

**U.S. Securities and Exchange Commission Historical Society  
March 27, 2007 Fireside Chat – View From Congress**

**THERESA A. GABALDON:** Good afternoon and welcome to the 2007 broadcast season of the Securities and Exchange Commission Historical Societies Fireside Chats on [www.sechistorical.org](http://www.sechistorical.org). I am Theresa Gabaldon, Lyle T. Alverson Professor of Law at The George Washington University School of Law and moderator for this year's chats.

As our listening audience may know, the Securities and Exchange Commission Historical Society preserves and shares the history of the US Securities and Exchange Commission and of the securities industry through its virtual museum and archive at [www.sechistorical.org](http://www.sechistorical.org). The museum's collection of over 2000 materials, not easily available through other online sources, is free and accessible worldwide of all times. The Society and the virtual museum are both separate and independent of the SEC and receive no federal funding.

I am pleased to introduce ASECA - The Association of SEC Alumni, Inc. as a new sponsor for the 2007 Fireside Chats and to welcome back Pfizer, Inc. as a returning sponsor. Their support, along with gifts and grants for many other institutions and individuals, will help make possible the growth and outreach of the virtual museum this year.

We launch our 2007 Fireside Chat season with a view from Congress of the SEC and of the securities industry, considering both the current mindset and looking back over previous years. With last year's mid term elections giving the Democratic Party control of both the House of Representatives and the Senate for the first time in over a decade, this seems an appropriate time to discuss how shifting political mandates shape the legislative impact on both the U.S. Securities and Exchange Commission and the securities industry here in the United States and abroad.

Joining me this afternoon, are two senior staff members with the US Senate Banking Housing and Urban Affairs Committee - Dean V. Shahinian, Democratic Senior Counsel, and Justin D. Daly, Counsel. Their collective work has included staffing and number of oversight and nomination hearings, assisting in the negotiating and drafting of the Sarbanes-Oxley Act of 2002, and discussing legislative and regulatory issues with representatives of federal and state agencies, trade associations, securities firms and many others.

Their remarks made today are solely those of the speakers and are not representative of the Society. Our speakers cannot give legal or investment advice.

Dean and Justin welcome.

**DEAN V. SHAHINIAN:** Thank you, good to be here.

**THERESA A. GABALDON:** It probably would be useful to some in the audience to start with the structure of the House and Senate committees dealing with securities matters. Dean, could you give us a very brief run down on how a securities initiative becomes a law?

**DEAN V. SHAHINIAN:** Certainly. Securities laws are generally created when the Chairman of the committee of jurisdiction in the Senate, the Banking Committee, or in the House, the Financial Services Committee, decides to draft and move legislation, and works with the Ranking Member, to the extent possible, and other members of the committee to pass it through.

Generally, the Chairman identifies a problem and determines whether it's isolated or systemic. If the problem is systemic, he'll then look to see whether self regulation or government regulation can address it. If not, he will assess whether a new law is needed and, perhaps more to the point, whether it's likely to pass. There will be hearings and discussions with interested parties and the solution chosen may or may not be legislation.

Back in 2002, with the Enron, WorldCom, and Adelphia problems, the solution was legislation. However, in 2004, the Banking Committee held another 10 hearings on the mutual funds, involving late trading and market timing. However, aggressive action by then SEC Chairman William Donaldson and ICI head Paul Schott Stevens precluded legislation - they seemed to have things in hand.

**THERESA A. GABALDON:** What would you say the role of congressional staff is in setting the agenda for securities regulation?

**JUSTIN D. DALY:** This is a bit self serving, but staff play an important role in the work of Congress. Our job is not to formulate an agenda necessarily, but to carry out whatever our boss sees as a particular priority. I do think it's important for staff to always remember that we are here to serve the boss and not vice versa.

**THERESA A. GABALDON:** Is there a great deal of continuity in the legislative staff?

**DEAN V. SHAHINIAN:** There is a quite a bit of turnover on the Hill. However, saying that, I have been with the Banking Committee for 10 years.

**JUSTIN D. DALY:** I've served in the Capitol Hill since 1995 in different capacities.

**THERESA A. GABALDON:** It sounds like you've both been there long enough to know the players and one of the players I'm curious about is the role of the lobbyist. How important a role do you think lobbying plays, particularly in the process of regulating securities industry?

**JUSTIN D. DALY:** Lobbyists play an important role in every industry. We have an open door policy. We speak with all interested parties. Generally speaking, there are lobbyists on every side of an issue. Our jobs are to formulate sound public policy and we take into consideration what they say and other stakeholders have to say.

