular the advisor fee, is appropriate. And often what was occurring in the practice at the time was that the advisor's executive, usually its chief executive, would also become chair of the board. So we believed that that was contradictory to good governance.

WT: Did the staff produce this before or after the scandals that broke, I think in 2003?

Because I know it had been discussed even under Chairman Levitt, so I know that the discussions at least date back that far.

RC: Exactly. So there had been work done, and studies and surveys and efforts that had been done over the years, including, as you say, under other Chairs in other administrations, obviously under Clinton. So what had occurred is—and now I don't recall exactly—but we had an unusual scandal in the mutual fund world having to do with timing. And there, what was occurring was that certain investors were allowed to buy or sell after the 4 p.m. closing, which essentially gave them the benefit of knowing what the closing price was going to be, which is not supposed to happen. So this occurred among some mutual funds, and then there was also what we call—the other timing involved foreign companies using the time zone differences to be able to make investments, again, at a point where they could see what the closing price was going to be, giving them certain advantages.

So these scandals occurred, and we have enforcement actions against mutual funds and their advisors at that point. That may have influenced the staff to propose this particular rule change, which was that an executive of the advisor could not be the chair of the board. Or, in other words, that the board chairman needed to be independent of the advisory company that gave the recommendations and made the decisions as to what stocks to invest in.

So, it made sense to me, after listening to the staff, after evaluating the situation. But this was another divisive item. The Republican Commissioners that weren't the Chair, Paul Atkins and Cindy Glassman, disagreed very strongly. They supported some industry groups, which included Fidelity and its chair, Ned Johnson, who just didn't see that as a

necessary item. So we voted. And in this particular case the Chairman, Bill Donaldson, who, again, oversaw the staff, agreed with Harvey Goldschmid and me, and we three passed that particular rulemaking. Now, that was challenged and the D.C. Circuit ruled on an administrative basis that the SEC had not gone through enough process and developed its administrative record sufficiently.

WT: What's that to do with, cost-benefit analysis?

RC: Yes, cost-benefit analysis, exactly.

WT: Was this kind of a new strategy that was being used in challenging the SEC?

RC: Yes. There had always been a requirement to do a cost-benefit analysis. The problem with a cost-benefit analysis in the main, from my perspective, is that it's always easy to see cost, very difficult to quantify benefits. What's the benefit, for example, and how do you quantify it, of better governance, of independence? Things that clearly are good, but can you say that a certain amount of money was not lost or that the company made more money? Very difficult. So it's a concept that is good in theory.

But using that as sort of the bulwark and the leverage, there was a particular D.C. Circuit judge named Ginsberg who is a former economist or pursued an economic study, and he very strongly believed in a very robust cost-benefit analysis, and frankly, he didn't believe that that had been done. He may just have disagreed, as well, with the rule. That

sometimes happens with judges. They find a way to justify their own views in this particular era.

But the truth, in terms of what I could see, is that the staff had done a lot of work, and it was not done haphazardly. A lot of study had been done. There is a concept called the Chevron concept, *Chevron* being a case that occurred, in which the agency is given deference for expertise. That never was given in that challenge and in that decision by the D.C. Circuit, so that decision was overturned, and the decision was made not to appeal it, I believe.

Now the interesting thing is that the industry has, on its own, essentially now deemed it to be good practice not to have an executive of the advisor be the chair of the board, and they have gone to self-police and to adopt voluntarily this practice. Where today, if it's not a majority, it's close to a majority of mutual funds, subscribe to the notion and to the concept that their chair and the other board members should be independent and not be an employee or an executive of the advisor.

WT: On the themes of self-governance and the independence, could we talk a little bit about the SROs and some of the issues that were going on there around the same time, particularly with the New York Stock Exchange.

RC: Sure. Do you want to give me a little flavor of what you're looking for?

