Securities and Exchange Commission Historical Society
Interview with Lori Richards
Conducted on July 16, 2021 by Kenneth Durr

Ken Durr:

This is an interview with Lori Richards for the SEC Historical Society's Virtual Museum and Archive on the history of financial regulation. Today is July 16th, 2021. And I'm Kenneth Durr. Lori, thank you very much for taking the time to talk today. I appreciate it.

Lori Richards:

I'm really happy to be here, Ken.

Ken Durr:

I always start out with some background and I want to go back to your undergrad experience because that sort of sets people on their path. So let's talk about how you got on your path.

Lori Richards:

Sure. I went to Northern Illinois University, and I graduated in 1982. While I was there, I studied political science and I became interested in public policy and politics and started a bunch of clubs, political-oriented clubs there, and loved my experience at NIU. I had some very inspiring professors. And then I determined when I graduated that I needed to go to law school in order to really make a career in public policy. So then I went to American University Washington School of Law, and I went there because it was in Washington, D.C. My family was from the Midwest and Toronto, and I really needed to come to Washington, D.C., I thought, in order to develop some expertise and experience in public policy. So I went to Washington College of Law and really enjoyed my time there. I graduated in 1985.

Ken Durr:

Okay. So how did you get turned from public policy towards securities law?

Lori Richards:

Well, they're really not different. I was interested in public policy as a way to do some good. I took a securities law class with Professor Mary Siegel and I was really inspired by it. My father was an accountant and a treasurer of a public company, and my mother was very interesting... She was also an activist, I would say. So the combination of the two, I think, and Professor Siegel's class really inspired me.

Lori Richards:

I remember studying for her final exam and I had a big whiteboard behind me. And I think I stayed up all night and I wrote the history of the securities law in tiny little letters starting I think at the top with Howey, and I did it from memory and I'm sure now it was crazy. It was lack of sleep, but it was also passion. I really was inspired by securities law. And I interned at the SEC when I was in law school and had a good experience doing that and decided, I guess that was my second year or my third year in law, that I really wanted to work for the SEC because it was a good blend of my interest in finance and securities and public policy.

Ken Durr:

Tell me about the internship, where did you work?

Lori Richards:

I worked in the then-Washington regional office which was here in Arlington in Ballston. I expected that staff attorneys would be hanging around the hallways arguing the finer points of securities law. That's what I really thought it was going to be. It wasn't quite like that, but I got a sense of what it was like to work for the SEC, how the SEC was structured. Overall, I had a positive experience.

Ken Durr:

Did you work on some cases?

Lori Richards:

I was an intern, so I did document organization. I didn't have a lot of exposure to big picture cases or issues there.

Ken Durr:

So did you decide to go right into the Commission after that?

Lori Richards:

I did. I was at my third year of law school, I applied to all of the Commission's regional and district offices. I don't know how many there were then, 14 or something. Every single one, there were paper applications. And the first office that interviewed me offered me a job. It happened to be the Los Angeles Regional Office. I would have gone anywhere to any office, but they offered me a job and I accepted it right away. The summer after I graduated, I moved to Los Angeles and started at the SEC as a staff attorney in the division of enforcement in September of 1985.

Ken Durr:

Why did you apply to all the regional offices? Why not headquarters?

Lori Richards:

I think I did apply to headquarters as well. I believe I did. As I said, I would've gone anywhere. I didn't know so much about headquarters, I didn't know about the different regulatory divisions. I was familiar with enforcement because of my internship and case law. As I said, I would've gone anywhere, but Los Angeles was the first to make me an offer.

Ken Durr:

Right. So was it the Pacific region at this point? Is that what it was at the time?

Lori Richards:

Yes. I mean, LARO, the Los Angeles Regional Office was what we called it.

Ken Durr:

What you called it, yes. The nomenclature gets confusing through this period.

Lori Richards:

It does. There were some changes.

Ken Durr:

So were you just part of the enforcement team? What was your title?

Lori Richards:

I was a staff attorney. So that's the entry-level. I think I made $37,000 a year, which was a lot for me, even living in Los Angeles. It felt like it was a lot of money. And I loved it. I got experience right away. I had my own cases, my own investigations. I learned a lot the first couple of years. They had a protocol where they had so many investor complaints that twice a month staff attorneys were responsible for doing intake. People would just stop by the office and talk about their experience, how they felt that they'd been defrauded. So I learned a lot from people, people who came into the office to complain that someone had stolen their money. It was something that nobody really liked to do. Staff attorneys didn't really like to spend their time doing that. But in retrospect, I learned a lot and it helped me have some personal experience with people who felt that they had been defrauded.

Lori Richards:

So, I was a staff attorney for two years and I had my own cases. My first enforcement case was against a radio guru who was trying to sell people gold, who actually stole their money. It was a good experience because I took the testimony. I had a branch chief, but I was the one that was taking the testimony, reviewing the documents, writing the subpoenas. It was a lot of experience for a new attorney right out of law school and I loved that.

Ken Durr:

Who else did you learn from during that period?

Lori Richards:

I had very good colleagues. Elaine Cucheras was my good friend. And she eventually became the regional director of the office. And I had another very good friend, Rose Schindler. And we were all doing our cases, but we talked all the time about strategy and securities law and how to get things done. We were wanting to bring cases, wanting to be activist and bring cases. I worked with some great regional directors. I worked with the US Attorney's Office quite a lot. A number of my cases became criminal investigations. So I worked closely with Jim Asperger and James Sanders from the US Attorney's Office in Los Angeles.

Ken Durr:

Was that a pretty easy working relationship? Were they used to plugging into SEC regional stuff?

Lori Richards:

Yes, it was very routine. And also with the California Department of Corporations, we routinely shared information about all of our cases. So they had the option of investigating it with us or just so they would know what we were doing. They would take a fair number of our investigations on as criminal investigations. I worked with the postal inspectors when I brought my first case and they went in and did a seizure of all of the documents of this investment guru's offices. And I remember part of my investigation was sitting in a warehouse looking at all of the documents that had been seized, a cold dreary warehouse, and finding evidence. And so that's very heady for somebody right out of law school.

Ken Durr:

Was there a common denominator? Was there some kind of fraud that was prevalent in LA?

Lori Richards:

Yes. So I was there for a total of nine years and there were a lot of offering frauds. People selling securities without registering the securities. A lot of broker dealer fraud, there were a lot of boiler rooms. In Southern California there's a lot of money, a lot of retirees in that part of the country, a lot of money. And fraud is where the money is. So there were a lot of brokers who defrauded clients, a lot of Ponzi schemes. We did a fair number of TROs. In the time period that I was in Los Angeles, those nine years, I think we brought more temporary restraining orders in court on an emergency basis looking to shut down offering frauds and Ponzi schemes. I think we brought more than any other regional office. And it was really just an indication of the types of frauds that existed in that part of the country. We also, in addition to Southern California, we covered Hawaii, Oregon, Washington State, Arizona, I think that's it. So we traveled across the region, and there were a wide variety of cases but the bulk of them were offering frauds.

Ken Durr:

Yes. It does sound daunting to be in LA and be responsible for Alaska.

Lori Richards:

Right. I never had a case in Alaska. I did in Hawaii and that was nice but-

Ken Durr:

How bad? Did you get to go there?

Lori Richards:

Yes.

Ken Durr:

Any stories that you picked up when you got there? Did you get a sense of the culture of that office?

Lori Richards:

They were young. People in that office were young. There was a lot of turnover. So branch chiefs, the assistant directors, those management positions would turn over. It was a young office.

Ken Durr:

Okay.

Lori Richards:

That was beneficial to me because I was able to progress up the career chain fairly quickly. I was a staff attorney for two years, a branch chief for two years, and assistant director for two years. And then I became associate director running the enforcement program for Los Angeles and San Francisco and also played a coordinating role with the Seattle Regional Office at the time. I was fortunate to be in an office where there was so much opportunity. We were assertive, we were young, we were excited. It was a really great staff and it was a really positive experience for me.

Ken Durr:

You mentioned San Francisco and at one time that had been the regional office. That had been the big Joe. What were the relationships like with the San Francisco, I guess it would have been the branch or the district office?

Lori Richards:

Yes. I don't remember if it was the branch or the district, it probably had both nomenclature during my time. It was a good relationship. We divided up the states into Northern and Southern, and it was a smaller enforcement staff than we had in Los Angeles. But I think we worked pretty well together. And also in Seattle, we worked pretty well with the Seattle office as well. We were very much... Our identity was, in my mind, it wasn't just “we are the Los Angeles office,” it's “we are the region, we are the Pacific region.” So we helped each other and supported each other.

Ken Durr:

No territoriality like, "Hey, this is our case. We want to handle this one."

Lori Richards:

Not that I remember. I do remember lots of territoriality with New York Regional Office. In your experience talking to former SEC people, I'm sure you've heard about that. Los Angeles is three hours earlier, so we would get cases opened in the system early and then we'd argue about it with the New York office or headquarters. Where was the nexus, appropriate nexus, for the case? And I know there are standards and rules now at the Commission for which office investigates a particular matter, but at that time, it was real competition. So if a public company was traded on the New York Stock Exchange, the New York office would say, "Well, we should be investigating this case." So, I mean, it was good natured and it was friendly, but I mean, I think it's indicative of the fact that the enforcement staff was really aggressive, really assertive about wanting to tackle fraud. It was all fun though.