**DEAN V. SHAHINIAN:** I think good lobbyists communicate information and identify not only the strengths but the weaknesses of their principal's positions, as well as the strengths and weaknesses of their opponent's positions. That can be very valuable. They also perform a function I guess one might call "herding." If you've got a highly contentious piece of legislation, the lobbyists can form a coalition, so that the staff or the members who are dealing with a limited number of people on any given issue can help move the process along.

**THERESA A. GABALDON:** How closely does the staff work with the staff of the SEC in formulating various initiatives?

**DEAN V. SHAHINIAN:** I think the relationships with the SEC staff are very close. I think they are cordial. We receive briefings by telephone and in person from the staff. We call upon them frequently to provide technical advice on proposed legislation. We see them at seminars, hearings, receptions and at "SEC Speaks." As a former SEC staffer, I feel particularly close to the Commission staff and have many friends there.

**JUSTIN D. DALY:** We work closely with the SEC staff. They are a very professional work force and they really are one of the best sources of information for us on the Hill because they have very specialized areas of expertise. On the Hill, necessarily, you have to be a generalist because we cover all of the areas of the securities industry. At the SEC, they work in one of the operating divisions and they can focus and specialize in a particular area.

**THERESA A. GABALDON:** I think that you two give me the perfect opportunity to ask a set of questions I have always wanted to have answered. I am very interested in the subject of legislative intent and the role that it should play in interpreting laws and particularly the federal securities laws. Do you think that such a thing as legislative intent really exists?

**DEAN V. SHAHINIAN:** Absolutely. I think the members, when they pass legislation, have very clear views about what they do want to happen and what they do not want to happen. They present statements on the floor; they present statements at hearings. They craft committee reports which as clearly as possible outline what they do want and what they don't want to happen. At least from my perspective, legislative intent is a very real phenomenon.

**JUSTIN D. DALY:** As a non-expert on statutory construction, I will nonetheless give an answer. Sometimes Congress passes laws that are ambiguous. Sometimes that is done on purpose and most of the time it's unintended. There are numerous statutes that include ambiguous language and to the extent that we need to clarify the congressional intent in a Senate report, we do try to do so. And we do believe that a Senate report should be considered when interpreting the statute if it is necessary to resolve any ambiguities. But the preference of course is to draft perfect statutes so that any reader will be able to identify the congressional purpose. But that doesn't always happen.

**THERESA A. GABALDON:** I suppose the academic musing is to the effect that the legislative history is largely a question of staffer's intent as opposed to necessarily the legislator's intent?

**DEAN V. SHAHINIAN:** Is there a difference?

**JUSTIN D. DALY:** I can think of a few Supreme Court Justices who believe that lobbyists and other interested parties actually draft the legislative history. But as you said, we can only speak from our experience. We take the Senate Banking Committee reports very seriously and we try to make them helpful and explain why we are doing a particular thing.

**DEAN V. SHAHINIAN:** Indeed.

**THERESA A. GABALDON:** Unrelated but even more as a direct line, I am curious about the significance of legislative lack of action. There is a doctrine known as legislative acquiescence, to the effect that if the federal courts are interpreting in this case securities laws in a particular way, if Congress doesn't do anything to correct them, Congress must be deemed to acquiesced in the interpretation. Do you think that's valid?

**JUSTIN D. DALY:** I think sometimes it is and sometimes it's not.

**DEAN V. SHAHINIAN:** In order to pass legislation, it takes a lot of time and a lot of effort. It could be that Congress is not acting because there are more pressing issues that it wants to legislate on or it would be too tough to enact legislation. It does not necessarily mean acquiescence.

**JUSTIN D. DALY:** If there is a clear and erroneous application of a Banking Committee statute, then I think we would feel responsible to advise our bosses to introduce legislation to correct that erroneous implementation.

**THERESA A. GABALDON:** And would that extend just to looking back to interpretation of what the immediate past Congress had done or would you willing to look back several years and try to define for yourself what some prior legislature had intended and then try to keep the courts marching in line with that?

**DEAN V. SHAHINIAN:** Legislation is moved primarily by the current Chairman of the committee of jurisdiction. He or she has been elected for the quality of his or her own views and may not feel as strong a duty to champion the views of his or her predecessors. The farther back you go, there may be less impetus for that.