WT: Yeah. Well basically events. In a very specific case there is the case of Dick Grasso's pay, which raised the larger question of independence. I know that Bill Donaldson wrote a strongly-worded letter on that. I'm not sure if that was considered to be in violation of the rules or not, or if it was just not considered kosher, so to speak. Then, of course, there was the specialist front-running and the even broader issue of the broker-analyst conflicts. I don't know if we would want to loop that into this discussion as well.

RC: Dick Grasso, just to begin there, was a very interesting and perplexing item from various aspects. One, the New York Stock Exchange, and being its chair, had been viewed—I think I can safely say this—in the past as being sort of a public service kind of an arrangement. Bill Donaldson himself had been chair of the New York Stock Exchange, and he certainly viewed the time he was there not as a time to be the head of a public company where he could essentially legitimately get stock options, for example, or whatever. But he found it very difficult to accept the idea that someone being the chair of the New York Stock Exchange, given the premise that it was a utility, public service kind of a situation, would be compensated \$40 million. I'm not saying he didn't deserve it, I'm just saying just the notion was foreign.

And he wrote a letter. I think the Commission—we didn't have a particular enforcement matter, because it was done in such a way where it didn't violate a rule, as I understand, maybe a spirit in the minds of many, but there was no violation, per se. And so, aside from our view that this was very bad form by an SRO, I don't think there was much more that we could do about it. Certainly, at the time, the Attorney General, Eliot Spitzer,

brought an action, and he had an interesting civil theory about the appropriateness and the propriety of that particular amount. And frankly, I think the case was eventually dismissed and it died and Dick Grasso kept his money (laughter), in terms of what occurred.

And again, from a public perception, it just was very bad. It didn't look right. It looked like there was some self-dealing that went on, and this at the time, given the aftermath of the Enron scandals, was just not healthy for building public trust in the stock markets and buying public company stock as a legitimate investment. So that occurred.

Switching to another area, the analyst scandal, which involved analysts privately saying to themselves—and I'm quoting here from one of the e-mails—"This company is a dog," or words to that effect, and yet recommending it highly in their public publications to shareholders was a big item and it caused friction. Harvey Pitt was still the Chairman at the time. Because what occurred is our OCIE, our Office of Compliance, in examinations, did not find this particular violation or this particular existence of these conflicts. But instead, the Attorney General's Office did, and so they brought an action under the Martin Act. So there was a contentious period between Harvey Pitt on behalf of the SEC and the Attorney General's Office in terms of who had jurisdiction. And, yes, the Attorney General had its own particular Martin Act and jurisdiction, but the SEC traditionally, and through the federal authorities, had oversight of analysts in that activity.

So ultimately it was a compromise, and both jurisdictions ended up bringing cases and they settled, and they set up a situation in which the analysts and their firms agreed to build firewalls. They agreed for a period of time to have an oversight monitor to make sure that conflicts did not arise, and that those giving opinions and advice on particular stocks were not also on the selling team in some fashion, so they wouldn't be compensated by whether their companies made lucrative sales, services in one way or another, to someone whose stock they were touting. So that continued, and that was an interesting time and got a lot of attention.

WT: And you were a critic of the settlement, is that correct?

RC: I don't remember.

WT: Okay. It didn't exercise you that greatly.

RC: Well, I looked into it, and the ultimate settlement, as I recall, I felt was appropriate. I may have felt that more monetary sanctions should have applied, but I think I ultimately approved or agreed in terms of a vote on the settlement that went passed here.

WT: So how involved was the Commission with the creation of NYSE Regulation?

RC: We had at the time an NYSE Regulation that oversaw the market activities, and then we had what was left of NASD, which as you know had evolved and developed the

NASDAQ and spun the NASDAQ out. So we had an SRO embedded in the NYSE, and we had the NASD on its own with oversight responsibilities of the NASDAQ. And so the Commission, together with the staff, determined that it would be more efficient to bring most of the New York regulatory aspects, to combine it with the NASD into an independent organization, an SRO, enabling them to both oversee the NYSE, which kept some of its compliance functions internally, and the NASDAQ and broker-dealers. And that came about. Mary Schapiro and Rick Ketchum were the two heads. Rick, of the NYSE Regulation and Mary Schapiro was a co-head of the NASD.