Ken Durr:

I want to touch on a couple of the highlights in that period. There's something called the Wymer fraud case that came up in my research that you were involved in. Can you tell me a little bit about that?

Lori Richards:

Sure. He was an investment advisor in Orange County. And the way that I got the case was a referral from the examiners in the Los Angeles office. They had done an examination, found indications of fraud. My recollection was that it was both investment advisor and broker dealer examiners. It would have been Stan Mayakawa, who was the assistant regional administrator for broker dealer exams and Mike Levitt, who was the assistant regional director for investment advisor exams. They referred the case to enforcement, and I got it. It turned out he had diverted account statements, that were meant to go to clients directly from his clearing broker, and had stolen their money. It was a lot of money at the time, it wouldn't be now. But it turned out in the end to be about $100 million. And I brought the case and it generated a lot of press.

Lori Richards:

A number of municipalities had been defrauded, sadly. A big municipality in Iowa had lost a lot of money. So it was a real tragedy. We brought the case, as I recall, as a temporary restraining order, had a receiver appointed right away who then went about doing the analysis of investors who had received prior returns that were fraudulent and figuring out how to obtain disgorgement and eventually paying money back to investors. It was a really exciting case. As I recall, I was an assistant director, I think, when we brought it. I worked really closely with folks in Washington on it. Colleen Mahoney, who at the time was the chief counsel for the division of enforcement, was really helpful to me in figuring out strategy and how to go about bringing the case.

Lori Richards:

I remember the day we brought the case the phones were ringing with reporters and it was mad. In the end, he went to jail. We obtained an order of disgorgement that was unique at the time. I don't know if the SEC's ever done it before, but rather than ordering what he would disgorge, we ordered what he would be allowed to keep and everything else would be turned over to the government. And we were pretty tough on him. He was allowed to keep one suit. We were very tough on him. He basically had to disgorge and give up everything. And he had acquired the fruits of the fraud. He even lived a lavish lifestyle as they say. So in the end, I think justice was done. It was an exciting case.

Ken Durr:

Why did you come up with that settlement, that sort of turning everything backwards and deciding what he got to keep rather than what he had to give up?

Lori Richards:

It was easier. You didn't have to inventory this car and that and this piece of art and... We just said everything because we had evidence that indicated that his entire lifestyle was funded by this fraud. So it seemed appropriate to craft an order that everything he had, even if we couldn't identify it at the time we entered the order, needed to go back to the government for restitution to victims.

Ken Durr:

Any other high profile cases from that time?

Lori Richards:

Not high profile, but I was particularly interested in regulated entity cases. I brought soft dollar cases against investment advisors, a suitability case against registered rep, and then a failure to supervise case against the registered rep's employer. And I really enjoyed those cases. I really enjoyed the regulated entity cases. It gave me exposure to the investment advisors act and the investment company act which I came to really enjoy. And it was relatively rare, I want to say, back in those days. Rick Marshall in New York was doing ‘40 Act cases and Anita Nagler in Chicago did ‘40 Act cases and I did ‘40 Act cases. So it was a bit of a niche. And it allowed me to, as I say, to learn about the ‘40 Act and also to meet people in

Washington who helped me understand the law, people in the division of investment management and the division of, at the time, market regulation.

Ken Durr:

So a regulated entity, that's an investment advisor. Is this gatekeepers and lawyers, things like that?

Lori Richards:

No, regulated entity in that parlance is registered broker dealer, registered investment advisor, transfer agent, mutual fund.

Ken Durr:

Okay.

Lori Richards:

Yeah.

Ken Durr:

Yeah, that's the ‘40 Act?

Lori Richards:

Right.

Ken Durr:

Okay.

Lori Richards:

And the Exchange Act for broker dealers. Yes.

Ken Durr:

So you moved up to... At some point you became acting director, right?

Lori Richards:

I was acting director of the San Francisco office.

Ken Durr:

Right. How did that happen?

Lori Richards:

Well, when I was the associate director in charge of enforcement in Los Angeles, the regional director of San Francisco left and they asked me if I could split my time between San Francisco and Los Angeles. That was really fun because as I came into it, they didn't really know me. I had to make clear that I was supportive of them. I had to make sure the morale was good. I really wanted to make sure that they continue to do the work that they were doing. It also gave me much more exposure to the exam program in San Francisco because I was responsible for it for the first time and got to know the examiners there and their work, and that was really exciting. I didn't do it for very long. I think I was commuting back and forth from Los Angeles to San Francisco for about a year.

Ken Durr:

Okay. And in doing that, you're also... One of the things that the director has to do is to make sure the trains run, just operate the office. Where did you get the insights and sort of the knowledge that you needed to do that?

Lori Richards:

Well, I relied on Jim Clarkson, who was the head of regional office operations. For administrative stuff, he really helped me quite a lot. I moved the office in that period in San Francisco, from one location to another, and I was heavily involved in things like, "What phone system should we buy? What should our desk chairs look like?" Just every minutiae of the move. I mean, the thing about the SEC, certainly at that time, was it had very little support, administrative support. The people in charge were really in charge of everything, including the office move and what phone systems you have, as well as what types of enforcement cases are you going to bring? Do you have the evidence? What types of exams are you doing? All that stuff.

Ken Durr:

Right.

Lori Richards:

I mean, one thing I would say in retrospect, is I considered myself in my own head kind of a "turnaround person." I was going to fly in and I was going to help make sure the office is running well, the investigations and the exams are going well. I did that in San Francisco and I did it a little bit in Seattle too. So I thought of myself as kind of a "turnaround person."

Ken Durr:

Is that how it worked out? Did somebody step in then?

Lori Richards:

Yes, there was then a permanent regional director/district administrator appointed in San Francisco and in Seattle.

Ken Durr:

Yeah. It's interesting because so much of your career is in examinations and inspections, but at the beginning you were heavily involved in enforcement.

Lori Richards:

Yes.

Ken Durr:

It sounds like you started to get that examinations' perspective fairly late in this early period.

Lori Richards:

Yes, I did.

Ken Durr:

Okay. And what was your sense of how that was working out? The regions essentially were an entity of their own, but then they had this split personality, the enforcement and inspections. Give me your sense of how that system worked then, some of the insights you had about how it could have worked better or been improved.

Lori Richards:

Well, they were very separate, exams and enforcement, very separate. And enforcement attorneys had a public profile, they were in court, they were in the press. Examiners had a much, much lower profile. And it was really when enforcement attorneys received referrals from the examiners that I think they came, as I did, to really understand and appreciate what regulation is, as it was called then, what they were about and what they could do. But even within the exam program, they were very separate too. There was a broker dealer exam program, an investment advisory/investment company exam program, and then there was a smaller bankruptcy program in many of the regional offices. So it was really quite fragmented. They came together at the top. The regional director/district administrator supervised both programs. But there wasn't a tremendous amount of interaction we had. We made sure that we had regular picnics, office picnics, where regulation would play enforcement at softball. And I think it was pretty evenly matched friendly rivalry, but they largely went about their activities and their function pretty separately.

Ken Durr:

Did examinations also do Reg A filings at that point?

Lori Richards:

Yes, they did. I didn't have much exposure to that at all.

Ken Durr:

At one point that was pretty big business, but it might've been tapering off at that time.

Lori Richards:

Yes.

Ken Durr:

Anything else we should talk about having to do with your time in the Pacific region?

Lori Richards:

I don't think so. It was really through this Wymer case that I got to know people in Washington better and in particular, Chairman Levitt and his then-chief of staff executive assistant, Colleen Mahoney, recommended me to take over her role. My recollection is I flew out from Los Angeles to Washington, D.C. on a Thursday and met with Chairman Levitt and we hit it off. And he said, "Can you start on Monday?" And I said, "Yes, of course." So my recollection is my time in Los Angeles came to a close pretty abruptly when that happened. But it was a very good office, very strong office, a lot of female attorneys, female accountants. I said that the office there had a fair amount of turnover and that was in the attorney staff. The accounting staff were experienced and were long-term. So it was overall a very positive experience for me.

Ken Durr:

That's interesting. So the examinations and inspections people tended to stay.

Lori Richards:

Yes.

Ken Durr:

Okay. That's something I hadn't picked up on. When you met with Chairman Levitt, what did he talk about? Was there an agenda or were you just going to come in and assist him with whatever?

Lori Richards:

I don't really remember that. It was kind of a blur, the actual interview. It was a very heady experience, the Chairman of the SEC, for anyone who works at the SEC. But particularly somebody from a regional office who doesn't have ongoing exposure other than enforcement cases to the Commission, meeting with the Chairman was a big deal, really big deal. And with Chairman Levitt in particular, he was extremely activist. He had a lot of ideas. He was engaged, he was charming, he wanted to get things done. I think he wanted his second chief of staff executive assistant to also be somebody who had experience within the agency to help him navigate different offices. He was still relatively new at that time, I think, maybe a couple of years in to his tenure. So he was looking for somebody who knew the agency who could help him navigate internally.

Ken Durr:

Okay. Did you bring some of your expertise that you developed and sort of influenced what he was looking at? I mean, I guess the point here is you had looked at examinations, for example, and OCIE comes along fairly quickly after you come into headquarters. Were are you talking about examinations and how agents could work better?