**JUSTIN D. DALY:** Agreed.

**THERESA A. GABALDON:** One of the things obviously I am sniffing around is the subject of continuity and whether one can reasonably expect to see flip flopping and changes in legislative agendas as well?

**JUSTIN D. DALY:** I think it's an interesting concept. I would just amplify what Dean said and also point out that, at least on the Republican side, chairmen's terms are limited to six years. Those six years go by awfully quick and the chairman needs to accomplish his or her legislative agenda. I think looking back and relying on what past chairmen did is probably not a significant factor.

**DEAN V. SHAHINIAN:** In the recent history of the Banking Committee, one might see different views, different priorities from Chairman D'Amato to Chairman Gramm to Chairman Sarbanes to Chairman Shelby to Chairman Dodd on different issues and that could influence their decisions of which causes they champion.

**JUSTIN D. DALY:** It does tend to be one of the more bipartisan, collegial committees. We're not dealing with hot button social issues that, for instance, the Judiciary Committee has to grapple with. There is a somewhat of a bipartisan consensus when it comes to financial services regulation. That is not to say that Republicans and Democrats are always going to agree, but there is a general consensus that investors

need protection and that we need to stimulate economic growth. The question then becomes, how do you achieve the proper balance of those two policy goals?

**THERESA A. GABALDON:** So the goals are the same?

**JUSTIN D. DALY:** I think the goals are the same; there may be differences but they are more at the margins than fundamental in nature.

**DEAN V. SHAHINIAN:** No Chairman or Ranking Member wants to preside over a crisis in the securities markets. They want to avoid that at all costs.

**JUSTIN D. DALY:** I don't know if this is sort of related in your mind, but it's an interesting question of how and why Congress passes legislation. If you look at Sarbanes-Oxley, for example, it took major corporate scandals and market failures to create an environment where Americans were demanding that Congress act. Under normal circumstances, it is extremely difficult to pass legislation, even if there are no opponents. We have deeply embedded checks and balances in our system of government and this goes back to the first question of how legislation gets enacted. It is very difficult to get a consensus among both parties and both Houses, the President and all the financial regulators.

On the Banking committee, if the Chairman and the Ranking Member are not in agreement, it is difficult for that legislation to even reach the Senate floor. I am sure there have been examples which contradict that generalization. But at least in recent years that seems to be the case.

**DEAN V. SHAHINIAN:** I agree; you are spot on. In terms of how events can overtake planned agendas, I reflect back to May 2001 when, as you may recall, the majority flipped in the Senate. On May 24th Chairman Paul Sarbanes had a press conference and he announced an extensive agenda. In the agenda were two words about securities and investor protection.

**JUSTIN D. DALY:** I thought you were going to say Sarbanes-Oxley.

**DEAN V. SHAHINIAN:** No, and at that point, there were many other issues that he was very concerned about. However, the accounting and investor protection problems raised by Enron, Adelphia, Merrill Lynch, WorldCom and so forth overtook them and led to 10 hearings and the Sarbanes-Oxley Act, which while not envisioned in May 2001. I think clearly that was a very significant part of his Chairmanship of the Banking Committee.

**THERESA A. GABALDON:** Obviously Sarbanes-Oxley raises a host of interesting issues. The first one that I wanted to ask about has to do with what I think seems to be a shift in spirit if nothing else from some major legislation that had been adopted just a few years before having to do with the deregulation of swaps, making it clear that swaps were not going to be regulated as securities. Would you agree that that is a change in spirit or is there something else that explains what was going on there?

**DEAN V. SHAHINIAN:** I think the Sarbanes-Oxley Act was a direct response to the problems and the misconduct and the dishonesty that was revealed in connection with a host of public companies. The constituent parts of it were meant to address that. Title I created the Public Company Accounting Oversight Board as a response to perceived

failures of the peer review. Title II focused around auditor independence, and was perceived as a response to the situation where an audit firm would get twice as much in revenues from its consulting businesses as from its audit clients.

Title V, in terms of precluding certain conflicts of interest between stock analysts and the securities underwriters, was a response to the perception of conflicted stock recommendations which resulted in misleading and sometimes fraudulent stock recommendations. I think it would be appropriate to characterize Sarbanes-Oxley as a response to the crisis that presented itself in 2001.

*The Wall Street Journal* said on May 8, 2002 that Main Street loses faith in Wall Street. Eventually, the stock market fell below 8000, a host of problems came up which eroded investor confidence as well as the investor pension holdings. I think it's probably best to view it in terms of a reaction to those situations as opposed to a particular response to prior legislation.