WT: NYSE Regulation itself was only a few years old at this point.

RC: Yes.

WT: When it was decided to combine them.

RC: Right, and this is what became FINRA; they changed their name and so forth, and that's what we have today. Mostly, it worked out pretty well. The members of NASD, which are brokers, had to agree, and NYSE also, in their board, had to agree, and there was some trickiness there, but with the urging of the SEC and the Commission as a whole, this came to pass. We felt that was an improvement, and now we have the aftermath today, we have a robust, independent FINRA and they're looking to expand some of the things they do, and that's the decision of the SEC now.

WT: Making our way through our list of issues—and there seem to be quite a lot of them in this period—but Reg NMS, after many years, finally gets going at this time. Can you talk a little bit about what motivated that push to get it through in the mid-2000s?

RC: Well, there was a lot of concern, and there had been in prior years, that the outcry system—in other words the floor brokers, they were called specialists at the NYSE, they were called just floor brokers elsewhere—at one time, you had an AMEX, you had an American Stock Exchange, you had a Philadelphia Stock Exchange, you had a Boston Stock Exchange, you had a Pacific Stock Exchange, and we started getting electronic exchanges that were coming in vogue.

The NASDAQ pioneered in the U.S. some of that because they were essentially a trader's desktop approach. The concern of the staff and other critics, other academics, was that the floor brokers were able to benefit and trade ahead of orders. They had a peak, as it were, for a period of time, and if they were dealing with a stock they could also do their own proprietary trading and earn substantial returns at the expense of ordinary investors, so the argument went. Europe had started going this way, anyway, in terms of electronic markets and orders being put in from various sources, but electronically as opposed to on the floor and manually.

So the staff had evolved to the point where they believed that a new system could be put in, and the idea was that the principal benefit would be that investors would get the best price no matter where it was. The idea was that, well, the way things were being

transferred and passed on, if Joe X from Baton Rouge, Louisiana, put in an order, he might end up at the NYSE, and the NYSE might execute it through the particular floor broker specialist that was assigned that stock where there was a better price at the NASDAQ, who also quoted that particular stock, or that particular share. When we began this in '02-'03, we had many exchanges then. They hadn't yet consolidated the way they are today.

So, this was an eureka item. I mean this was not a small thing. The idea that a small investor who didn't have any clout, who wasn't Goldman, who wasn't Merrill or some other large investment bank, could put it in and their order would get the best price being quoted at that instant, and it would be pinged around until it found the best price in a way that was fair and appropriate. That was very appealing to me and the other commissioners. It became no longer a matter of who you knew or did you know how to play the game, and your particular broker has got an "in" with the floor brokers at a particular exchange, to get better treatment, so that was one of the major reforms that was very attractive. Along the way, part of NMS also involved decimalization, which is still controversial, but it reduced the spreads, the spreads being where the intermediaries, the brokers, i.e., could make money. It's smaller, they're just smaller nibbles that are available, and by putting it in hundredths versus eighths, a fraction of a dollar, made it much smaller.

And so the industry, in many quarters, didn't like that because that did squeeze their margins; what you were paying for market data; the idea of making everything

transparent, at least in equities; putting up quotes where there was no secret quote somewhere else being done was also attractive; and the idea that the best price would be available, as we just discussed, but also it would be known, and that would be reported. So one issue was to incentivize the markets to give up that data and put it in a consolidated tape, giving huge transparency that had never been there before. I'll note that in Europe, you still don't have a consolidated tape. You still have situations where there's a price in one market, the Deutsche Börse, and there's another price at the LSE for the same security, and the quotes just are different. So that was another item.