Lori Richards:

Oh my gosh, no. I helped the Chairman with his kind of day-to-day, which extraordinarily busy. He had a big investor education push to meet with investors across the country, with the local press and local congressmen and senators. He was very active in pay-to-play, Rule G-37, auditor independence, the NASDAQ, the NASD market-maker case was kind of coming to fruition then, we had market structure rules, he was testifying all the time, he was giving a lot of speeches. I was just helping him kind of organize this.

Lori Richards:

He didn't need ideas. He had a lot of ideas. Remember, he came to the SEC, had been the chairman of the American stock exchange. He had a huge book of contacts. He knew people all over the industry, all over Washington. In 1994, it was the Republican revolution. So, Congress flipped from... Both houses became Republican. He was trying to navigate that. He was extraordinarily busy, charismatic, influential.

I just helped him kind of run the ship, make sure he had what he needed in order to go out and do what he was doing. I didn't have anything to do with the idea to create OCIE.

Lori Richards:

I worked for Chairman Levitt for about a year. And he really influenced me. He was an activist like I naturally am. He was my mentor and deeply influential to me in my career. But it was the staff within the chairman's office, who covered trading and markets, who were critical of most inspections, stock exchange inspections, for the most part, who came up with the idea to... Well, there's two different inspection functions, one in investment management and one in trading and market regulation at the time. Why shouldn't we have a professional cadre of examiners? And shouldn't they be independent from these larger policy-making rulemaking divisions? So, they came up with the idea, not me. I didn't even know about it.

Ken Durr:

These were people in trading and markets?

Lori Richards:

No. This was in the Chairman's office.

Ken Durr:

Okay.

Lori Richards:

The Chairman had dedicated staff, Kerry Dwyer, Mark Delaney, responsible for looking at all of the market regulation issues.

Ken Durr:

Oh, Okay. Gotcha.

Lori Richards:

So, it was their idea to strengthen the exam program, to reduce inconsistency between the different exam programs that existed at the time. There were lots of complaints about overlap and duplication and different processes that the different functions used. And I think they wanted... They were looking at GAO as an independent inspection function. Lots of firms have internal audit that's independent, independent accounting functions. And they said, "Why don't we have our own independent inspection division?"

Lori Richards:

So, the idea came from them. Chairman Levitt had, as part of his stated mission, said he wanted to look at areas where the functions of the agency could be improved, including the organization of the Commission. So, a couple of years earlier, he had changed the reporting structure for the regional directors so that they no longer reported directly to the chairman. They reported to the head of enforcement. And there were other organizational changes that he made. I think he considered this of that type. How can we strengthen and improve the way the Commission operates, and be responsive to some of the perceived weaknesses in prior inspections?

Ken Durr:

That goes along with what you've said about Chairman Levitt having all his own ideas and things, but let's double back. Were you there in the region when that reorganization happened and the regions suddenly reported directly to enforcement?

Lori Richards:

To the director of enforcement. I believe I was. I believe I was still in Los Angeles. I was not a regional director. I was the associate director for enforcement, so I didn't perceive that that was a significant change for me.

Ken Durr:

Okay.

Lori Richards:

I think it was for some of the regional directors, particularly those who had been there for a long time, who were used to reporting directly to the chairman of the SEC. And now, to report to the director of enforcement, some of them, I'm sure, perceived that as a step down. But it was really meant to reduce the separateness, the separate regional offices doing their own thing. It was one enforcement division. And it later became one -- when I was head of OCIE -- one exam program.

Lori Richards:

By my view, that was all for the better, because it made us much stronger. We had a much louder voice when we were speaking as one agency program, Division of Enforcement or OCIE.

Ken Durr:

Right. So, tell me how the OCIE thing rolled out. You've discussed this idea and the fact that it made good sense to put the inspection functions together. How was it developed? Was there a pilot program? Did a group get together and flesh it all out?

Lori Richards:

Well, the idea for it, as I said, I wasn't involved in. Arthur came to me after he had decided to do it and said, "Would you do this? Would you start OCIE?" And it had another name in the beginning, the Office of Securities Industries Exams.

Ken Durr:

Right, which is also OSIE...with an S.

Lori Richards:

So, he came to me. He said, "Would you do it?" And I remembered my time working with examiners. And I said, "Yes, but only for eight months." I would start it. And then, I would move on to do something else. And he said, "Okay. You might change your mind, but okay." And I wasn't really interested in doing it on a long-term basis because exams were still perceived as a little bit sleepy in the agency. They had a very, very low profile. At that time, it was individual exams of individual companies. And the exam staff would, at the end of the exam, send the firm a deficiency letter.

Lori Richards:

The communication was very one dimensional. It was from an exam team to a registrant. And there was little or no extrapolation of exam findings. What are we finding more broadly? How are we looking at issues in a systematic way? It was very individual firm by firm by firm. And I think that's the reason why it was relatively sleepy. They weren't heard from within the agency, and certainly not outside the agency. So, at first, that's why I was reluctant to say yes. I said "Yes, for eight months," which of course is.. It's funny to look back on now. I did it for 14 years.

Ken Durr:

Were the exams also generally on a periodic basis at that point?

Lori Richards:

Yes. So, there are exams and inspections. That nomenclature means nothing. We were responsible -- OCIE, an exam program of the agency -- for conducting exams for compliance of investment advisors, investment companies, transfer agents, clearing agencies, broker dealers, and the stock exchanges, and self-regulatory organizations. I believe I've remembered them all. But those are a lot of very different types of entities, so, investment advisors and investment companies, the SEC was a sole regulator. For broker dealers, obviously, the SROs had the primary regulatory responsibility. For investment advisors and investment companies, at that time, there was an exam cycle no later than once every five years.

Ken Durr:

Okay.

Lori Richards:

That was every registered entity once every five years, and at that time, the exams were pretty consistent. There was an exam module that was big and long. So, no less often than once every five years, more frequently for cause. If we had an indication of a fraud or a violation, we would immediately go in. That never changed.

Lori Richards:

We always gave cause exams priority. But for investment advisors, investment companies, once every five years. And broker dealers, there were two types of exams. Oversight, where we would go into evaluate the quality of the SROs, oversight of the broker dealer. Then there were all other types of exams, including cause exams. Surveillance exams, we called it. But the routine frequency was performed by the SROs. And then, for the SROs and the stock exchanges, there was also a frequency. I don't remember what it was now, but we would look at different parts of their activities, their listing programs or arbitration programs, surveillance program, disciplinary program, et cetera. And those exams would be done on some frequency.

Ken Durr:

Okay. So, that was the system when you came in. Right? What were the drawbacks? What did you hope to do to start to readjust things?

Lori Richards:

As I recall, it was within the first couple of weeks that I took on the job. And I was alone. And we had a whole empty floor, the ninth floor of the office that prior division had moved out. So, it was me on day one, John Walsh, who came from the chairman's office, who became my chief counsel of OCIE, who was really important in the creation and development of OCIE, and my secretary, and my human resources person. And we got an entire floor to ourselves. So, it was lonely. But one of the first things we did is to create a mission statement for all exams. And the mission statement was, as I remember it, "We are independent. We pull no punches. We call it as we see it, basically. We are going to be a tough but fair exam program in all types of exams."

Lori Richards:

I felt that was really important because I wanted to make sure the examiners knew that I would support them if they were going to make a tough call, that that's what I expected, that we were going to write our reports straight-forward. We weren't going to make it look pretty. We were going to call it. And I thought that was important to demonstrate right off the bat to examiners, that whatever their past experience was within the other divisions, that this was new, that we were going to be tough, but fair.

Ken Durr:

How were things made to look pretty in the past, just generally speaking?

Lori Richards:

Well, there was a perception that the examiners didn't call things. I wasn't there then, so I don't know. I do know the first year of OCIE, I had a couple of experiences with senior folks who had joined from another division. I remember, I had to deliver some really strong words to a particular firm. And I called them in to Washington. And I was ready to sit them down in the conference room and tell them, with a lot of seriousness, “You must change. These findings are serious. And I mean it.” Right? So, I'm ready for that meeting. It's one of my first in that way. I did a lot of those types of meetings over the course of my 14 years, but I recall that was my first.

Lori Richards:

The firm's senior management comes in along with a couple of my senior people. And they had just been out to lunch together. And they came in and they were smiling and laughing. And I thought, "This is the wrong message. This is the wrong message." And I saw a couple of examples of things like that, that I just thought we needed to make sure that firms, the industry, were viewing us solely as inspectors. All we're here to do is to tell you where we've had problems with what you're doing and make recommendations for improvements.

Ken Durr:

Yeah. Is part of the problem that inspectors, examiners, go to the companies and spend time at the companies and get to know people and sort of start to identify?

Lori Richards:

I saw it with a couple of people, senior people, who had ongoing relationships with these entities. I never saw it with examiners. Examiners were... They really wanted to find fraud. They really wanted to do a good job. They wanted to feel empowered. They didn't want to feel like somebody in some other division could tell them, “Don't be so tough on this firm.” That was anathema to them, to such an extent... And this is, I think, really important in my recollection of OCIE. Very frequently, when we would be sitting down talking about, "Well, what do we do about this issue? Or what do we do? What is our recommended solution going to be to this company to fix this problem, this violation that we found?" Inevitably, someone would say, "Well, investors will best be protected by doing X."