**JUSTIN D. DALY:** I would agree with all of that and just say that when Americans demand action on something, Congress, for better or worse, is responsive and for about six weeks in the summer of 2002, corporate governance was the biggest issue facing Congress. Americans were, I think, appropriately disgusted with these widespread accounting scandals and Congress responded.

**THERESA A. GABALDON:** Is there ever in your experience a response of, hey wait, let's not rush to judgment here, let's slow down and maybe take a little longer to look at this, come up with a better product?

**DEAN V. SHAHINIAN:** In terms of the mutual fund late trading and market timing issues that came up after Sarbanes-Oxley and after the global settlement with the securities analysts, I think there was a perception that Congress would enact legislation. But 10 hearings later and after a good deal of rulemaking and some very strong statements by Paul Stevens and the Investment Company Institute, a decision was made that Congress would not to seek to move legislation. As it has turned out, it looks like regulations and self policing have addressed the problem. So, in that case, there was a deliberate look and saying, "well, we don't need legislation," at least at that time.

**JUSTIN D. DALY:** I would agree. I think that's a good example and Congress shouldn't legislate simply to legislate and sometimes the regulators, in this case the SEC, is the more appropriate body to address some of these issues.

**DEAN V. SHAHINIAN:** And there are times when the Chairman of the committee will call a hearing in order to motivate the regulators to take actions so that the legislation is not necessary.

**THERESA A. GABALDON:** Something else that Sarbanes-Oxley brings to my mind has to do with -- pardon the expression -- federal intrusion on a traditional state prerogative having to do with the regulation of corporate governance. Was that a big concern at the time? Was the federal government doing something that intruded on the states?

**DEAN V. SHAHINIAN:** There was an awareness of the role of the States in corporate governance at the time. There was also simultaneously concern about the role of

corporate audit committees, whether they were in touch with the auditors, whether they were aware of problems that were discovered in the audit process.

The provisions of Title III of Sarbanes-Oxley were included in the original bill that was introduced in the Banking Committee and the staff and the members were aware of potential concerns. While some of the concerns were raised, and I am speculating now, but I think the calculus was the problems were so severe that this needs to be addressed because, to my recollection, there were no serious attempts to remove those in the Committee and there were no attempts to remove it on the Floor when the bill came to the Floor.

WorldCom had just taken place. So, by July 8<sup>th</sup>, after Senator Sarbanes introduced the legislation on the floor, members were getting up either to praise the bill or to say, "I have got an amendment that can make it even stronger." Nobody was looking to gut Title III.

In drafting, we were aware that parts of Title II may be taken out, Title III may be taken out, Title V. I was emotionally prepared for one's work being taken out. But after WorldCom, people were just seeking to make it stronger.

**JUSTIN D. DALY:** Agreed.

**THERESA A. GABALDON:** I know that this was before your time on the Hill. But it wasn't that long ago that Congress gave the SEC a tremendous exemptive authority under both the 1933 and 1934 Acts. Do you think right now that the amount of delegation is just right or should there be more? For instance, should it be up to the SEC to decide what isn't a security?

**DEAN V. SHAHINIAN:** I suppose it is just right. One wants to make sure that the SEC is adequately staffed to appropriately administer the exemptions that they have in connection with Sarbanes-Oxley. There were some concerns about its application in Europe. It's my recollection that Alan Beller, the Director of the Division of Corporation Finance at the time, crafted some exemptions to take into account special situations which were consistent with the spirit and intent of the law.

I think the Congress was pleased that the SEC had the exemptive authority on the one hand. On the other hand, Congress is mindful of giving too much exemptive authority - and I don't know how much is too much, lest the Commission exercises it in ways that Congress did not intend. I think with additional exemptive authority, Congress assumes a greater responsibility for oversight.

**JUSTIN D. DALY:** I think it's a really important concept. It really strikes at the basic relationship Congress has with some of the regulators. I agree with Dean. I don't know if Congress has delegated too much authority to the SEC. I think it's an interesting question. I also agree with Dean that Congress should give the SEC maximum flexibility so that they can carry out their mission. At the same time, Congress does have oversight of the markets and the SEC, and Congress, established by the Constitution as the Article I branch of government, has a role to play and should be careful not to delegate too much of its authority away to the SEC. It really is a careful balance and I don't know if Congress has gotten it right. But it's something we do think about.

