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Introduction

During the nineteen months I was privileged to serve as SEC Chairman, the Commission faced and responded to unprecedented challenges. The Commission and its Staff responded with alacrity, intelligence, and effectiveness to the challenges with which we were confronted.

A. Aftermath of Terrorist Attacks

Within a month of my taking office, the hideous terrorist attacks of September 11th occurred, disrupting market continuity, throwing our economic and financial system in turmoil, and threatening public confidence. The Commission's response was multifaceted. Among other things, the agency commenced an immediate and ongoing dialogue with the President's Working Group on Capital Markets. Working with the Treasury Department, the Federal Reserve Board and the Commmodity Futures Trading Commission, we ensured cohesive economic planning. The Commission and its Staff worked around the clock to coordinate its responses to the issues.

Our first priority, of course, was to get our markets back up and running. Toward that end, the day after these attacks, senior SEC Staff and I visited Ground Zero in New York and met in Manhattan with the leadership of major markets, securities firms, banks and clearing agencies, along with New York's Governor and Mayor, Con Edison, Verizon and the NY Fed, to assess the situation and determine readiness for a reopening of the markets. Working with the principal markets, market self-regulators and market participants, we were able to permit the markets to reopen on Monday, September 17th, issuing a number of critical press releases and holding news conferences to keep the public fully apprised and up to date.

Over the weekend before the 17th, the Commission oversaw extensive facilities and communications testing to ensure that the markets could reopen safely and fairly on the 17th. We reached out to major market participants, both directly and through industry groups, to determine whether we could provide appropriate temporary regulatory relief to facilitate the reopening of fair and orderly markets. As a result, the Commission invoked, for the first time, and in a substantial way, its emergency powers that had been granted after the market crash of 1987, issuing orders and interpretive releases to ease regulatory restrictions and provide necessary market liquidity. Among other things, we relaxed restraints on corporate repurchases, and encouraged hundreds of public companies and their officers and directors to announce repurchase programs.

We adopted a plethora of temporary rules and interpretive guidance to ease the crisis caused by the disruptions to our financial centers. Equally importantly, we extensively used our website to make information continuously available to investors, established a toll-free number for investor questions and, for the first time in agency history, established a hot-line for *market participants* so our staff could assist them when the markets reopened. The result was a triumph of public and private sectors, operating synergistically and cooperatively, in restoring our markets to their former vitality. On Monday, September 17th, all US securities equity and options markets resumed trading, at historic volume levels, without incident.

The Commission also had to respond to its own travails resulting from the attacks, since its office at 7 World Trade Center collapsed and turned to rubble, taking with it all the Commission's records and the effects of our entire New York Staff. We were blessed that every member of our New York Regional Office Staff was accounted for, and that we had not lost a single individual to the enormous tragedy of 9/11. Notwithstanding the enormous dislocations the tragedy caused, our Staff had extensive access to EAP assistance; we worked out strategic approaches to ensure that no enforcement action would be lost. It was a proud moment for the agency when, In October 2001 the Commission became the first federal agency to move back into New York's Financial District, a stone's throw from Ground Zero.

The Commission also commenced enforcement inquiries to determine if any conduct associated with the terrorist attacks might have violated the federal securities laws, and our Staff provided special assistance to the FBI in tracking down those responsible for the attacks. For one of the few times in the agency's history, the Commission announced these enforcement inquiries to provide more public information about the agency's responsive efforts. Even after order was restored, and the market disruptions began to fade from memory, working together with the Federal Reserve Board the Commission conducted a review of the industry's and its own responses to the terrorist attacks and developed a widely acclaimed white paper on lessons learned from this terrible experience.

B. Corporate Financial Reporting

Within a month of the reopening of the Nation's equity markets, a second crisis confronted the SEC — the first of a series of corporate implosions occurred with the dramatic demise of Enron Corporation. As the Commission later testified before the Senate Banking Committee, Enron was the poster child for something evident long before the company's actual demise — our financial disclosure and reporting system, and the professionalism of the accounting profession, had not kept pace with market changes. As a result, the Commission was confronted with evidence of deliberate misconduct on the part of public companies, senior officers of those companies, outside auditors, outside law firms and investment banks.

