SEC Historical Society
Interview with John Walsh
Conducted on October 21, 2022 by Kenneth Durr

Kenneth Durr:

This is an interview with John Walsh for the SEC Historical Society's Virtual Museum and Archive on the history of financial regulation. Today is October 21st, 2022. And I'm Kenneth Durr. John, good to talk to you.

John Walsh:

Good to talk with you.

Kenneth Durr:

I'm always interested in where historians end up on their career paths, so I'd love to start our talk with that one.

John Walsh:

Sure, yeah. I guess we're talking today as fellow historians.

Kenneth Durr:

That's right.

John Walsh:

I'm a fallen away historian though. You've actually stayed true. So good for you.

Kenneth Durr:

So, you got your undergrad in history. Was it law school from there? Was that an easy decision to make?

John Walsh:

Actually, no. I have a PhD in history and when I got out of college I went to, got a master's in history and then I was working on my PhD and actually it was ABD, all but dissertation when I went to law school. And I remember clearly sitting one night in my apartment in Boston, I was attending Boston College to get my PhD, thinking this is fun, but it might be interesting to get more involved in things. So, there you go. There's a profound motivator for a change in career. It might be fun to get more involved in things. And so, I started thinking maybe I should apply to law school and the rest as they say is history.

Kenneth Durr:

Okay. Did you get interested in securities law early or late in that process?

John Walsh:

I would say it was after I was actually out of law school and practicing. I first started with a law firm up in New York, Donovan, Leisure, Newton and Irvine. And it was Wild Bill Donovan's old law firm. And he of course passed away many years ago. And worked on some matters where the SEC was on the other side. And I thought that looks like a pretty cool place to work. And so, when I started to think about moving to the government, the SEC was an easy choice to apply to.

Kenneth Durr:

Why did you think about moving to the government?

John Walsh:

Well, I started working on international trade, which at that point in time seemed to me that that was going to be the, that was the issue of the future, international trade globalization and flows of goods and services. And after I'd spent a little time on it, I thought, I spent a huge amount of time on a case where the question was, was it a typewriter, which put it in one customs category or was it something else? And you can't imagine how many gray cells were expended, debating whether it was or was not. We actually convinced one adjudicated body that we were right. And the other overruled us and it was kind of a mess. But I thought, yeah, maybe it's time to give a try to the government.

Kenneth Durr:

So, you didn't want to get too sunk in the minutia, I guess international trade.

John Walsh:

Yeah, international trade is one of those things that sure sounds great until you get into it. But the reality is, after many years in the career, I always counsel people that every job has three elements, the fabulous element that you love, the middling stuff, that it's neutral, it has to be done and the terrible stuff that you hate. And every job, every role has all three. And the only difference between them is how each of those categories are weighted. A good job is weighted to the first, a bad job is weighted to the third, but all three are present in every job. So, there you go, there you go. Early morning. I'm going to take a sip of coffee after handing out wisdom like that.

Kenneth Durr:

Well, those are good words of wisdom. Let's talk about how that applied to the SEC. You went into the general counsel's office, right?

John Walsh:

That's correct. And it was great. I enjoyed it. I had an opportunity to work with Paul Gonson and Paul unfortunately has passed away, so he's not eligible for the history project, but he was a fabulous individual. And I think what really made Paul a great person, he viewed every contact with a young attorney as an opportunity for a learning experience. And when I worked on briefs with him, I worked on some matters with him and he would go through the brief and by the time it was over, you felt like you really learned a lot.

In fact, I still have a list of words I never use because one of the lessons Paul taught that I've really took to heart at the time, and I've held to ever since is legal writing is writing. And you've got to consider tone, you've got to consider innuendo. Just to pick an example, fulsome. And a lot of people use the word fulsome to mean a lot. And Paul said, "Ah, but underneath it has that tone of fulsomeness." And he says, "So you don't want the judge thinking, yeah, you got a lot of you know what. [inaudible 00:05:30] in this brief." And so, working with Paul was really, and there were other people there too. I don't mean to slight other people. Paul was a real mentor as the solicitor. And I heard somewhere he has his name on more briefs before the Supreme Court than anyone else other than Solicitors General of the United States. So tremendous role.