**DEAN V. SHAHINIAN:** I agree with Justin and one additional aspect is that with more delegation to the SEC comes more pressure from interests that would like an exemption granted. I think there is a sense in which Congress is better able to deal with those pressures than the Commission. The Commission is very talented and exercises its responsibilities in an extremely professional way. Having said that, there are pressures and sometimes it may be appropriate for those pressures to come to Congress rather than to the Commission.

**THERESA A. GABALDON:** Obviously something that's going on right now has to do with the ability to grant exemptions from Sarbanes-Oxley and how do you see that shaking out if at all?

**JUSTIN D. DALY:** I think the Chairman of the SEC has made it clear that Section 404 will apply to all public companies. So I don't think there will be a carve-out for foreign companies or small companies and I am not sure if they have the legal authority to do so. We have seen some people suggest that the Sarbanes-Oxley Act ought to be put into the Exchange Act and therefore under section 36(b), the Commission would have the authority to exempt particular companies from the internal control standard.

**DEAN V. SHAHINIAN:** I don't believe the Congress intended for U.S. small companies to be exempted from having adequate financial controls. I think the notion that if you buy stock in a big company, you can be sure that they have adequate internal controls, but if it's a small company, no, you really can't, seriously erodes the integrity of the markets and raises concerns in terms of investors in small companies.

Chairman Cox at the SEC and his Commissioners and Chairman Olson at the PCAOB are doing a fine job in terms of the proposals that they issued in December. I think they have gotten about 200 comments. And so they are in the process, as I understand it, while we are taping, working through those proposals. At least I hope they are working through. Are you guys working through the proposals? They are doing an outstanding work on that. Auditing Standard 5 is a significant improvement from 2 and the guidance that the Commission is giving I think will be very helpful. My understanding is that the comment letters have been very positive and we should see some results which will go a long way to reducing the costs on public companies for the attestation and on reducing the pressures on the SEC and PCAOB to get it right.

**JUSTIN D. DALY:** There certainly appears to be a consensus that the regulators need to solve whatever problems there are and that's from people who support Sarbanes-Oxley and people who oppose Sarbanes-Oxley. So everyone seems to agree that Congress should permit the regulators, the SEC and the PCAOB, to streamline the standard and make 404 more cost efficient.

**THERESA A. GABALDON:** Related to the question of delegation to the SEC is of course Congress's view of the SEC and I think you have indicated that earlier that they hold the SEC in high esteem and certainly securities lawyers and securities professors like to brag that the SEC would be most prestigious and most competent and adept of all of the agencies. Do you think that it's true that Congress might have different views of different agencies?

**DEAN V. SHAHINIAN:** Yes.



**JUSTIN D. DALY:** Unquestionably. I don't think FEMA is a popular agency.

**DEAN V. SHAHINIAN:** I recall the former Commissioner Bevis Longstreth said that the Commission was a jewel among federal agencies and I think at least a couple of members of the Banking Committee have quoted him on that. So I think they're held in very high regard. I think one of the former Chairmen had said "good people, important problems, workable laws." I think it was the motto for the 50<sup>th</sup> anniversary of the Commission and I think that it's true.

**THERESA A. GABALDON:** Sounds suitable for embroidering on a sampler. Well that seems to suggest too that there might not be an intense degree of congressional interest in various proposals about forcing a restructuring of the SEC or that Congress might generally be willing to just keep their hands off and let the SEC take care of it. It's all in in-house issues?

**JUSTIN D. DALY:** I would agree with that. As you suggest, there are proposals out there to reorganize and restructure the SEC. I think a reasonable view is that Congress should allow the SEC to manage the agency and structure it the way they see fit. If Congress were to involve itself it would probably be fair to say micromanaging the agency. The agency is probably best equipped to restructure if it decides it needs restructuring.

**DEAN V. SHAHINIAN:** Indeed. There is no need for legislation on that, and the Chairmen have the ability to do that. I know Bill Donaldson, who was the first Dean of the Yale School of Management, when he went to the SEC was looking at ways to "tear down the silos," I think he said, and promoting inter-divisional cooperation. There are various ways that that could happen. There have been some questions about other issues and the chamber has a proposal for reorganizing the divisions. But those are issues that the Commission can handle as they deem fit.

I think the Congress is most concerned with the effectiveness of investor protection and promoting fair and efficient markets and whatever organizational structure works best for that I think people would be pleased with. If the Commission in some ways is not effective in that, they would just say, "well, please produce the desired results." However you need to organize people.