So all these reasons led me—and I looked at, again, with other Commissioners, everybody was making their own evaluations—leaving it alone would have continued, essentially, an antiquated process of the specialists and floor brokers, and continued a system in which retail investors were not getting their best price. We looked at the problems, what were the benefits versus the cost. There was some concern about connectivity and could the electronics handle it. But I was convinced that the technology existed and that everyone could be connected. That was initially a problem. Well, you know, you can't connect the Pacific Stock Exchange with the brokers over here in the NYSE or the NASDAQ, and if an order comes in, how can it go around the block to find the best and be sent to the best place, and what part of the book is going to be disclosed, and all of that.

But we became convinced it could happen, they could do it, and the staff was very convinced that the electronics, and the technology, was up to snuff to accomplish this. So

when it came time—and this was almost two years of discussions, roundtables, the industry was coming and lobbying for their view, and so on, and a lot of people were just lobbying to preserve their business models, obviously. So ultimately, we did pass it. It was contentious. I think it was a 3-2 vote. Again, Paul Atkins and Cindy Glassman, if I remember correctly, opposed it. Bill Donaldson I think was the Chair at that moment, and he voted in favor of it along with Harvey Goldschmid and I. And, again, the concern was it was ambiguous and it would cause more harm than good.

I think the history has shown itself that NMS has been a very good thing, given the smaller spreads: the cost of executing orders in the U.S. is the lowest in the world, substantially. Retail investors find their best price. The recent controversy over high frequency trading is fair. That was certainly not in our realm. No one had that kind of fire power to be able to use computers by a broker in that fashion to try to do what *Flash Boys*, that particular book, says is occurring today. So, I believe that it's very appropriate to look at NMS again, but its basic principle should be maintained. I think there's ways to protect orders, someone from getting a hand or a peek at orders before others do. That's always been an issue.

WT: They're different generations of problems.

RC: Exactly. If you go back far enough, you had a situation in Europe where fast horses would take prices from one European city to the other and give a group of investors a heads up on the price before others would learn. Then they used pigeons, essentially. So,

we just have a variation of that problem now with high frequency trading. Many high frequency traders will tell you that they don't do that. What they really do is they do an algorithm that predicts where the pricing is going. So they're making a bet that the price, given these conditions and what's occurring, the price is likely to go up or down and they'll make a trade accordingly. And they tell me that if they're right 52 times out of 100, they're doing pretty well. So anyway, it's a fair area to look at to make sure that the public doesn't feel that there's an undue advantage to particular banks and brokers, but I think it can be very well handled within the current technology and the current structure that we have.

WT: And then there were the changes to the net capital rule in 2004. After the financial crisis, a lot of attention was put on those, perhaps in some cases misleadingly, but at the time, was that viewed just basically as kind of a technical update? Which is how I've read about it being in some areas, but I'm curious as to what your perspective on the discussions were at the time.

RC: Well again, they were controversial because they involved how much in reserves broker-dealers needed to keep on hand to protect their broker clients in the event of a collapse of some sort, so this is safety money, essentially. Brokers felt they had enough, in general that they had enough already, and the idea of raising the amounts and then recalibrating them for more safety for broker clients, and also what you would count against reserves, that was always a tier one. Certain category of government securities were tier one, certain rated commercial bonds and so forth were rated as tier one, and others less liquid,

in terms of the effort here, in terms of grading them, would not be considered or would be “given a haircut.” Grade B bonds, for example, I don’t remember the formula, but they would be haircuted. In other words, they would only count in terms of a fraction against their required net capital amounts.

All these were discussed, and there was a lot of back and forth. And I have to say, what occurred during my era was that the industry would come in, sometimes with lobbyists, and they would make a presentation to the staff, then they’d make a presentation individually to the commissioners, we would learn about it, we would go back to the staff, talk about these issues, and say, “Are they right when they told me such-and-such?” We would ask some of our own internal experts. I would have my own staff do research. And, in this way, we tried to get it right in terms of the item, through the expertise internally at the SEC, through my own personal staff, and through doing our own research at times. So yeah, that’s essentially what occurred, and we made changes on the net capital rules, and I think we haven’t had many broker-dealers fail as a result.