Kenneth Durr:

Yeah. Jake Stillman was there as well, right?

John Walsh:

Yes. I didn't work as much with Jake when I was young. I worked with Jake, I believe he has passed away now as well, unfortunately. Yeah, I worked with him later when I was chief council in the Office of Compliance Inspections and Examinations (OCIE) and not to tell war stories, but my favorite memory of Jake is I go into his office and I say, "Jake, we're kind of working with an odd problem," and I'll spare you the details. It went to the authority of the exam program and we're trying to figure out how to respond to these demands. And Jake goes, "Wait." And he goes to this pile of briefs, and he digs down into the pile of briefs and he pulls out this brief and I mean this is a big pile of briefs. And he pulls out this brief from the bottom and he says, "I'm sure we said," well, it turns out, I don't know, 20 years before or something, before the Fifth Circuit or something, the SEC had taken a position in a footnote. Jake opens it up and you know what? That was the answer. That was our position. And I was like, wow, this is pretty impressive.

Kenneth Durr:

So, you ended up in enforcement after general counsel's office?

John Walsh:

I did, I did. Look, I'm going to be blunt here, everybody knows enforcement. They're the big dogs at the agency. And I think anybody who goes to the SEC, I am confident at some point thinks about, well, I'd like to spend some time in enforcement. And the reality is, if you want to understand how financial regulation works, you've got to spend some time in enforcement and see how that process works.

And so I went to enforcement, actually the chief counsel's office, Colleen Mahoney had been in the general counsel's office, and she moved over to be chief counsel. And Joan McKown was her assistant director. And Jim Clarkson was, I forget his exact title, but it was something like executive manager for regional office operations or something like that. And it was a great place to be because these are the days before video and real time private broadcasting and stuff.

And so, the chief counsel's office would go to the Commission to present all the regional office enforcement cases. Every enforcement case that the Commission is voted on by the Commission. And so, I was in front of the Commission every week and I was in front of the regional offices constantly and working on their enforcement cases. And our role was, depending on who described it, we heard from the Chairman's office, it was kind of quality assurance, which I was never crazy about because we were working with highly skilled regional office attorneys. And I always thought that was not the best way to describe what we were doing.

But on the other hand, we were a sounding board to communicate policy and where the Commission was, because from one Commission to another, and even one Commissioner to another, views of the enforcement docket can change. And people in the regions need real time feedback on how Commissioners feel about particular precedent or things like that. So, it was a great place.

Kenneth Durr:

Interesting. So, you're sort of bringing some consistency or some accurate transmission between the regions and the Commission?

John Walsh:

Yes, it was, I would say if I had to put it in a single sentence, we were doing enforcement policy.

Kenneth Durr:

Okay. What was the insight you got? You're looking at the regions. You've got a pretty broad view. You're looking at the regions, which are the grassroots and you're looking at the Commission. Did you pick up some insights during that period about the...

John Walsh:

Well, it was a crash course in securities law because more than two thirds of the enforcement cases that the Commission brings come from the regional offices. So that meant you were up to your neck in whatever the Commission was doing in broker dealer cases, disclosure cases, net capital cases, investment advisor cases, and really in the weeds of what makes this a case? Why is this a good case? Is the penalty appropriate? Is this the kind of penalty the Commission's looking for today? Does the Commission read this particular highly ambiguous provision in the securities laws the same way, you sir, in the regional office are trying to read it? Things like that.

But you asked, did I have any great insight? I would say probably, at least this passes for insight with me. The greatest insight I had was if a case has a narrative, it's a much, much better case. Cases that came with narratives, the son betrays the father. The husband is using his violations to fund behavior he wants to hide from his wife. The brother-in-law denies all knowledge of his brother-in-law, things like that. And if there's a story, if there's a narrative attached to it, then that really made it a good case separated apart from the provisions and things like that that you might be looking at. And that's a lesson sort of like Paul and his “never use” words. That's a lesson I've taken with me. Look for the narrative. What's the narrative? We're all human beings. We all learn by stories; we all communicate by stories. And I think that's probably the most important insight I got from my, what was it? Two, three years of constantly under water with enforcement cases.