Lori Richards:

And it wasn't just assumed. It was spoken out loud. How are we best going to protect these investors who are doing business with this firm? And that was the way we decided what to do. It wasn't, “What is so-and-so going to think about this?” Or “Is somebody going to complain to people on the hill?” It was never that. It was always only about investor protection. So, the exam staff were fantastic. They were really high caliber. And I think they would say that the creation of OCIE brought them this kind of ability to be single-minded. They didn't have to worry about policy, or a new rule coming, or what so so-and-so would think.

Ken Durr:

Right. And the exam staff themselves are working for different divisions.

Lori Richards:

They had been previously. Right.

Ken Durr:

Right.

Lori Richards:

So, bringing them together... The other thing on day one was seeing the inconsistencies in the two programs. And it's a normal natural thing, right? I mean, they just grew up differently, so different processes, different procedures, different documentation standards, different... One group that had a policy that they would conclude exams within 60 days. And the other one had a completely different policy. And just, from little things to big things, there were big inconsistencies. And not only between investment advisor, investment company exams, and broker dealer exams, but in each regional and district office.

Lori Richards:

Because they had grown up on their own, they didn't have a lot of leadership or direction from Washington, it was normal that they had different practices. So, day one began, for me, a 14 year process of driving consistency, and driving consensus to the extent we could, and driving us to be one program. And John Walsh was incredibly helpful with that, the protocols, the policies, the procedures, that standards. All that stuff was an enormous amount of work to bring people together so it could really be one program.

Ken Durr:

Right. So, that was your main intellectual task at that time is trying to make that happen, I guess, the thing you were thinking about the most.

Lori Richards:

I was certainly thinking about it. But this is a time when the markets are really active. There are a lot of different things happening. So, I'm doing the management and the bringing of people together, but I'm also doing inspections. I believe, at that time, we put out an inspection report on sales practices and supervision. I think that happened... We did that the first year of OCIE's creation. And then, we initiated an exam sweep of soft dollars. I think that was in year two. Brokers, advisors, mutual funds.

Lori Richards:

And that was a way to say, "Okay. We're going to create one exam module and different regions and districts. You're going to go out and use this exam module. And then, we're going to pull together those findings into one coherent story about the state of compliance around this issue." So that was important. And it was important because it then set the standard for lots of other exam sweeps and exam initiatives, where we were acting as one exam program.

Ken Durr:

Okay. So a sweep is essentially coming up with a plan and implementing it nationally.

Lori Richards:

Yes, nationally. Or sometimes, like later... I asked individual offices to develop ideas for sweeps within their regions for issues that they thought were unique to their region. Okay. You guys in Atlanta go out and look at... The sale of church bonds, as I recall, in Atlanta, was an issue. And so, I asked them to do that and they did it. They thought about what particular emerging compliance issues existed in their region. So, they would do it regionally.

Lori Richards:

But then there were other exams sweeps where we did them nationally. And it could be a dozen firms, or it could be 200 firms. They ranged in size. But at the end of the day, what we wanted to do was to learn from that. It's the first time, really, that as an everyday part of our program, we were trying to learn about emerging issues and what the state of compliance with respect to those issues or those firms was. So exam “sweeps” were a tool to allow us to relatively quickly do that.

Ken Durr:

Something else that is discussed a lot early on is the idea of taking a risk-based approach. Talk about implementing that.

Lori Richards:

Sure. So, that was in reaction to the very large exam modules that were being performed. In my memory, it was mostly investment advisors and investment companies, and big, long, soup-to-nuts exam modules of every firm, at least once every five years. And I thought, "Okay, all those issues may not be relevant to these individual firms. So, let's allow examiners to risk target their work within a particular firm to those areas where there were indications of high-risk."

Lori Richards:

And in the very beginning, we called those “smart exams,” which was a huge mistake, honestly. And I think it was probably my idea to call it smart exams. And what I meant was be smart about how you're targeting it. And the industry loved it. Smart exams. That means more targeted exams. But the staff did not like it. And I heard about it. "What were we doing before? Were we doing dumb exams, Lori?" And so, they were really insulted by the nomenclature. So, we changed the nomenclature. I completely got it. We changed the nomenclature and they became “risk-targeted exams.”

Ken Durr:

Okay. So, you started up in '75, right? Or I'm sorry, '95?

Lori Richards:

Yes.

Ken Durr:

How long was it before you felt like OCIE was really kind of up and running? Obviously, there was a period where you're breaking in, you're doing a lot of hiring or bringing people in. How long was it before you felt like OCIE was really standing on its own two feet?

Lori Richards:

I felt we were standing on our own two feet right from the beginning.

Ken Durr:

Really?

Lori Richards:

Yes. Because here I am in this empty floor, and then people started to come and populate the floor. And we were still doing exams. It's not like everybody was paused, waiting for this new organization to come together. We were doing things right away. We were still doing, obviously, all the inspection work. I feel like we got better and better and better over time. I believed in constant improvement. I believe that was part of the mission statement. I believe that we should always be looking for ways we can improve. We're never going to be done. That was really important to me. And I believe, the entire time that I was in OCIE, I think we tried to do that. We really tried to do that. So, I've never felt like, "Oh, this is it. We've reached the perfect nirvana of this organization."

Ken Durr:

Always a work under construction.

Lori Richards:

Right, or improvement, always constant improvement. And I often thought... Because I was there for 14 years… I often thought, "How would somebody else sitting in my chair do this? How would somebody else react to this issue? Or how would they handle this issue?" Because I didn't think I always had all the perspective. I really wanted other people's perspectives.

Ken Durr:

So, after the end of the eight months anyway, did you sit and say, "Well gee, I guess maybe I'll move on, but maybe I won't"? Was it tough to decide, or...

Lori Richards:

No, it was fun. Remember, I had considered myself kind of a turnaround person. So, this was a real... I felt like this was a real “startup,” and it was fun. I want to say it was within the first year... I gave a terrible speech, my first speech. I was really nervous. I was not a natural public speaker at all. And it was a terrible speech. And I got really bad reviews. You know the comments at the end? It was really terrible reviews. And I was a little daunted by that. Could I do this? Could I be the voice, the face of this program? Could I do that? And that... I took that as a personal challenge. And then, I was talking to a reporter. Reporters were very interested in this thing, this new thing. And the industry was really interested in it.

Lori Richards:

I remember there was some skepticism of me at the time because I came from enforcement. And so, some of the trade groups in particular thought, "Oh. She's an enforcement person. She's a hammer. The nail is the enforcement case. She will just want everything, all the exams to go to enforcement." So, they were nervous about me. And I knew that. I knew that at the time. And some of my staff, they didn't know me. They didn't know who I was. They didn't know what I was about. And they wondered if this enforcement mindset would change what they do. So, I found that to be something that made me want to stay and keep going. And then also, I was talking to a reporter, and as I've said, the press... There was a lot of interest from the press.

Lori Richards:

And the reporter asked me, "What keeps you up at night?" And I said, "Suitability in sales practices, broker dealer sales practices. It really worries me." Suitability cases were notoriously hard to prove. It was always, he said/she said. And so, that was what worried me. And the next day there was an article in the business section of the New York Times. "Lori Richards says this is what keeps her up at night." And I thought, "Oh my gosh. I can use this. I can use this role. People care."

Lori Richards:

And by the way, firms went out and looked at their suitability sales practice compliance and supervisory programs. After I said that, they went out and looked at their own programs. And I realized the power, from a public policy perspective, of what this program could be. If a reporter cared about what kept me up at night, we can really go somewhere with this.

Ken Durr:

And what kind of levers you had to deal with personally, too? I mean, just by saying these things, you could get something accomplished.

Lori Richards:

Yes. But more than that, I could start to use this otherwise quiet function, and what they were finding, and what they were doing. And we could talk about that. We could get the word out about what issues we cared about, what we were going to be focusing on in the next year's exams. That became something very routine for us to say, "Here are the top 10 issues we care about." And what the findings were of our existing exams. That became the basis for a lot of public reports and speeches, et cetera.

Ken Durr:

Okay. Let's disperse with the old chestnut at this point, which is that you can't break exams and enforcement apart because the enforcement people learn from the exam people. They need to be in the same room or the under the same boss. Because there was a lot of that. I mean, there were people who felt that it was not good to move all the exams and inspections over here. What was your answer to that?

Lori Richards:

I think the people who may have said that were not the examiners themselves, because the examiners themselves, the feedback I was getting, felt empowered by this. They were now their own function. Examiners sometimes felt overshadowed by enforcement for the reasons I've said -- they were more colorful, they're in the press, they get all the glory, bring the enforcement cases to the Commission for approval. And examiners were much sleepier, or were perceived in that way.

Lori Richards:

So, I don't think that the examiners felt that. I think some of the senior people, regional administrators, may have felt that, that here, "Oh, here's another country heard from. Here's another... Now, this OCIE director is going to be my boss." So, I think there was probably some of that at the beginning. I think that went away pretty quickly because there's a big difference between the tools that enforcement uses and the tools that examiners use, and their function, very different.

Ken Durr:

So, you didn't find that to be a big hurdle in any way, I guess.

Lori Richards:

No, I didn't.

Ken Durr:

Okay. Let's talk thematically about some of the things you dealt with. One of the things I have here is research analysts. Around 2002, there were some conflict of interest cases you worked on.