To deal with various facets of the deficiencies in our regulatory system, among other things the Commission put a stop to the fraudulent use of pro forma financials, required public companies to assess and disclose critical accounting principles and commenced a long overdue review of all Fortune® 500 companies. In addition, the Commission outlined its proposal for a new private sector regulatory body to oversee the accounting profession, a proposal that ultimately formed the model for the current PCAOB. The Commission also identified issues in MD&A to be addressed regarding off-balance sheet financing arrangements.

The SEC pushed the private markets and SROs to adopt practices that should prevent the problem from reoccurring. At the Commission's direction, the NYSE and Nasdaq developed more extensive corporate governance requirements for public companies. In these and other SRO responses to industry problems, the Commission insisted that the SROs adopt fully comparable standards, the first time that kind of directive was issued by the agency; it was responded to forcefully by the SROs. Many of the Commission's initiatives were incorporated whole-cloth into what eventually became the Sarbanes-Oxley Act. Beyond these preliminary steps, the Commission initiated a first-time review of, and then oversaw the adoption of extensive and effective new standards for, analyst reports.

Long before passage of the Sarbanes-Oxley Act, the Commission was asked to assist the President in formulating his historic ten-point plan for corporate responsibility, in response to the corporate implosions being witnessed at that period. Working with the President's Working Group on the Capital Markets, the Commission played an instrumental role in shaping and defining the Administration's response to corporate misconduct.

In formulating its responses to the implosion of so many public companies, the Commission also convened a series of three interactive public forums to discuss accounting and financial reporting issues, with participation by former SEC Chairmen, former senior SEC Staff, institutional investor representatives and private investors, like Warren Buffet. The results of these forums enabled the Commission to propose its own regulatory responses to the corporate reporting crisis, and ultimately informed much of the substance of Sarbanes-Oxley.

C. <u>The Demise of Arthur Andersen</u>

One of the consequences of these corporate implosions was the demise of Arthur Andersen, which admitted that it had destroyed documents related to the Commission's Enron investigation. The demise of a major accounting firm had never occurred in this context before, and the Commission responded by utilizing its emergency powers to issue orders and temporary rules to assure a continuing and orderly flow of information to investors and the US capital markets, in light of Andersen's indictment.

D. <u>Revitalization of the Commission's Enforcement Program</u>

For decades, the Commission's law enforcement efforts were patterned most closely on US Attorney investigations — the Staff would investigate until it was satisfied that it had put together an effective record that would permit successful prosecution of securities law violators. The problem with this approach, especially in the wake of so many corporate implosions, was that enforcement action often resulted many years after actual wrongdoing had occurred, and often after the fruits of such frauds had long been squandered. Instead, the Commission instituted its "Real Time Enforcement Program," designed to make the Commission's law enforcement activities even more effective than they had been in the past.

Among the principle tenets of "real time enforcement" were: assessing whether frauds were ongoing or already completed so priority could be given to ongoing frauds; analyzing whether fraudulent fruits existed, so they could be recouped for public investors; bifurcating cases to permit the Commission to take immediate action to publicize and stop frauds in their tracks, and yet preserve the agency's ability to pursue additional violations that might come to light later; affording substantial credit to companies that self-reported possible misconduct, self-investigated the wrongful conduct (and shared results with the Commission), took steps to deal with that misconduct, make the public whole, and provide assurances to the Commission there was little likelihood violative behavior would recur.