Kenneth Durr:

I think there's a little bit of a historian in there too.

John Walsh:

Lovely. Well...

Kenneth Durr:

Let's talk [inaudible 00:12:26] about your-

John Walsh:

Historical training helped a bit in assessing factual records as well. Yeah, yeah. Where the facts of record end and the interpretive gloss that's passing as facts of record begins that that's always a historical skill.

Kenneth Durr:

Yep. Let's talk about working directly for Chairman Levitt. You went in as special counsel after a few years. Tell me about the working relationship with the Chairman, some of the things you did, some of the notable cases, decisions.

John Walsh:

Sure. Well, I think well, first off, Arthur Levitt, I thought was someone who really came to the agency with a clear sense of what he wanted to do. And I'm sure you've heard the old saying, there are two kinds of people who go into public service, those who go into public service to be something, and those who go into public service to do something. And he was definitely the latter. He had had tremendous success in his private life and when he came in, he had a really clear idea. In fact, I think he had four key things that he wanted to do, and he really made significant progress on all four of them. And so, working with him was really a pleasure. It was a really small office then.

When I look at the size of the Chairman's office today, it would be fair to say it's grown a lot many times over. So, everybody there got involved in everything. As a general matter for I'd say at least half of the time I was there, I was kind of solely the person managing the enforcement docket form. And he had, I think, again, this is talking lessons learned. He wanted to know what's important here. What's important? There's going to be noise, there's going to be this, there's going to be squabbling in the record, but what's the important point here? And I used to tell my wife, look, I'm at the office super late, not reading the case, not understanding the case, not analyzing the case. It's boiling it down to the key here, Mr. Chairman is what you need to think about here. Here's where you're making a change, making a policy. And from time to time there was, oops, there was a miss. But I think there were a lot of wins. And that was really interesting.

He also sent me off to work on the Public Utility Holding Company Act, and we did a whole study. I was his representative on this task force that studied it and reformed it. Actually, came up and it was one of these things saying, well, Congress, if you won't repeal the darn thing, here's what we're going to do to try and make it more workable. There was adjudication. The Commission, in addition to being an enforcement agency, is also an adjudicative agency. And the ALJs work goes up to the Commission on review, FINRA and the SRO, well then and ASD's work goes up to the Commission on review. So, it was a lot of things like that. And it was a great working environment.

And it was a different time too, because not only was the office small, but it was open. And I know this sounds incredible. No one can probably would believe today that there was a time in Washington DC when you could walk in the front door of the SEC, get in the elevator, go to the floor with the Commissioner's offices, walk into the Chairman's office, walk up to the receptionist and ask to see the Chairman. And I mean, now to do that, you'd have to go through multiple layers of security and locked doors. We used to say, if we're under threat here, it's because someone has a beef with the other SEC that plays football, not the SEC that regulates the securities markets.

And not to tell war stories, but one day, may I tell a war story?

Kenneth Durr:

Absolutely.

John Walsh:

Okay. One day, I'm sitting in my office and apparently what happened was a clown literally dressed as a clown, I forget his name. It wasn't Bozo, but it was something like Bozo with the big red nose and everything, comes into the Chairman's office and demands to see the Chairman and the receptionist looks at him and in a moment of quick wittedness, points to my office and says, "That's his office right there." And the clown walks into my office. And I have to tell you, I've, over my years as a regulator, I had some unusual engagement with people, that was probably the, "Are you the Chairman?" "Who says I'm the Chairman?" "They told me you're the Chairman." I'm thinking if I say yes, are you going to pull out a gun? What does a clown do? I don't know. It was pretty exciting. But that, that's for me, even though it's a little bizarre, it's a warm memory because you know that; we've lost that Washington.