**THERESA A. GABALDON:** How about proposals to do a bit more to restructure the overall regulatory schema of the financial markets. For instance, proposals to merge the SEC and the CFTC?

**JUSTIN D. DALY:** We support that.

**DEAN V. SHAHINIAN:** I have no comment. I am aware of the proposals.

**JUSTIN D. DALY:** I am just joking. Idea like that have been out there for some time and many people point to the FSA in the United Kingdom. They took nine regulatory agencies, I believe, and combined them into one super-regulator, the FSA. And the FSA is pretty well regarded as far as I can tell and I think as the markets continue to evolve in the United States and the New York Stock Exchange starts trading derivatives and the Chicago Mercantile Exchange gets involved with new products, we are going to continue to see people suggest that maybe the SEC ought to oversee all of these different products, not only stocks and bonds, but also derivatives and other things.

**DEAN V. SHAHINIAN:** Justin mentioned the FSA, and I recall a few weeks ago Sir Callum McCarthy, head of the FSA, was in town. He took a card out of his pocket and said, I have the principles that we have here right on the card - and of course there has been a debate about moving to more principles-based from rules-based regulation here. And he said well I have this card with the principles on it and there are 8500 pages of text which explain these principles. So I know there has been that movement as well towards principles based. But I don't know how that will play out.

**THERESA A. GABALDON:** Does it seem to you to be the type of issue that is more likely to wait for the agencies to agitate and come with proposals?

**JUSTIN D. DALY:** Like any committee in Congress, I think the Banking Committee would support adding jurisdiction. I don't think there is a serious chance that it will happen anytime soon. I don't know that there are any proposals out there to do it. But certainly all the changes in the marketplace will be the most likely driver of this.

I don't think the SEC will come up and say, we want more power, and I don't think the Agriculture Committee will say the Banking Committee can do our work. I think you will need the marketplace to drive it just like Citigroup's merger with the Travelers helped lead to Gramm-Leach-Bliley. I think it would take something like that to demonstrate that this outdated system of regulation is not equipped for today's marketplace.

**THERESA A. GABALDON:** Before we leave the topic of the congressional view of the SEC, Harvey Pitt, while he was the Chairman of the SEC, stated that the SEC could basically do the accounting oversight work that was necessary, yet the PCAOB was created. Why did Congress do that?

**DEAN V. SHAHINIAN:** In January 2002, he had a proposal for dealing with this issue. And I think there were two things. One was preference for another body to look at it. And of course the PCAOB is essentially under the jurisdiction of the SEC. They appoint their board members and they review their rules. But it is a separate group that deals with that.

The other thing is, if it's at that point in time, the proposal before it was announced may not have been fully vetted with Congress or with other interested parties before it came out. I think the Public Oversight Board - Chuck Bowsher, who was the former Comptroller, was the Chairman then - disbanded in response to the proposals. I think there may have been something in the process which may have precluded that from getting a further hearing. But that's my recollection.

**THERESA A. GABALDON:** I think there are a number of interesting hot topics that we have touched on already but we should take a few minutes to see if we can unpack at least some of them. Would Congress, being prompted to revisit at least some of the requirements of Sarbanes-Oxley, also be prompted to do something or not about the regulation of hedge funds, something or not about the regulation of mutual funds, something or not about the proxy access? Could you expand on the list as well as perhaps make some comments about where you think the current Congress might be headed with some of these issues?

**JUSTIN D. DALY:** You did hit on so many of the most controversial subjects. I think in terms of hedge funds, Congress is certainly interested in doing oversight, and Congress needs to establish whether hedge funds pose a systemic risk to the markets and whether there is any of the so-called retailization of hedge funds as some have suggested and the SEC I think is responding by raising the accredited investor standard which was last updated in 1982. So it's been a quarter century since that time.

The President's Working Group recently issued a series of principles and we're taking a look at them. I think it's premature and probably less likely than not that there would be direct regulation of hedge funds.

**DEAN V. SHAHINIAN:** In terms of Sarbanes-Oxley, most of the focus has been on 404 and I think the efforts of the SEC and PCAOB which we discussed earlier probably will diffuse a lot of the momentum to changing the statute. Section 404 is only about a half a page and just says that management has to attest the fact that there are internal controls and an auditor has to attest to the adequacy of those controls.

Those are principles that people wouldn't disagree with and hopefully the SEC and PCAOB efforts will provide a framework for the application in a way that people will find acceptable.