The Commission's "real time enforcement" program produced meaningful results, including the astonishing effort of the Enforcement Division to seek and obtain relief against WorldCom, Inc. within forty-eight hours of learning of its fraudulent behavior. Learning from its Enron experience, the Commission sought and was granted the appointment of a Special Monitor — the Commission recommended, and the Court appointed, former Chairman Richard Breeden — to ensure that no improper payments were made during the pendency of the action, and that no evidence would be destroyed. Former Chairman Breeden's performance in that role was exemplary, and fully justified the Commission's decision to recommend him.

As a result of the Staff's wholehearted embrace of real time enforcement, the Commission filed a record 598 actions in fiscal year 2002, a 24% increase over the number of actions brought a year earlier, and nearly 20% more than the number of actions brought two years earlier. The Commission's focus not just on numbers of cases, but also on remedies especially tailored to provide meaningful protection to the public, produced dramatic changes in the effectiveness of the agency's enforcement program.

Among other things, the Commission filed a record number of financial fraud and issuer reporting actions. Officer and director bars, sparingly utilized theretofore, increased exponentially, up 147% over the prior year. The SEC's enforcement team also significantly increased its filings of temporary restraining orders, seeking immediate relief to prevent irreparable harm to investors. And, the Commission brought more subpoena enforcement actions and sought larger disgorgement orders and penalties than ever before in its history.

During the pendency of the SEC's inquiry into the fraud at Enron, the company falsely asserted that it could not disclose its true financial condition because of the pendency of the Commission's investigation. In response, the Commission demanded, pursuant to §21(a) of the Securities Exchange Act, that Enron disclose its true financial position, or publicly acknowledge that it was unable to do so. Enron acceded to the Commission's demand, and the Commission began using its § 21(a) powers as more companies indicated financial chicanery. Ultimately, the Commission used this authority to require CEOs of the 947 largest public companies to certify the accuracy of their financial statements on August 14, 2002, which put an end to speculation about more shoes waiting to drop.

E. Implementation of Sarbanes-Oxley

At the end of July, 2002, the Sarbanes-Oxley Act was signed into law by President Bush. Building on the Commission's initiatives in the areas of corporate governance, current disclosure, real time enforcement, regulation of the accounting profession, and improved financial reporting, the Act required SEC rulemaking of a scope, breadth and rapidity that was unprecedented. The Commission adopted dozens of regulations and proposed dozens more, in response to the Sarbanes-Oxley directives. Throughout its effort, the Commission did not miss a single deadline, and every substantive regulation required by Sarbanes-Oxley was passed unanimously.

Thus, within thirty days of the enactment of S-Ox, the Commission adopted rules requiring corporate CEOs and CFOs to certify their company's financial statements; accelerated the filing dates of periodic reports; and required insider transaction reporting within two business days of the transaction's execution, rather than ten days after the end of the month in which the transaction occurred.

During the six months following enactment of S-Ox, we continued to propose and adopt rules at a record pace. In January 2003 alone, the Commission adopted twelve rules governing a multiplicity of topics. The SEC entered its busiest period of rulemaking in the shortest period of time in its history. Many of the rules adopted were aimed at improving corporate governance. For example, public companies are now required to disclose in their annual reports whether they have adopted a code of ethics that applies to the company's principal executive officers and senior financial officers — and, if not, why not. They also must disclose whether they have at least one "financial expert" serving on their audit committees, and if not, why not.

Directors and executive officers of publicly-held companies are now prohibited from trading company securities if employees are subject to a pension plan blackout period. As noted earlier, the Commission also requested that the NYSE and Nasdaq come forward with proposals that ultimately produced the most substantial corporate governance and listing standards reform in decades.

To ensure that corporate constituencies can trust what companies say about their financial performance, we proposed rules on internal controls reporting to implement the provisions of S-Ox §404. These rules, ultimately adopted substantially as proposed, require a company to file an internal controls report as part of its annual report. This report addresses management's responsibility to establish internal controls and procedures for financial reporting and requires management to evaluate the effectiveness of those controls and procedures as of the last day of the company's fiscal year. In addition, as required by S-Ox §404, the company's external auditor must attest to, and report on, management's assertions in the internal controls report. These rules work in tandem with the rules we previously had adopted requiring companies to conduct a quarterly evaluation of their disclosure controls and procedures.