Lori Richards:

Yes. So thematically, I worked on a number of crisis type issues. And research analysts was certainly one of those. In the very beginning, I think this was at the end of Chairman Levitt's tenure, we noticed that there were star analysts. The Jack Redmond's of the world. They were everywhere on CNBC. They were getting a lot of press. It was unlike the research analysts of the past. And so, we noticed that. And we wondered why. Why? And we thought, "Well, maybe research analysts... Maybe they own stock in the companies that they're touting."

Lori Richards:

And we perceived that they were touting companies. So, we wondered about that. So, we did a series of exams to look at that, whether individual research analysts stood to benefit from the companies where they were issuing research, a really fundamental conflict of interest. So, that got us into the world of research analysts. And then, my recollection is that enforcement, along with the New York attorney general, became interested in research analysts and the various conflicts of interest that could exist.

Lori Richards:

And we didn't really understand at that point. So, I launched, along with Steve Cutler -- and eventually included FINRA, the New York Stock Exchange, the Attorney General and NASAA -- a fairly large series of exams looking at the structure of research within the big firms. How were research analysts compensated? What were their relationships with investment bankers whose only job really is to bring in potential new business? What about independent research? Why wasn't independent research more valued? All the structural issues.

Lori Richards:

So, we divided up the world of big firms between all these different regulators. We kicked it off. We met in Washington and kicked it off and then went out and did these exams and reviews and came back. I don't know how long it took. It took a while. I don't remember how long it was, but we came back and compiled our findings and our observations. Enforcement was right along with us. We were working very closely together. It's very much a joint collaborative effort. Steve Cutler and I worked really closely together and then Steve really led the negotiations with the firms about settling. And it was extremely complicated because of all these firms and all these different regulators were involved.

Ken Durr:

So, you did find the kind of thing that you were concerned that you might find?

Lori Richards:

Yes. And it's a story of a lot of my time at the SEC -- that conflicts of interest are what breeds problems. When someone has an incentive to favor themselves, or in this case, research analysts wanted to curry favor with investment bankers who had a role in determining their compensation. Those conflicts of interest can corrupt processes. And I saw that over and over in my time at the SEC. So, two thematic issues that I think come from research analysts, or maybe three. Research analysts, and then later the other big initiatives that we undertook often with the division of enforcement and other regulators, are conflicts of interest email. Email will tell you the truth about what's really happening, what people are really thinking. You can have all of the policies, procedures, whatever, but it's the internal email where people are talking to each other where you can see what they're thinking and how they're feeling.

Lori Richards:

In my recollection, this was one of the first cases where it was the emails that really told the story and made it kind of irrefutable when we went to talk the firms about settling -- made it irrefutable, what was happening. So that's the second thematic thing. And then the third one is the power of working collectively with other regulators. And it was not easy, certainly, but at the end of the day... And Steve really crafted so much of that settlement. So much of the proactive, the forward-looking relief really came from Steve Cutler. And at the end of the day, all of the regulators signed off on it and implemented it together. And we had the power of New York Stock Exchange, NASD, NASAA, the Attorney General, and SEC, and that was a real success I thought.

Ken Durr:

What were the challenges of working with the other regulators? Did they naturally have other concerns or were there personalities, or was it just too many cooks?

Lori Richards:

There were a lot of cooks and there's a lot of personalities. I mean, we were in the press all the time. There was a lot of focus and scrutiny on regulators. And so everybody, eventually we locked arms and "let's do this, let's get this done together." So everybody had to compromise in some way, the firms certainly did. And we certainly did. And I think at the end of the day, everybody looked at the relief, which really was fairly unique, and implemented. Structural reform, separation of functions, compensation changes…independent research had to be provided to a firm's clients so that they could look at the independent research and the firm's own research and be able to evaluate. And that was pretty unique in terms of SEC settlements. And I think that really helped people come on board, helped regulators come on board. This is good not just looking backwards, but it's going to be good for the industry looking forwards.

Ken Durr:

And this is a global settlement, so everyone has to sign on?

Lori Richards:

Yes.

Ken Durr:

Yes.

Lori Richards:

It took a while. I mean, it wasn't overnight. It took a while to negotiate.

Ken Durr:

And I assume there was some rulemaking that followed that in the Commission.

Lori Richards:

We always thought that, eventually, the reforms that were implemented in the global settlement would result in Commission rules. It didn't. I think there were SRO rules. There were New York Stock Exchange, NASD rules, if I recall, but global settlement didn't sunset. I believe it continues.

Ken Durr:

Okay. Well, we talked about analysts, you mentioned earlier that you were particularly interested in mutual funds advisors, that kind of thing. And the next big thing you get is the late trading and market timing with the mutual funds.

Lori Richards:

Yes.

Ken Durr:

Let's run through that a little bit.

Lori Richards:

That was pretty soon after the research analysts. And by the way, in between, there were a lot of other things happening, which I'm happy to share with you the most memorable ones for me. But, so my recollection is that there was a tip or complaint whistleblower that approached the New York Attorney General, Attorney General Spitzer and he announced that there was an issue. And I think both Steve Cutler and I, at the same time were, “Oh boy, here we go. Here's another one.” We don't know how big this is. We don't know if this is limited to the firm where the whistleblower complained about. Or if this is more widespread.

Lori Richards:

And I got my staff together, my exam staff in Washington, and I said, "We’ve got to find out. We have to find out how big this is and we need to go big. We're not going five firms here, five firms there. We're doing this big. We're going to send out our document requests, exam requests to..." I don't remember. It was like a hundred and some firms. And I remember somebody on my staff saying, "We can't, this is too big. We can't manage this. And I said, "Oh, yes, we can. I have confidence in us." And then somebody else said, "Yeah, but do we really want to know the answer? What if it's really big and then we're going to have to say, we found this and it's really big?" I said, "Yeah, that's what we got to do. We have to find out."

Lori Richards:

So, we launched this and we did find that there were other indications, other examples of market timing, late trading. I don't remember the percentage, but it was a significant percentage of the firms that we had communicated with. So, we told Congress, we told everybody, this is what's happened. And that ultimately resulted in a lot of enforcement cases against firms for allowing market timing and late trading. Also conflict of interest because they were favoring certain investors over others. So again, the conflict of interest. Also emails, there were emails that were involved there. But that market timing and late trading resulted in rulemaking that I was really pleased with. I mean, rulemaking came pretty quickly after the understanding of the problem. That's the way I always thought rulemaking should happen. It's hard to do rulemaking before knowing what the problem is, but hopefully you have rulemaking pretty quickly after you identify the problem. Investment management, Paul Roye and I worked really well together.

Ken Durr:

So this was the compliance rule?

Lori Richards:

Well, there were a lot of other rules around market timing and late trading that were specific to that conduct. But yes, the compliance rule was so important to our program and to the industry. And Chairman Pitt advocated for it because, remember, at this time, let's see in 2002, the industry grew exponentially and outstripped our ability to examine every firm at least every five years. We lost that ability. The industry grew so big, so fast. So, we had to switch to a completely risk-based program, which was deeply scary to me, really, because what were we not able to see?

Lori Richards:

So, thinking about how can we encourage advisors and funds to man up to their own compliance programs to a greater degree. The compliance rule, for the first time, required funds and advisors to have written policies and procedures around compliance. Before that they didn't need written policies and procedures.

Ken Durr:

They just complied.

Lori Richards:

It's what they said. We just know what to do, and that's what we do. And do we have evidence of it? No, we don't have evidence of it. So I mean just crazy stuff. So it really professionalized compliance in a way that it needed to become professionalized. Required every firm to have a designated chief compliance officer who performed reviews at least annually, wrote a written report on the state of their compliance program to senior management. It did a lot of good things. Then we were later able to use that to really push the chief compliance officers and the compliance function to become more professional, to be fully resourced, for firms not to cut compliance staff. That was a big message that we communicated, particularly during the financial crisis when firms were looking to cut expenses. So that was, in my view, one of the most significant rules in the compliance world that the Commission ever adopted.

Ken Durr:

Was that a tough rule to put together?

Lori Richards:

No.

Ken Durr:

It was clear what had to be done?

Lori Richards:

Well, I wasn't the rule-maker. It was the Division of Investment Management. But the rules designated a chief compliance officer, policies and procedures, annual reviews, forensic testing. Those are the elements of any good compliance program. So, I didn't see it as controversial. I'm sure that there were pieces in the original formulation that investment management was working on that maybe were, but in my mind it was pretty straightforward.

Ken Durr:

And predating this, there were some enforcement actions against SROs, New York Stock Exchange included?

Lori Richards:

Yes.

Ken Durr:

Let's run through that a little bit.

Lori Richards:

Sure. I had a really good inspection staff for trading, market-making, arbitration, listings. I had really good staff and they were mostly in Washington. I had a lot of confidence in them and they proved that it was worthy. One of the first big inspections that I remember was of the New York Stock Exchange and it found pretty pervasive violations by exchange specialists trading ahead, I think proprietary trading and a very lax surveillance and disciplinary program on top.

Lori Richards:

We wrote a very, very strong report, an inspection report. Non-public inspection reports go to the SRO and generally to their boards of directors and require improvements. And this was a very significant report. New York Stock Exchange, huge. And we had used -- I think it was one of the first times -- the office of economic analysis to look at the data and identify the violations and quantify the amount that was gained or lost. So it made our reports much, much more powerful. It wasn't just, "Oh, we observe." It was, "No, here's the data that indicates the violations in the dollar amount that was lost or gained." So that report was filled with that kind of data.