Kenneth Durr:

So-

John Walsh:

That Washington is long gone.

Kenneth Durr:

Yeah. Was that a performance advocacy group kind of thing going on? Do you remember?

John Walsh:

I think it ended up that he was supposed to deliver birthday greetings or something like that. Yeah, it was, and actually there was a phase where people would do sort of stunt and they come in Happy birthday, Mr. Chairman kind of thing.

Kenneth Durr:

Okay.

John Walsh:

Yep. But there you go.

Kenneth Durr:

But you got the happy birthday instead.

John Walsh:

Actually, that would've been really interesting if at the end he honked his horn and said something like, can you do anything about 10b5? That would've made it even more memorable, I have to admit.

Kenneth Durr:

Yeah. Well, you didn't do anything about 10b5, but you did a lot in the area of compliance. And if we can, I want to step back just a little bit. And talk briefly about the rise of compliance. I'm assuming this is one of the things that Arthur Levitt wanted to do when he came in. And my understanding is that this was growing out of the corporate world, out of the regulatory world before the SEC put in its office.

John Walsh:

Yeah, it was. And I think it grew, if you really want to trace its roots at the SEC back, you should probably trace it back to the special study of the securities markets back in the 1960s. And then there were developments in the 1970s and eighties, but by the time the SEC really got involved in it, there had been a lot of what I would call organic development in the business.

And by the nineties, I think a real change had taken place because when it started, a lot of the people who worked in compliance, the real pioneers of compliance were operational people. They came out of the cage; they came out of operations, and they moved over to compliance. And in the eighties and nineties, because of the growing need to take account of a lot of different variables and oversight processes and deal with the changing regulatory environment, you started to see more and more people not viewing it as sort of a second step or oftentimes late in their career, but as a profession and a career in and of itself.

And so, the question really is, well, how is it that the businesses we regulate are all investing heavily in compliance and we at the SEC are not really doing anything about it? And so, the Office of Compliance Inspections and Examinations, now known as the Division of Examinations was created in large part to be the SEC office that works with compliance that just as if you're an issuer, you go to Corp Fin. If you're an advisor, you go to investment management and so on. If you're a broker dealer, you go to Market Reg or trading in markets, and it's let's have a compliance office of our own both to interact with the compliance community and also both to try and ensure their compliance short of the need for enforcement action.

I think the great vision of compliance is sort of a simple concept: Is it possible to prevent problems before they arise? And I think the SEC -- the Division of Enforcement -- is really good at coming in after a problem has happened. And I don't mean any disrespect to Enforcement, having once been in Enforcement myself, that's really reactive. And the goal of compliance and I think the goal of the examination program is to be more preventive. How do you get out in front? It's kind of like preventive medicine versus serious surgery. I think that was the vision that animated him. And I think that's the vision that certainly animated the early exam and the early days of OCIE.

Kenneth Durr:

Interesting. I haven't heard it put quite that way. In a way there, he wanted there to be a group that could speak the language to compliance officers, that kind of thing.

John Walsh:

I think so. And also, to reinforce compliance. In the early days of compliance, there were serious debates in the compliance program. What's the best way to validate compliance? Do we ask the questions, or does it put compliance on the spot and undermine them? And as director of the exam program, Lori would write letters to the business saying, hey, we understand that people are cutting back on compliance when everybody's got to take their heads in a bad downturn, but it better be proportional. If compliance bears a disproportionate burden, that's a problem. And I think that kind of advocacy for compliance was what I think Arthur Levitt envisioned. That was the kind of compliance for compliance.

Kenneth Durr:

Were you there at the outset of setting up the office or did you hear about it after the fact?

John Walsh:

The three of us went from the Chairman's office to the new office. Lori was the director. I had some fancy title; I forget what it is now. Basically, I was the policy and legal guy. And there was a third person who was the Chairman's office manager, and she came over to be the office manager for the new office. And so, I guess you could call us the seed personnel, the founders, whatever, the three of us. And then kind started gathering people in from other offices and divisions and so on.