We also directed our attention to reforming the SEC's disclosure rules and the issue of corporate transparency. Our public disclosure system has, until very recently, been founded upon a virtually exclusive backwards look — what has the company done and from where has the company come? And yet, sophisticated investors all seek current and forward-looking information — information about how the company is doing *now*, and how it is likely to do over the coming months and years. We tackled this by proposing rules to expand current reporting on Form 8-K and accelerate its filing date. The amendments to Form 8-K that we proposed, and which were recently finalized, move us closer to a system of "real-time" reporting. They are a major step that metamorphoses our disclosure system from its backward looking perspective into a current disclosure system.

Because of the unfortunate extraterritorial application of much of S-Ox as drafted, the Commission convened a special interactive roundtable to consider the concerns and observations of those familiar with the international community. As a result of this roundtable, the

Commission was able to modify some of its proposals to eliminate unintended interference with foreign laws.

The rules adopted were directed not only at public companies, but also the gatekeepers that allowed or facilitated improper or illegal corporate conduct. The new rules strengthen auditor independence and require additional disclosures to investors about the services they are providing to the company. Accounting firms are now required to retain audit records, including workpapers that form the basis of their audit or review and related documents. We also established standards of professional conduct for attorneys who appear and practice before the Commission. Attorneys are required to report evidence of a material violation to the chief legal officer, or to both the chief legal officer and the chief executive officer. If an “appropriate response” is not received, attorneys must report “up-the-ladder” to the Audit Committee, another committee of independent directors, or to the full board. Alternatively, if a company establishes a Qualified Legal Compliance Committee (QLCC) consisting of independent directors, attorneys need only report potential violations to the QLCC.

Beyond the rulemaking required by S-Ox, the Commission also completed and sent to Congress four required studies on: (i) The Role and Function of Credit Rating Agencies; (ii) Violations by Securities Professionals; (iii) Commission Proceedings to Obtain Civil Penalties and Disgorgement; and (iv) Enforcement Actions Involving Violations of Reporting Requirements and Restatements of Financial Statements. Each study was completed within the stringent and ungenerous time limits S-Ox established.

F. <u>Market Reforms</u>

An important task undertaken by the Commission during my tenure was reforming and restructuring our securities markets and redefining the roles of those who participate in them. Prior to my tenure, concerns had been raised about securities analysts. Upon assuming the Chairmanship, and before evidence of fraudulent misconduct surfaced, I convened a meeting of the NYSE and NASD, and the major securities industry firms, along with senior SEC Staff, to galvanize the SROs into revising the ways in which analyst reports were prepared and presented. This effort, begun before 9/11, but delayed by those tragic events, culminated in groundbreaking reforms to minimize and disclose conflicts facing research analysts.

When evidence surfaced in March, 2002, of fraudulent analyst reports, the Commission commenced a full-scale, industry-wide, enforcement investigation. Working together with the North American Securities Administrators, the NASD, the NYSE and the New York Attorney General, on December 20, 2002, the Commission announced it had reached an historic global settlement in principle with the nation’s top brokerage firms.

In late 2001, the Commission and the NASD announced an historic resolution of the first IPO abuses case. The case, which involved CS First Boston, resulted in the imposition of fines and disgorgement in the amount of $100 million, and prompted the Commission to request the NYSE and the NASD to commence a full-scale review of IPO practices with a view toward recommending significant improvements in the practices then prevailing.

Market structure issues also demanded attention and response. Toward that end, the Commission began several initiatives which are now being finalized. Thus, in November, 2002, the Commission held several interactive hearings to discuss key issues relating to the structure of the US equity markets. The hearings addressed issues regarding the collection, consolidation and dissemination of market data, broker-dealer duties of best execution, intermarket access rules, trade-through protections, the proper role of ECNs and the self regulatory system.