Proxy access is a very important issue. And I don't know how that's going to play out. But I think it's very important. Institutional investors are very concerned about that. I think individual investors are also. I don't know how that will play out now or in the future.

**JUSTIN D. DALY:** There has been legislation introduced in the House establishing a non-binding shareholder vote on executive compensation. I don't believe there's legislation yet introduced in the Senate. I think some would be concerned about something that you raised earlier, which is the federalization of corporate law and Congress overstepping its role in terms of regulating the business affairs of corporations. So I think that's an ongoing concern that some people would have.

**DEAN V. SHAHINIAN:** And of course there are a whole host of other issues that are out there on the radar screen which may receive informal scrutiny, such as the executive compensation issue. I believe tomorrow the House Financial Services Committee will mark up legislation on that. There are issues involving market data fees, improving regulatory effectiveness, the combination of the NASD and the NYSE, and regulation protecting senior citizens from investment scams which is a recent initiative of Chairman Cox, the roles of registered reps and investment advisors (advisors which have fiduciary responsibilities), developments in the options market with determining whether penny increments make sense, the bond markets' transparency, new participants in the U.S. bond markets, accounting developments, sale of securities over the Internet and the increasing incidents of fraud that take place over the Internet. John Reed Stark has done a great job at the Commission in terms of that.

**JUSTIN D. DALY:** Dean keeps plugging specific members of the SEC staff; I think they all do a great job.

**DEAN V. SHAHINIAN:** Indeed, they do.

**JUSTIN D. DALY:** A global commendation.

**THERESA A. GABALDON:** The way you lay things out, it does indeed sound like a daunting list. Do you have anything to add?

**JUSTIN D. DALY:** When it comes to CEO pay, that controversy is not going away and so long as people see a de-linking between company performance and executive compensation, it will continue to be a controversy. Is pay without performance a widespread phenomenon or are there just a few boards out there that aren't doing their job?

I don't think Congress should be involved in this issue. Congress can certainly do oversight, but I don't think Congress should legislate on this issue. I think the boards need to do their job, and I think shareholders, particularly the institutional shareholders, ought to raise the issue with directors if they are unhappy with compensation levels.

**THERESA A. GABALDON:** I suspect they will. Given the length of the list, I am prompted to ask first of all, is there really some way of conducting triage on these issues or does one simply wait for public outcry that would point the way?

**DEAN V. SHAHINIAN:** I think many of these issues are actively under consideration by the Securities and Exchange Commission. Chairman Cox and Commissioners Atkins, Campos, Nazareth and Casey are on the job, on these things. So, the expectation is that they will address these issues; they know them more intimately than we do and if legislation is needed to address any particular problem in the marketplace, I expect they will come to the Congress and ask for legislative authority.

Also, the States have a very important role and are involved in addressing a lot of these issues. So, we are not waiting for problems to erupt and then have a gotcha hearing. Instead we are aware of these issues, and we keep track of them. There may be some benefit to the regulators to know that we're concerned about this because that supports their efforts and there are a lot of very talented and very passionate people among the regulators who want to protect investors. It's part of our job is to support them and encourage them in their good work.

**JUSTIN D. DALY:** I think in an ideal world, Congress is proactive and gets ahead of problems and operates in a non-crisis environment. Unfortunately, sometimes there needs to be a crisis for Congress to act and that's just probably the way it's always been and certainly Congress needed the WorldCom bankruptcy to occur to give Sarbanes-Oxley the necessary momentum.

**DEAN V. SHAHINIAN:** Absolutely.

**THERESA A. GABALDON:** You suggested that hedge funds might be on the radar and that seems to me to be such a large and troubling issue, and you mentioned something about concern about their effect on overall market stability. How does Congress actually go about acquiring the information that it needs on which to base legislation? Obviously it holds hearings. But can you flesh that out for us a little bit?

**JUSTIN D. DALY:** I think what we would first do is to seek out the most knowledgeable people in the markets, in academia, and among the regulators, and invite them to come testify before the committee and flesh out all the issues. I do think that before Congress

acts, we need to establish certain things such as, if there's a market failure, this is something the regulators can't do and there needs to be legislative authority. So, I think the job of compiling the best information is very, very important and it's something we would certainly seek to do.