Lori Richards:

We sent it to the Commission and the Commissioners were alarmed, upset. This is a terrible thing. And as I said, our reports are non-public. I happened to be at a course on regulatory and enforcement agencies, how to run a regulatory and enforcement program at Harvard's Kennedy School for a week, I think, and I opened the newspaper -- Wall Street Journal or New York Times -- and there was the inspection report, basically. A huge story about this inspection report that had just the previous week been sent to the New York Stock Exchange, non-public. I mean, I'm still stunned by this because they had the report. It was clear they had the report. Because there had been some incidents of leaks of our reports in the past. So what I would do before we finalized a report to send to the Commission for their approval, they reviewed and approved our SRO Inspection Reports. I would put some number on the back. I just make up a number and put it on the last page.

Lori Richards:

And when the reporters would call me, I'd say, "I don't know if what you have is real, I don't know if it's really the report. Is there a number on the back page?" And they would... So in this case, the reporter gave me that number I said, "Oh my gosh, it is the report. It's the report." Someone had leaked it to the press, which was a big deal, really big deal. So it got a lot of attention. New York Stock Exchange was obviously very upset. I was upset. No one knew who did it. There was an inspector general investigation, subsequently. Never revealed who sent it, so I don't know. But a lot of drama in that report, it ultimately resulted in enforcement case against the Exchange for failing to surveil and discipline and against a number of specialists and specialist firms for engaging in the violations.

Lori Richards:

And that was another tool that we used. So when you're looking at an exchange, the exchange is responsible for surveilling and disciplining its members. We would look both at the exchange and at the members, so we could put the two pieces together. And it made for a much more compelling inspection because we had the weaknesses by the specialists and the violations. And then we had the weaknesses from the Exchange perspective. So that was something new that we did. And we subsequently did it in a number of SRO inspections.

Lori Richards:

So my recollection is New York Stock Exchange was one of the first inspections for trading ahead failures on customer limit orders, proprietary trading. But then we examined all of the other exchanges and the options exchanges. Ultimately, many enforcement cases against SROs followed. And I like to think that the data analysis really helped the exchanges in the end, because they then could improve their own surveillance, their own discipline, tighten their time parameters for surveillance. And it resulted in a lot of improvements, but it broke a lot of eggs, too. It was hard work. It's hard to sue a stock exchange.

Ken Durr:

Yeah.

Lori Richards:

A fellow regulator in some ways.

Ken Durr:

This case, when the non-public report came out, would that have been in the late nineties or in the 2000's?

Lori Richards:

I think it was 2002.

Ken Durr:

Okay. And there was-

Lori Richards:

Probably 2003.

Ken Durr:

... there was a trading ahead case that kind of hit the headlines in 2005, that period. And another thing that's happening is that a friendly congressmen is looking to get rid of OCIE.

Lori Richards:

Yes. That was a big surprise. There was legislation introduced. What was that 2003? 2003 was my… our report. And I shouldn't always say my, I mean, really I had fantastic inspectors who worked on this. John McCarthy, Eric Swanson... 2003 was the leak of the report. 2004 was the enforcement case, I believe. The legislation was introduced by a Staten Island congressman. It was basically, eliminate OCIE, put OCIE back where it came from in the divisions. The Division of Trading and Markets and the Division of Investment Management.

Lori Richards:

And I couldn't believe it that somebody cared that much about this, that they introduced legislation. I remember John Walsh, my chief counsel of OCIE, and I went to visit the Congressman to try to understand what the thought was. We didn't meet with him. We met with his staff and came away with really no idea what the basis for this was. I think it was reintroduced a couple of times and then it eventually died. But I mean, I would be asked about it when I was out talking to the industry or giving speeches or participating on panels. I would often be asked about what I thought at this legislation. I had to have no comment.

Ken Durr:

He didn't tap into a ground swell on the hill or anything about OCIE?

Lori Richards:

No, thankfully.

Ken Durr:

Okay. And another thing I've got on my list here is credit rating agencies. You did a pretty substantial report about that.

Lori Richards:

Yes. This was our last public report. I have a copy because it was the last one. And I think we did at least a dozen public inspection reports. So this is one of many, but this was the last one. And it was really important because it followed the meltdown of mortgage-backed securities, residential mortgage-backed securities in 2007, 2006/2007. People wanted to know why these securities that had previously been rated AAA were suddenly being downgraded en mass. Why? What was wrong with the original rating? What were the assumptions that were made at the time of the original rating that no longer proved to be true at the time of these downgrades? And we didn't have actually inspection authority over the rating agencies at this time.

Lori Richards:

I don't think that came until later. I think we initiated the inspections before we had the authority, but we wanted to know why. It was a meltdown. The financial industry is in a lot of turmoil. What the heck was going on with these rating agencies. So we commenced exams right away. I think it was the week before Labor Day. And we said you have seven days or something to produce records over Labor Day Weekend. And eventually we examined Fitch and S&P and... I'll remember it by the time we end. The three biggest rating agencies. Okay. And what we did was, consistent with what we had done in the past, we went in and looked at the organizational structure. How were the analysts who are responsible for rating compensated? Who did they communicate with? What were their methodologies? Were there standards? And email.

Lori Richards:

And what we found was that, again, conflict of interest. The volume of business exploded and this was the model that existed that I believe it still exists today. The issuer pays model. So if you're issuing a residential mortgage-backed security, you choose your rating agency and you pay the rating agency to rate that particular instrument.

Lori Richards:

So, what we found was that that model had inherent conflicts of interest. Issuers would be incentivized to go to the particular rating agency where they felt they had the best likelihood of being rated AAA. And the volume of work that the analysts were getting indicated that they couldn't keep up. They just couldn't keep up with the work. They sometimes didn't follow their own methodologies. They didn't document when they didn't follow their methodologies. And as I said again, email, lots of good emails where analysts were communicating. "Even a cow would rate…" Crazy internal emails that showed how much pressure the analysts themselves were under and how they could deviate from their existing standards.

Lori Richards:

So, we put that report out. Again, it was a public report. Great work by the inspection staff, really great work. I mean, they were incredibly dedicated day and night, they never gave up. The review of emails is not easy. It's very time consuming, very labor intensive. And I was just really proud of their work. It helped explain a lot of what happened with the rating agencies during that time period.

Ken Durr:

How long did it take you to get the report out?

Lori Richards:

The report came out in July of 2008. So if we started in the fall of 2007. For that volume of work and the analysis, and remember our reports, they weren't just my reports. I sweated every comma in every report that we ever put out. Anybody will tell you that I spent a lot of time with the reports, but it certainly wasn't just me. It was the staff in OCIE, staff in the general counsel's office read all of our reports in each of the divisions. And the Office of Economic Analysis helped us a lot here, looking at the methodologies as well as the Chairman's office and the Chairman's office staff and all of the commissioners and their staff.

Lori Richards:

So a lot of eyes on all these documents before they're released. And not just eyes on, a lot of commentary. And people have different views and different perspectives. And I wanted that because I wanted the final product that went out to be one where nobody in the building could say, "I didn't know about that. I don't know what the heck they're doing in OCIE." I never wanted that. So I was always trying to be quite transparent, even though it was very difficult to get all these different comments back and sometimes objections.

Ken Durr:

It would have come out at a pretty good time too, because things were still... They hadn't quite exploded yet in mid 2008. Right?

Lori Richards:

It was a good time. We had a press conference, Chairman Cox and Trading and Markets, Economic Analysis, and myself. I felt very good about revealing that this was happening within the rating agencies.

Ken Durr:

Any other important-

Lori Richards:

Moody's.

Ken Durr:

Yeah. There you go. Any other important sweeps or reports of this nature? Landmarks of your time?

Lori Richards:

I was really concerned about the relationship between brokers and mutual funds -- the brokers who sell particular mutual funds. Why do they sell these funds? Why do these particular funds get top shelf treatment? I knew when I went to see a financial advisor for the first time, that financial advisor seemed to prioritize particular funds and sometimes not funds that were performing particularly well. And so why? So we did, I want to say two or three different exam sweeps of that issue to find out why. We did an exam sweep of brokers. Why are you prioritizing these particular funds for sale to retail investors? And then we looked at the funds, why, what are you paying? The payments for shelf space is what it was called? So brokers were saying, "Wow, the mutual fund industry is really exploded. We want a cut of the action, we want to be paid more." And mutual funds they want to be sold. So they want that top shelf treatment.

Lori Richards:

So they were finding ways to compensate brokers that were not disclosed, including by the use of brokerage commissions, soft dollars. They were basically paying more in brokerage commissions to have their trades executed in order to compensate the broker for giving top shelf treatment. That really bothered me because it was undisclosed conflict of interest affecting everyday retail investors. So I think we went at that over a couple of years in different ways, so we could get traction. Ultimately, the Commission adopted a rule that prohibited funds and advisors from using brokerage commission to pay for shelf space, pay these marketing expenses.