Based on our initiatives, the options markets, in February 2003, went live with a linkage system that eliminated the theretofore fragmented market operations, eliminated the need for trade-through disclosure rules, and assured customers that their agents could find the best execution for their transactions in any market in which the listed options sought were traded.

Among other critical areas of market reforms successfully addressed during this period, the Commission worked closely and effectively with the CFTC to permit the timely introduction of single stock futures. In addition, the Commission addressed significant concerns about its initial foray into regulation under the Gramm-Leach-Bliley Act, which removed barriers to comparative financial services, and adopted the first of a package of significant rules. In the wake of Enron and other financial frauds, the Commission launched a thorough examination of the role of rating agencies in the US securities markets, convening an interactive public dialogue on the issues raised by rating agencies, and ultimately submitting a Report to Congress, on January 24, 2003, detailing the Commission's conclusions and observations.

G. Mutual Fund, Investment Adviser and Hedge Fund Reform

The continued safety and soundness of mutual funds was another important topic during my tenure, especially since mutual funds had replaced bank accounts as the Nation's savings vehicle of choice. In the face of flat or declining markets, we were concerned investment advisers would increase their profits by either selling more shares or cheating. The latter possibility encouraged us to take action before the mutual fund scandals ultimately erupted in late 2003. Perhaps equally significant as an impetus to action was the fact that the Commission's examination program had, years earlier, targeted funds and advisers for inspection only once every five years. Even if that target were met, it was insufficient to provide meaningful protection to the mutual fund investing public.

This prompted us to contemplate a tri-partite approach to mutual fund reform: better disclosure; requiring appointment of compliance officers and delineation of specific compliance policies; and the "outsourcing" of mutual fund examinations to the private sector, to utilize limited Commission resources more effectively. All but the last of these have been finalized.

Among other things, we proposed requiring mutual funds to disclose portfolio holdings quarterly instead of semi-annually. Similarly, in response to abuses we uncovered by corporate managers and advisers of the proxy voting process, we required mutual funds to disclose their proxy voting policies and procedures, and required funds to disclose how they actually cast their proxies. Many have credited the significant withheld vote involving Michael Eisner of Disney to this change in operative policy. We also required registered advisers to specify how they would address material conflicts of interest that might arise between them and their clients. We also proposed rules intended to encourage mutual fund advertisements to convey more balanced information to prospective investors, particularly with respect to past performance. To assist investors in understanding business practices, services and fees of investment advisers, we initiated a website permitting comparative analysis. The website also contains disciplinary information regarding advisers.

We learned, in late 2002, of troublesome indications of potential "breakpoint" violations — the failure to give mutual fund investors advertised discounts for combined fund participation accounts. In response, the SEC Staff, in an unprecedented mailing, contacted all brokerage firms that sell mutual funds, directing them to conduct an immediate review of the adequacy of their existing sales load policies and procedures, and to report the results of that review to the Commission and the NASD. In January, 2003, the SEC and the NAD announced a multifaceted action plan to ensure that investors are charged correct sales loads on their mutual fund transactions, including a coordinated examination, with the New York Stock Exchange, of firms selling front-end loaded mutual funds. And, at my request, the NASD, the SIA and the ICI convened a working committee under the NASD's aegis, to explore and recommend ways to prevent similar abuses and errors in calculating sales loads.

In the area of governance, we adopted rules extending the application of S-Ox certification and disclosure requirements to registered investment companies, and we implemented the "code of ethics" and "financial expert" disclosure requirements put in place for operating companies for mutual funds and other registered management investment companies, as well.

Because of our concern that mutual fund boards needed to do a better job of monitoring the activities of fund advisers, we proposed, and the Commission ultimately adopted, rules requiring all investment companies and their advisers to have compliance officers, to adopt and implement compliance policies and procedures reasonably designed to prevent violations of the federal securities laws, and to assess and evaluate the state of compliance annually. We proposed for comment a policy initiative that would require the largest mutual funds to be independently inspected annually, and other funds to be inspected bi-annually, pursuant to a detailed inspection routine to be identified by the Commission. The intention was to have reports regarding these annual or bi-annual inspections reported to mutual fund boards *and* the Commission, enabling the Commission to focus its limited resources on problem areas that showed up in this process. This latter policy initiative remains pending at the agency.