WT: I want to ask just to make sure we don’t run out of time, this interview is being done as part of a series that’s in support of a Gallery that the Historical Society’s putting together on the Executive Branch. Now, I imagine that you didn’t have all that much contact with the Executive Branch, but I’m curious about the general signals coming from the Bush Administration at this time, if any, with respect to the SEC, what those would have been perceived to be. It seems to me that there was a lot of emphasis on things like tax cuts on capital gains, of course tax policy, but do you have a perspective on that?

RC: You're right; I did not have any direct discussions at any time when I was a Commissioner with anyone from the Executive Branch any way whatsoever. Now, there were always rumors that certain Republican Commissioners during the Bill Donaldson era were complaining about Bill Donaldson, and that Bill Donaldson didn't support the "Republican views" as tenaciously as he should or something. Now again, I always found that to be odd because the work of the agency is not partisan. It's not a political item.

What you're supposed to do is all Commissioners, and the staff, essentially make a pledge to the mission, which is to protect the integrity of the markets and to protect investors. And you make calls that may fall initially harder on a particular industry or a particular regulated industry or business, but I never viewed that as either a Republican or a Democratic item. If investors benefit and they get more clarity and more transparency, everybody benefits. If there's better governance in public companies, everybody benefits.

NMS, I didn't view it as partisan either. We talked about this already, the choice of a chair of the PCAOB, I'm not even sure it's—well, I don't know if that's still an issue with the Commission in its recent appointments. It shouldn't be, and I hope it's not. So, if there were discussions going, I don't have any idea whether the Chairs, who were all Republican at the time, had a channel to the Executive Branch. I don't know whether Harvey did, I don't know whether Bill Donaldson did, I don't know whether Chris Cox

did. I know each of the Chairmen I worked under was very serious about their obligations to the public investor.

WT: I wanted to ask you about international issues as well, because I know you took a particular interest in this. In fact, from reading your speeches, I learned about the differences between convergence and equivalence, and harmonization maybe at the far horizon. I wonder if you could give me a few highlights of some of the issues that you worked on.

RC: Well, I volunteered to be the agency's representative in international forums, and at the time—and I went to Harvey Pitt with my willingness to do it—none of the other Commissioners particularly wanted to do it because it involved a big commitment in time and a lot of travel, overseas travel. But I enjoyed it immensely because, essentially, what we were doing was trying to find a way to, as we said, converge the different securities regulation regimes across the world, where something wrong in the U.S. would be wrong also in Europe and also in Asia or South America, you know, where there wouldn't be sort of a, "it's wrong only in America but not elsewhere," things like that.

I'll give you an example. Insider trading, as we know it today, a very established concept: if an individual gets information from a so-called insider, usually an executive or member of a senior management team that knows about something that's material, that's about to occur, could be announcing very good earnings or it could be announcing losses. Anyway, if that information is conveyed by a tipper to a tippee, then you have a

problem of insider trading. There's also recent cases which are complicated that say that there has to be a benefit to the tipper, but those concepts are not universal across the world. Even in London and in the UK, insider trading was viewed differently than in the U.S.

And then—recall that I started in '02 and we immediately began implementing Sarbanes-Oxley—so the whole issue became: does Sarbanes-Oxley apply to other foreign jurisdictions outside the U.S.? And I'll give you an example. The PCAOB that we've talked about required its auditors to register with the PCAOB if they audited a public company. Then, by so registering with the PCAOB, they subjected themselves to oversight and to examination by the PCAOB.

European auditors and their representatives and their regulators said, "Wait a minute, we oversee European auditors. What gives you, America, and the SEC, the right to require European auditors to register with the PCAOB?" Well, we had a simple answer. Well, some companies that are foreign, for example, Volkswagen—think of any large (or it could be small) European company or Asian company—if they want to sell their securities in the U.S. they have to register in the U.S., and they have to submit audited financials as part of our system. And if auditors from other jurisdictions, other parts of the world, perform the audit, then we believe we have the right to review those.