Lori Richards:

So that was a big one. I felt really good about that and how that came out. We did a big report on pension consultants, and again, conflicts of interest and emails. The relationship... It's kind of the same thing. Pension consultants provide advice to institutional investors about which money managers to use. Pension consultants were also selling products to money managers. Inherent conflict of interest, not disclosed. That was important, I felt, because we also spent time with the Department of Labor on that because these pension consultants we're fiduciaries, but that seemed to be really inconsistent with their fiduciary obligations. So we coordinated and worked quite closely with the Department of Labor. I thought that was an important one. And I cared about that one because I had done the soft dollar case when I was in Los Angeles. And I learned a little bit about the relationship between pension consultants in the industry. For Gene Gohlke, who was my associate director, that also was something that resonated with him, too, so that was important. There were a lot of really important ones, but those are the ones that stand out for me.

Ken Durr:

Okay. And you mentioned Gene Gohlke. Who were some of the other people that you relied on through the years in OCIE?

Lori Richards:

In Washington, Mary Ann Gadzilla, John Walsh, absolutely. John Walsh was hugely important to OCIE and to the program. John McCarthy, who ran the SRO inspection program, Helena McGee, who oversaw parts of the SRO oversight arbitration listing the non-trading aspects. I was lucky to have a really, really, really good staff. And Dor Mehan who did the rating agency report.

Ken Durr:

Okay. In the middle of all this, you talked about, well, these were the big things but there were a lot of other things you were doing in between all those big-

Ken Durr:

There were a lot of other things you were doing in between all those big things. Did those change over time? The nature of your day to day during your 14 years or however long it was, was there some sort of transition in the kinds of things that OCIE was facing or was it always the same conflict of interest that sort of thing?

Lori Richards:

It was the same. I mean, sometimes the nature of the facts changed. Conflicts were always, I mean, there's a huge bucket of exams where the violations are not driven by a conflict. They're unintentional, they're mistakes, they're errors. Those we dealt with, I think, in the right way. We sent deficiency letters saying, “correct this problem and make sure your systems don't allow it to happen again.” But the real serious stuff is what is derived fundamentally from a conflict of interest. And that affects a lot of investors and can involve a lot of money. And so those are the serious ones. We made enforcement referrals throughout this period where we found fraud. The percentage of enforcement referrals stayed roughly the same, I think it's between seven and 10% of exams in the investment advisor, investment company area, maybe a little larger in the broker dealer area because we were able to target any firm we wanted because the SROs had the primary oversight.

Lori Richards:

So that stayed the same. I mean, and through all this, there was 9/11, there was Y2K. These are all things that were super important. At the time we were revising our exam modules all the time. We were doing risk assessment. We needed to have a better risk assessment program after we were no longer able to have this routine cycle, we needed to find a better way to risk assess the entire industry. So we started a program. I had two or three people do it full time and they went out to examiners and asked them, “from what you see and what you hear, what are the top risks that you're concerned about? Say what those are, and then rate them in your view, what are the most risky, one to 10,” or whatever. And then we compiled all of that data and then we added to it, “what are we seeing in our enforcement referrals? What are we seeing in enforcement cases that are brought?” I don't remember, there were other inputs.

Lori Richards:

Anyway, we came up with a huge map of risks, and the risks were sometimes different within each region, but overall we had kind of a view of what the risks are. And so then we use that to target and to set our goals. Each year, we had a goals memo that told examiners what we were going to focus on for the coming year. So that's pretty rudimentary risk assessment. We pretty quickly realized we didn't have the data necessary to couple that examiner insight with actual registrar data. And that was a real weakness. That was really a big deal. So, for example, we didn't know who a fund or advisor's auditor was, or their custodian. Kind of pretty basic information that would have allowed us to better target those entities with kind of rinky-dink service providers.

Lori Richards:

This was a mission that we were on for many years to get better data. We didn't have data about hedge funds. Hedge funds would just -- this was before they were regulated, before their advisors were registered -- they'd just blow up and we'd read about it. They just blew up. And we would say, “we need a better way to see who was at risk” because not only does that hedge fund blow up, the hedge fund *and* the hedge fund investors, but it can blow up the clearing firm, and it can have ripple effects. For example, Long-Term Capital Management. So, this was a huge frustration for us, this lack of data. And we subscribed to services that would provide us with information about hedge fund returns so we could see those hedge funds that were outperforming, but that data was voluntarily reported to those private services, so question the integrity.

Lori Richards:

So, we did a lot of things. I would talk to people. I called everybody I knew. “What are you worried about? What's the issue? What's happening? What's around the corner?” And Steve Cutler taught me about how to do that. He was really, really good at that. But our risk assessment was pretty basic. And I did as much as I could internally inside the SEC to say, “Wow, we need to have early warning systems on hedge funds. As they get close to having a margin call, why don't we require the clearing firms to tell us who's in that situation? Why don't we require mutual funds to submit better data so that we can re risk assess performance?” Money market funds. I mean, we didn't have some pretty basic information on money market performance.

Lori Richards:

We couldn't see the aberrations on an industry-wide basis. We couldn't see the aberrations to know who might've been cutting it too close to the two-way seven bucket. So that was a really persistent complaint and I felt like I was always, always banging the drum about getting better data. I finally, I gave a speech about mutual fund data and I put out the call, we need better data. And I felt like I made a good case, but the industry said, no. No. And I mean, ultimately after Madoff, we did get better data on identity of custodians and accountants, et cetera. But in my view, it didn't come soon enough.

Ken Durr:

So I'm trying to understand this a little bit. The sense is you knew pretty quickly what the risks were or what kind of risks there were out there, but you needed to find markers. You needed to have markers that would tell you that that risk exists in this particular location. Is that what you were thinking?

Lori Richards:

Absolutely. Everybody said, just for example, valuation of an investment advisor, mutual fund holdings valuation, huge issue. It's going to be subjective, but how do we know? We don't even have performance data that would show. So yes, exactly. And then that made it made it much more difficult to target firms based on those particular risks.

Ken Durr:

Okay. Winding down toward the end, I see here that Bill Donaldson provided a good bit of extra funding for OCIE when he was chairman? Where did that extra funding go? What were your priorities?

Lori Richards:

Where did it go? So, first, Chairman Donaldson was wonderful to work for. He was the one that would say, “Look over the hill and around the corner. Always be looking ahead for the next risk.” I completely internalized that. And he also said, “Pull up your socks and just get it done.” I completely internalized those things, so he was wonderful. Over the 14 years that I was in OCIE, resources, and then there'd be a freeze and they'd be reduced. So we got resources and there'd be a freeze. And we never were able to, as an agency, to be able to say okay, there are, just investment advisors, there are 14,000 investment advisors. So to examine those firms every X, whatever period, we need X number of examiners. It was never looked at that way.

Lori Richards:

It was always looked at as well, you have 425, I can give you another 10. But that gap was never used as to make budget decisions. And I know it was because that gap was so big that you would be asking for many, many hundreds of people, and that was not palatable. That was not palatable during this period. So, it was always incremental, given and taken away, given and taken away. And the way that we always put the resources to the best use? Investment advisor, investment company exams often got the bulk of it because we didn't have the SRO for investment advisors who could pick up the slack. And it went to the regions and districts that had the greatest growth in the number of investment advisors. Internally we used that methodology, but externally we didn't.

Lori Richards:

So I was very frustrated about this. This was probably my biggest frustration because examiners bore the risk of this lack of resources. We bore the risk and that's not the way you'd want to see the operation work. So I started creating metrics to ascend to the hill. We would report periodically. I started sending metrics that would compare the exam frequency for advisors and broker dealers. As I thought okay, come on, you can see this, you can see that broker dealers are inspected much more frequently and why don't you say what the heck is going on over here with investment advisors and investment companies? But it never really happened, the agency never got the full funding that it really needed to have strong programs. And the sad thing about that is that the public expected that examiners would be in there looking more regularly than we were able to, and there was a gap between their expectations and what we could do.

Ken Durr:

Right. Which was revealed in 2008.

Lori Richards:

It was actually revealed many times.

Ken Durr:

Yes.

I was trying to get to things that changed over time. And one thing that changed over time is you did get chief compliance officers in all the organizations. Talk about working with them and how you developed the CC outreach program. CCO outreach, yes.

Lori Richards:

I don't know if it was my idea, it might've been Gene Gohlke's idea, but it was a way to basically have additional compliance resources. The SEC can't do it all, let's empower, let's be the chief compliance officer's allies, let's help them. So it was fantastic, I was really proud of the program because it was really popular, people came, we had big sessions in Washington, DC, and then ultimately in all of the regional and district offices. And then even after that, we took CCO outreach on the road, there are a large number of non-US SEC-registered investment advisors. So we would go internationally and do these programs. And what we were doing was helping them feel that they were part of a professional cadre, new cadre of CCOs. They would hopefully have relationships with each other, share information amongst each other. And we would share information with them.

Lori Richards:

So for one of the first CCO outreach programs, we put together a summary of the kinds of forensic testing that we did, that examiners did on exams and gave it out because we wanted them to use these same techniques and to develop their own techniques. And that was a little controversial because people thought were revealing the secret sauce, but it wasn't, it was a really good thing. And we did regional seminars. Anyway, we did all kinds of outreach. And then we started issuing risk alerts, which I was very proud of. They were called compliance alerts and they weren't inspection reports or exam reports, they were just summaries of things that we had seen and we were worried about. So, it was much more of, I don't know, an informal narrative about a bunch of different compliance issues. And I was very proud of those because, again, they allowed us to communicate with the industry in a direct way, which I thought was only going to improve compliance.