Kenneth Durr:

It gives you a sense of how important it was that he essentially picked his office up and put it over here in OCIE.

John Walsh:

Well, in an institutional sense that's really one of his great legacies that the freestanding examination program, the freestanding compliance program is something he created and it's now, it's like the second largest office in the Commission right behind enforcement and plays a really important role in the life of the financial sector of the securities business.

Kenneth Durr:

You talked about some of the rationale for putting this together, but there must have been some considerations. For example, trading in markets, knew the markets. They had a really good sense of the lay of the land. And same with enforcement. Was there a sense that there might be some hazards in separating the compliance side from the rule making side, the policy side?

John Walsh:

Well, I know people who I respect a lot and have a really high opinion of, except in one small area and that is that they have never reconciled themselves to the examination program being separated from their former division. And I think that's a mistaken view. And what do they say? Occasional differences make life complete. I mean, that's an example of it. I think that's a mistake. If you go back and you look at the separation of the division of enforcement from the regulatory offices back, I believe in the early 1970s, as I recall, I think they went through much the same thing and.

John Walsh:

I think they went through much the same thing. And unfortunately, I think that the idea that the exam program is simply an arm of a particular regulatory office, it's a mistake. And you really need to have a freestanding program that can deliver the kind of training, professionalism, flexibility. I worry that if you, or I worried at the time and still think it's not a dead issue, that if you get so focused on a particular thing, it's very easy to miss the larger picture around that. You're examining for this role and nothing else, when you should be thinking, well what's the overall health of the institution that I'm here for? What am I looking at? What do I care about? And so, I disagree with that.

Now having said that, I will admit, and I think this is absolutely accurate and well-founded, to be a good examiner, you need a lot of specialized expertise. And you don't get to be a good net capital examiner by examining investment advisors. And you don't get to be, I could pick almost any role in the investment company space and say you don't learn about that by doing broker-dealers. And so, anytime you put these things together and people said, we're going to lose the expertise, and that's something, really is a key thing not to lose that expertise.

So yeah, I would say the challenges, there were real challenges preserving and validating the expertise within a combined office of varying expertise, but at the same time as a unit. But then I think there were also some cultural issues that I think were mistaken.

Kenneth Durr:

Right. But was this something that you guys thought about at the outset?

John Walsh:

Absolutely.

Kenneth Durr:

Like, is this a good idea? Or was it pretty obvious that you really needed to put the exam function separate by itself?

John Walsh:

Well, I think the need for a compliance office, I think, was pretty clear. And how to make it work, how to balance being independent, within a larger institution of course, with how do you preserve the various forms of detailed expertise, that was a separate issue. Yeah, I think the latter issue got a lot of attention.

Kenneth Durr:

Yeah. And you had, not only were you creating an office in Washington, but you had to work this through the regions. And they had had clear lines between market reg and IM. Talk about making that happen.

John Walsh:

Yeah, I think to some extent the work of the chief counsel's office and enforcement, where the actual work is being done in the regions and then is channeled through the home office, was really not all that dissimilar in the exam program.

Kenneth Durr:

Okay.

John Walsh

Where ... the examiners in the region. And one of the things actually that I always advocated for was preserving sufficient autonomy in different regional offices, that they could really have different styles and different approaches depending on their territory. There are regions, which I will not name, where the communities that they regulate are just wild. And every exam is involved in money laundering and looking into money laundering and fugitive assets. And then there are other regions where everybody's really asset management kind of stuff. And that variation I always thought should be respected and preserved. And I think someone who was a real advocate for that as well was Jim Clarkson. And we talked about him before. I think Jim was very much in favor of that.

So, in some regions, almost every exam was a cause exam. And other regions they'd call them up weeks in advance and say, hey we're coming to see you. And that kind of variation worked out really well. So I think the bottom line is anytime you have a headquarters and field offices, you're going to have communication issues. I think Lori really tried to pull the regional office management into meetings and conferences and things like that to make sure their voices were being heard.