Now, the compromise that occurred was that those audits of auditors that audited companies that listed in the U.S. would be led and principally done by the local

authorities, with the PCAOB being involved and watching, and whatever they had, that has evolved over time, slowly. But, essentially, it provides the sort of assurances that the PCAOB is looking for with the procedures that are done to examine foreign auditors that also have a large audit role in the companies that are listed in the U.S. that may be from other jurisdictions.

I had to face a lot of animosity initially, and outrage. You know, you're trying to regulate us. If the SEC doesn't have the right, why is the U.S. passing these laws and so forth? Well, it took a while, but I think they came to believe—and I'm talking now about my colleagues who are securities regulators or other types of authorities in Europe and Asia and elsewhere—that this was a reaction to try to improve things in the U.S. No one had thought too deeply about the fact that it might touch foreign auditors who are scrutinized by other authorities and other regulators, or even foreign lawyers who have something to do, at times, with the listings and the financial statements.

So that was a very interesting time in doing that, and one of my goals was to develop a more robust international regulatory community. Arthur Levitt, during his time, did not do a lot with it. He was interested at one point, and then other, larger priorities came to take his time, and so there had been some neglect. I believe that the U.S. SEC, which was the preeminent securities regulator in the world, being actively involved gave it new life and a new vigor, and enabled the organization to meet a lot of its objectives.

We wanted to have international security standards, for example, and we worked on those high level, and they were hopefully converging. We had the issues of the U.S. GAAP, versus what became known as the international accounting standards, or IFRS, International Financial Reporting Standards, and those were different in many respects. In some respects they were better, frankly, in other respects they weren't as rigorous as U.S. GAAP, and so there's been an effort to converge those over the years, and it began strongly during the time that I was there. It was one of the things that I encouraged to occur.

WT: The last big issue that I wanted to address, which is very controversial, was the shareholder access question.

RC: That was always a big issue when I was there. I left in '07, so we had not yet passed shareholder access. The idea, very briefly, is that shareholders of a public company, as a normal rule, are presented a company proxy that has a slate of directors being nominated that the current board supports and management supports. So the concept is, well, should an investor somewhere in Peoria be allowed to nominate himself or his best friend or somebody, or maybe Warren Buffett, somebody who's very accomplished, as a director on that particular board? And there's no mechanism to do that very effectively.

A minority group of shareholders—and I say minority because a majority could obviously change the board, and they control enough shares to change the board on their own just with their own votes, but a minority does not have the ability to very easily run a

competing slate of directors. Let's say they hated all the directors and they want to run seven other people that they think would do a far better job. Well, they have to get this slate and this information, this proxy, to all the other investors who are going to vote. And they don't have a list and the process doesn't allow for this.

So the concept, in particular many pension plans, became very supportive of the idea. It would give them the ability to influence weak companies that they felt the boards were not active enough, or making the right decisions, changing management, or whatever they thought. Some activists thought that this would also improve governance. So we debated this over and over, and we had several roundtables on the matter. I remember convening a meeting over dinner of the Business Roundtable, which very much opposed shareholder access, and of many of the shareholder proponents of a new access system, and I tried to see if there was a way to broker a deal, make something happen.

The view of the corporate community at the time was, well, we have three Republican Commissioners and they're not going to vote for shareholder access. Again, this became viewed as a Republican and Democratic situation, which again I think is unfortunate because it either stands on its own as a good governance principle or it doesn't. In Europe, for example, in London, any shareholder can, frankly, call a meeting and call for a vote, with appropriate notice and all, and it's a far more robust system. The fact that it doesn't happen very often shows that there's some discipline in the system and that people don't do it willy-nilly, so that was used often as, "Well, why would it shake things up so badly in the U.S.?"