Ken Durr:

It is interesting in a way you're kind of creating a, you've created a new profession out there, this chief compliance officer thing and are trying to nurture it.

Lori Richards:

Yes, absolutely. And that's what John Walsh used to say, this is a profession now, this isn't just your side job. We had firms where the chief of marketing was also the chief compliance officer. This is your profession and it has standards and it has policies, there's protocol, there's a community of people who do this work. And yes, yes, absolutely. And now, I mean, I think it's been a real success. I know a lot of chief compliance officers and they really valued what we told them, how we advised them, and how we treated them as allies.

Ken Durr:

And throughout this whole period, IT is becoming increasingly more powerful. Did that make a difference? Were you able to crunch numbers in the late two thousands that you couldn't crunch in the mid 1990s?

Lori Richards:

Oh, absolutely. It became a very important part of our program. In all of our inspections. I talked about SRO inspections, and being able to see the data there, but we also used forensic testing in investment advisor, investment company and broker dealer exams, and developed some standard protocols for what that should look like. Churning. We developed some standard protocols about what level of turnover was indicative of churning. And then we used those in every exam where we looked at churning, we were using the same methodology. And that was really important. Again, consistency and we're one program.

Ken Durr:

Okay. So 2008, the Madoff thing comes up. Do you remember where you were and what you were doing when you heard about it?

Lori Richards:

December 11th, I think, or 12th. It was early in the morning and I got an email from the head of the New York regional office saying Bernie Madoff had just confessed. And I was like, what? And we had examiners in that morning, examiners from our New York office. I mean, this is what they did. Particularly in New York. All the boiler rooms and the fraudulent operations up there, they were used to just getting in there right away. So they did. And then I had reports every couple of hours about what was happening, what they were seeing, what they were finding. And within a couple of, I don't know how long it was actually, the lead examiner said, there's nothing here. There's no trading, there's nothing. And we had suspected for a while that he was front running and trading ahead, and that there were violations in the broker dealer

Lori Richards:

But the investment advisor, we had never examined before. It was only registered in 2006, I believe. And we had never examined it. And that's where the fraud was. It was in the investment advisor. So they came back and they said, there's nothing here. And that was incredibly shocking and upsetting. And obviously he stole a lot of money, but he had also lied for so long about the returns that he was generating so investors believed that their investments were worth far in excess of what they were. So it was terrible. It was terrible for investors, but also extremely challenging for the SEC.

Ken Durr:

How did that translate over the next few days, weeks, months?

Lori Richards:

Well, I had to testify right away. Congress was alarmed, as they should have been. So I was asked to testify. My colleagues, other SEC division directors were asked to testify too. I think we testified first before the Senate and then before the House. And then the revelations came out. I didn't know that there had been a whistleblower complaint, or a letter. I wasn't personally involved in it so I was learning about it as the public was learning about it. And that was disconcerting. So I felt it was important to take responsibility. I was in the chair, I was the director of OCIE. Linda Thompson, my colleague, Director of Enforcement, we both felt the same way. We need to not duck, we need to say what we know and talk about this. And it was deeply upsetting for us personally, but we needed to stand up and talk about it.

Lori Richards:

And we did and I felt good about that. We talked about the examiners and the exam program and how committed they are to finding fraud and how devastating this was for all of us. And then really, really quickly, we started to think about well, putting together the dots, what happened here and what needs to change so that we can detect stuff like this and, more importantly, deter it in the first place? So there was a lot of brainstorming sessions with FINRA examiners, just trying to figure out what we could do. And we came up with a pretty good list of things that we could do. The most important thing was asset verification. It was very difficult to verify assets for asset management firms before that. Banks would say, “Oh, this is private information,” or they would delay in getting back to us. It was not an easy process to verify the existence of assets. That needed to change.

Lori Richards:

In my mind, auditors, the auditors of this type of firm needed to change. They needed to be PCAOB-registered, they needed to be of high caliber, and the auditors needed -- as part of their audit process -- to verify assets. That seemed to me to be the best outcome. I had many meetings with many accounting groups, policymaking groups, along with Trading and Markets to say, “You have to do this. This is really, really important.” And the process doesn't move so fast. So, I spent a lot of my time doing that as well as sending examiners out on site in these surprise exams to verify assets, just to make sure that assets were there, that they do just that. And that we did nationwide, we did it across the country. It was incredibly time consuming. We also reiterated our exam modules about fraud and the indicia of fraud. Examiners are pretty well-versed, I think, in fraud, but we, I think really upped it. Examiners became certified fraud examiners.

Ken Durr:

Did you look for investment companies like Madoff's? Did you look for and try to say well, his firm looked like this, so we're going to check these people. Did you find anything there?

Lori Richards:

Yes, we found a couple. Sanford, the Alan Sandford case came up about that same time. And then there was a smaller one in California. I think that one came up. The other thing, I had this idea that we should do something that Corp Fin had done many years in the past, which was to require firms to attest to the SEC that their controls were in place and their assets were what they said they were. So, I spent a couple of months working on that as a project -- to require asset management firms, broker dealers, to come back to the commission and attest. That, ultimately, never went anywhere. But yes, the Commission has made rulemaking changes in light of Madoff, and that's a good thing. Examiners made changes to their protocols.

Lori Richards:

And auditor's now *do* verify the existence of assets during audits, and they communicate with the SEC staff that they've done that. So there are definitely lessons-learned. And then, fundamentally, we did not examine -- I mean, for me fundamentally -- we didn't examine the asset management side of his operation. And I think if we would have, I’d like to think we would have found the fraud. We had in the early years, a protocol where newly-registered advisors are examined in their first year and that fell away when we lacked the resources to do that. So for me, that was another lesson -- having the resources to be able to go into a newly registered advisor and check it out.

Ken Durr:

Okay. I know for Enforcement after Madoff, essentially the idea was just blow it up and start over again, build something new. Is that what happened with OCIE? Did you leave all these things and say, “Here are the pieces. Here's what works,” and bestow them all on your successor to rearrange, or how did that work out?

Lori Richards:

Well, what Enforcement did was it created specialized units which were dedicated to particular issues, including investment advisor, investment company specialized units. That's super consequential. I left in place ideas that I had, and I had a roadmap for what I wanted my successor to do in the next year, which I left, a big thick document. But it was up to somebody else at that point. I felt like I had done all that I could do. I left in June of 2009, having put in place a number of these things. And I felt it was the right time. I also felt that the new chairman needed to have a clean slate post this terrible period. And I had been doing the job for 14 years.

Lori Richards:

So, it was the right time for me to leave. It was very difficult, but it was the right time for me to go. I mean, I had thought about leaving the agency prior to this many times, but I always felt that there was a risk that OCIE could be put back into the divisions. It was always this possibility. And so I thought, no, I'm not leaving now. I'm not leaving, I'm keeping this thing going. So by that time, a new chair, I didn't think it was likely that OCIE would be eliminated.

Ken Durr:

Okay. And now we know that OCIE's made it to division status.

Lori Richards:

Yes, I'm so thrilled. Oh, it's such a vindication of all of the good work of examiners and that the agency knows their value to make it a permanent division. I mean, it's nomenclature really. When we first started out, it was going to be a division, but Market Regulation and Investment Management wanted it to be an office. I say, okay, I don't care. It's just a name. But now, I think it does matter to examiners. It really does. And so I was really thrilled and grateful to Chairman Clayton and Pete Driscoll, who was the OCIE director last year when it happened.

Ken Durr:

So this has been a great talk. Is there anything that we haven't brought up that we should talk about to wrap up?

Lori Richards:

I think what I did after the SEC, because the SEC really influenced me after I left the SEC. It was a core part of my psyche. I initially went to Pricewaterhouse Coopers and I did compliance consulting for all different kinds of entities. And that was really fun to be kind of on that side of the table working with management on compliance programs. And I did that with a former commission lead examiner in New York, Tom Biaussie. We were co-leads of PWC's asset management regulatory group. And then I left PWC and I became a chief compliance officer myself at JP Morgan asset and wealth management. So covering both the wealth management side, the broker dealer side, and obviously asset management funds, private equity, everything, soup to nuts. And that was fantastic for me because I got to finally put in play all of the things that I had talked about when I was in OCIE.

Lori Richards:

I got to actually do those things and remember those things and use those things. And I could see how difficult it was being in that chair. But I loved that work. The firm was fantastic. It's a firm where they're expansive, you can get anything done you want. I talked about how it was difficult to send out 120 exam requests to the mutual funds. JP Morgan, anything goes, you can do anything. And so that was really refreshing. I had lots of resources and I really enjoyed my time there and being a chief compliance officer.

Ken Durr:

Did you learn anything and call up your successor at OCIE and say hey, given my new experience, think about this.

Lori Richards:

I did not. I learned a lot. I mean, I learned a lot about the business. I think when you're a regulator, you're obviously looking from the outside in, you're never going to be in the chair where they're talking about their new marketing program or this conflict of interest or that conflict of interest, but I was there in the middle of it doing it. And that was, I don't think I could have had as full of a career as I have unless I had been in the trenches as a chief compliance officer, it really kind of close the circle for me.

Ken Durr:

Well, terrific. I guess we can close the circle on this interview. Thank you very much.

Lori Richards:

Thank you, Ken.