**THERESA A. GABALDON:** Would Congress typically consider commissioning its own study on something like this?

**JUSTIN D. DALY:** The GAO is often asked by Banking Committee members to conduct studies and they do an outstanding job. We work closely with Rick Hillman and the GAO staff, and I figured out how to commend the work of at least one fellow government worker. The GAO does an excellent job. I think the SEC has been asked by Congress to do studies; they do an excellent job. Senator Schumer recently commissioned The McKinsey Group to do a study on the competitiveness of the U.S. capital markets.

So there are numerous entities out there that are able to conduct studies and help Congress do its work. And of course there is the Congressional Research Service which does an outstanding job. So we do have a tremendous amount of resources, and we certainly couldn't conduct business without all their fine help.

**THERESA A. GABALDON:** Now I can't let the hour end without asking an obvious question, to which I think I know what the answers is going to be. But obviously there has been a party switch, what's going to change as a result?

**DEAN V. SHAHINIAN:** I think the Chairman and ranking members and their staffs will continue to work together collaboratively on securities issues. There are many issues that are bipartisan in nature. So I would expect we would continue to be working to protect investors and promote fair and efficient markets.

**JUSTIN D. DALY:** I would agree with that. I think that the Banking Committee is one of the most collegial committees in the Senate and indeed the Congress. As a practical matter, the Chairman and Ranking Member will have to be in agreement for legislation to get to the President's desk and I think we are all aware of that. And so we work very closely together.

Generally, there is bipartisanship on the committee. I know that sounds idealistic. We are not debating the Iraq war and we are not setting withdrawal dates. We are trying to establish the most conducive environment for investors to save for their retirement, which is obviously crucial but it's not something that should engender bitter and acrimonious debate.

**THERESA A. GABALDON:** Dean, I have to ask if you got a better parking place with the shift in party.

**DEAN V. SHAHINIAN:** No, the same parking place.

**THERESA A. GABALDON:** We have got just a couple of minutes left for me to ask you each to polish your crystal ball, if you don't mind, and give a view on what change or changes you think Congress will have made in the federal securities laws in the next five years?

**DEAN V. SHAHINIAN:** Events can dictate to a large degree laws that would be needed. I think for most problems that are on the radar screen now the Commission or the State regulators or industry will probably sort those out, precluding a need for legislation. So it's difficult to envision major issues and knowing what problems are going to come up.

I think if you look back five years, you see Sarbanes-Oxley came up. But people didn't foresee that much before the events of Enron and so forth. One issue that one might look at would be shareholder access; conceivably that could percolate to the top. But again, the Commission is looking at the issue and its potential solutions to that issue. But it's tough to predict with any accuracy.

**JUSTIN D. DALY:** It is a very difficult question. No one would have predicted Sarbanes-Oxley in 2001 or even in the spring of 2002. It took WorldCom in June 2002 to really serve as the tipping point for legislation. So, it is hard to predict. I think the area of alternative investments is something that's going to continue to attract an increasing amount of interest from regulators and from Congress. I am referring to hedge funds, private equity and venture capital.

**THERESA A. GABALDON:** Looking out say 10, 20 years, obviously you become even less confident in your predictions. But do you see a combined financial regulator?

**JUSTIN D. DALY:** These are very speculative answers. But that won't stop us. I do think the U.S. will move to a more centralized regulator akin to what they did in the UK. So my prediction would be streamlined regulatory agencies.

**DEAN V. SHAHINIAN:** In, conceivably, 10 years. But I can't answer the other because that in part is a turf war type of thing. Technology will increase a great deal over the next 10 years and one expects that for example, if proxies are delivered electronically, then it becomes cheaper to list shareholder proposals or shareholder nominees and I suspect there will be an expansion of shareholder rights. But whether that's legislation or regulation, I don't know.

**THERESA A. GABALDON:** Well, thank you both very much. Indeed I would like to thank you for one of our more stimulating discussions. And it's been very inspirational to hear how well you and the SEC are getting along, and the high esteem in which you hold them. I mean that sincerely.

I would also like to thank again ASECA - The Association of SEC Alumni, Inc. and Pfizer, Inc. for sponsoring today's Fireside Chat. This Fireside Chat is now archived in audio format in the virtual museum, so you can listen again to the discussion at any time. A transcript of the discussion as well as the audio in MP3 format will be accessioned in the Online Program section in the coming months.

We'll be shifting our discussion in the next Fireside Chat to the impact and influence of the federal judiciary on the SEC and the securities industry. Please join me, Paul Gonson and Mark Kreitman on April 17th at 3 p.m. Eastern Daylight Time for our chat on The Courts and the SEC. Thank you again for being with us today.