So it was still being debated when I left in '07. The Commission became very distracted in '08, of course, with the meltdown that occurred. Finally, at the end of '08, the new President, Barack Obama, was elected. He came in and appointed Mary Schapiro as the Chair and Mary Schapiro did have a form of shareholder access passed. It was a technical 5 percent or so. You had to have a big enough shareholder block to propose it, other rules had to be followed, notice had to be given, and so forth. But, as you know, this particular shareholder access rulemaking was also struck down by the D.C. Circuit, and it was opposed and it was challenged on the same grounds, that the administrative analysis of cost-benefit analysis was not done sufficiently. And again it was a judgment call, and Mary Schapiro as Chair and the staff—it was her call ultimately—they chose not to appeal it.

WT: One issue that I wanted to very quickly touch on, I read somewhere that you were interested in it at least early on, and I know that Mary Schapiro almost got SEC self-funding in that same period. Of course that never came to pass, but I'm wondering if you have any insights on whether or not that was ever prominent during your time there, or approaching prominence.

RC: I supported it from the very beginning, because it seemed very obvious to me. You've heard me say several times that the SEC should not be making decisions based on politics. Obviously, the same thing for the Fed and for other major organizations that were essentially developed, remember, in the aftermath of the Great Wall Street Crash of

1929. The idea was that you would create—and this was post-Franklin Roosevelt and the Congress' effort to create a system that had independent checks—so, to me, the idea that the SEC every year had to go back on its knees and beg for resources enabled Congress to essentially starve the agency, if you will, if it chose to, in a fashion that would inhibit enforcement and inhibit other areas that a particular party or a group in Congress didn't like.

So, for example, this is not necessarily the case, but if they didn't like enforcement because they felt that the SEC was being too aggressive and bringing too many cases, well, if they provided less resources for fewer lawyers and fewer trial aides and so forth, they could affect that particular part of what they did. Or examinations, let's say, if resources aren't sufficient, you can't examine broker-dealers or investment advisors as easily, which now include private equity. So, I've always believed that it allowed for a potential influence that was based on politics because of Congress, because of the appropriation process. Now, the Fed has its own self-funding. They essentially get funded through levying of fees on the board members, on the banks that are members.

And so I believe that the SEC, essentially, through fees that could be paid in by those who are the biggest users of the regulators—the investment advisors, broker-dealers, not to mention enforcement—fees that went into a general pot, could also be subject to supporting the SEC. I pushed hard, I tried every way I could, I talked to the banking committee and its staff and others, and what I was told just very specifically was there was no way that at least the Republicans at that time in Congress would approve. They

wanted very much to be able to control the purse strings at the SEC. It was giving up too much power and authority, and so there was no hope of my being able to go anywhere with it because the basic politics were such that it wasn't going to occur. Frankly, today is the same thing. There is no way, given the makeup of Congress, that that would be approved.

WT: Okay. Well, I think I've brought you up to our time limit. It's three o'clock now, but if you have a quick word to say about your decision to leave in 2007? You weren't at the end of your term, right?

RC: No, I still had two years. I decided it was time for me to go back into the private sector. I had served five years, but I think I discharged myself with a lot of competence, and I felt good about what I accomplished. There's always more to be done, but I felt that it was a good time to leave. I was, I felt, on the top of my game and I was interested in, again, going back into the private sector. If you add my years in public service, I'm almost at twenty years, with my military service, including my cadet time, with my period of being a federal prosecutor and then my period as an SEC Commissioner, so I felt it was appropriate for me to take on new challenges in the private sector.

WT: Okay. Well, like I say, I'm conscious of the fact that you have other things to do, so I'll leave it there. Thank you very much for your time. I appreciate it.

RC: No, my pleasure. And if you want, later, when you listen to it and if you feel like you want me to augment, I'm happy to do it. We can set up other interviews or talk on the phone, whatever ends up being convenient.

WT: Okay. I appreciate it.

RC: You bet.

[End of Interview]