The Commission also approved the first exchange-traded funds based on fixed income indices, giving investors additional options to invest in a basket of fixed income securities, providing lower expenses and intra-day pricing.

In May 2002, I announced the launch of a formal fact-finding investigation into issues currently affecting private investment funds, including hedge funds. The decision to study the hedge fund industry was based, in large measure, on the tremendous recent growth in the amount of assets under hedge fund management and the Commission's lack of information about hedge fund advisers that are not registered under the Investment Advisers Act and the assets they manage.

H. Investor Education

With the expanded opportunities available through technology, the Commission's Investor Education Office put real meaning behind the mantra that an educated investor is the first and best defense against fraud. In the face of staggering losses to small shareholders, we felt more had to be done in the area of investor education. Among other things, the Commission launched six "scam" websites that, first, attempt to induce prospective investors to be gulled into a fraudulent scheme, and then warn them that, had the site been real, the investors could have lost their funds and perhaps their life savings. These sites, which were crafted by the Investor Education Office's head, Susan Wyderko, were a phenomenal success, ultimately attracting millions of investors, and winning the Commission appropriate recognition for its efforts to protect investors, all at a cost of $50 per site. The sites were premised on actual fraud cases.

In order to respond to investor concerns about the implosion of so many public companies, the Commission convened its first-ever

Investor Summit, in which the Commission and its senior staff responded to questions in "real time" from investors all over the Country. We provided individual responses to over 82,000 complaints and questions from investors. In addition, the interactive "Fast Answers" database on the Commission's web site provided instant answers to nearly 206,000 questions from the investing public.

I. Improved Agency Efficiency

In the wake of the corporate reporting scandals, a recurrent question was whether the Commission had enough resources, and whether it was making appropriate utilization of those resources. As a result, I commissioned the first top-to-bottom review of the agency's performance, efficiency and responsiveness. The study was led by senior staff members, and was augmented by McKinsey & Co., and took seven months to complete. Once completed, the study produced a myriad of recommendations for improved agency efficiency. Many of the study's recommendations have been implemented, or are now in the process of implementation by the Commission, including the identification of a need for an agency-wide risk assessment management group.

J. Revitalization of the Administrative Process

From time immemorial, the Commission has had difficulty managing its administrative caseload. In order to rectify the situation, I first asked former Federal Judge and SEC Enforcement Chief Stanley Sporkin to do an analysis of the problems with the Commission's handling of its administrative cases. The report we received was published, and I then appointed Commissioner Roel Campos to come up with rule changes that would implement the appropriate recommendations of Judge Sporkin. In February, 2003, proposed rule changes were published for public comment, and they ultimately were adopted in June of that year. The changes assure the timely consideration and resolution of administrative proceedings, both at the initial trial stage and at the Commission appellate stage.

K. Budget and Employee Compensation Issues

Particularly in the wake of the corporate scandals, the adverse employment conditions affecting the Commission's Staff were brought to the fore. With the foundation provided by former Acting Chair Laura Unger, the Commission was able to see Pay Parity enacted, and then was able to implement a new pay parity standard that offered more realistic salary levels for the Commission's hardworking Staff. Over the course of my tenure, I signed off on three budget requests, and one supplemental request. Each and every one of them was approved by the President. By the time I left the Commission, its traditional inadequate funding situation had ended, and a budget more than double the budget I inherited was approved by the President.

Conclusion

During my tenure as Commission Chairman, the agency was confronted with an astonishing number of crises. With the cooperation of many people, the Staff and Commissioners were able to implement far-reaching meaningful reforms and make lasting contributions to investor protection.