It's a tough balance to strike, though. Enough autonomy you can react to your territory, but enough centralization that it's a single program across the country. Now, there's an art to it and there are some pitfalls. There are some really big ones from time to time. But then sometimes it works great. The good news is when it works great, you don't hear about it. That's part of the charm.

Kenneth Durr:

What's the nature of the really big pitfalls?

John Walsh:

Well, I think sometimes people in an exam would ... Just, here, let me see if I can give you an example. Should examiners have authority to declare that someone has violated the law? Can they make a, quote, finding that someone has violated the law? Well, what is that really? When a member of the staff in an informal proceeding, not to get all lawyerly on you, but in an informal proceeding, opines that that's a violation, well, is that a finding? It's certainly not a finding of the Commission. Is it a finding under delegated authority, which can be appealed to the Commission under section, I believe it's section four of the Exchange Act? What is that really? And so, I think you have to have certain guardrails to make sure people understand, yeah, we have a lot of autonomy, we can do things differently, but we're members of the staff and it's the Commission that makes the findings, not us. That's just an example.

Kenneth Durr:

Interesting. So, tell me about setting up the Washington office. I think I read somewhere that at the beginning it was a whole floor in the building and just you and Lori and maybe, as you said, one or two other people. Talk about building up this new organization within the SEC, and how you decided to structure it, how that structure worked, that kind of thing.

John Walsh:

Well, filling up the floor, we really lucked out because it was a vacant floor. I think somebody else had rented it. And so, when we moved into it, the accommodations were much better than standard government fare. And actually, we got that again when we moved to a new building across from the FBI. It had been a television, somebody had occupied it, and that was downright luxurious compared to standard government fare. Which was great because people would come in and they'd say, what the hey, how come you guys get this? And we're like, oh we don't know. You know, what the heck, who knows? But initially, I think to be sensitive to the concerns of people coming in, there was a real effort to preserve as much as possible the existing sort of chains of command. So that Mary Ann Gadziala and her team came in on the '34 Act side, Gene Gohlke and his team came in on the '40 Act side, the SRO inspectors came in. And everyone kind of sat together and exercised some independence.

Now, in time, an effort was made to mix people up and to get people, the different teams were sitting together, and people would go to joint meetings and think about what the implications were. But I think there's always been that effort to try and recognize that there are differences in regulation, even if the institutions and the entities we're examining are taking on an increasingly combined look. So yeah, I actually loved my office. It had floor-to-ceiling windows and all kinds of cool stuff. But it's the luck of the draw.

Kenneth Durr:

And so, you're essentially general counsel for OCIE, is that the way you'd look at it?

John Walsh:

Yes, from the time I became chief counsel, that was official. And I think my initial title was senior advisor for compliance policy. And my only requirement was I wanted the word policy in there. But I-

Kenneth Durr:

Why?

John Walsh:

Why not? Right? Why not? And actually, in all seriousness, I think, to be sincere, I thought that there are a lot of policy issues in how a government agency uses its inquiry authority to regulate the market. And basically, an examination program, whether it's the Federal Reserve with its inspection program, or the other bank regulators with their inspection programs, and simply coming in and asking the question, utilizing your inquiry authority, you're really making policy. Where do you ask? What do you do with the information you get? Do you write a letter, or do you sit down with management? How do you actually do this? And so, I was really interested in policy by inquiry, or examination if you want to call it that. And so spent a lot of time, well, I'd say in the early years throughout, thinking about what it meant and how to do it properly. What was not enough and what was too much.

Kenneth Durr:

Interesting. So, you're really getting at what's OCIE all about, what should OCIE be doing, and what's its function within the larger organization.

John Walsh:

If you're in enforcement, you know, you can write it out on a three-by-five card and say, find violators, take them to court or settle with them, stop the misconduct, and penalize it. And things like that. And that's good. That's the way it should be. If you're in an examination program, it's a lot harder. Are you looking for violations to feed to enforcement? Well yes, of course. Are you trying to prevent problems? Are you trying to play a prophylactic role, where you go into a firm and point out weaknesses and risks that they should be addressing? Yes, absolutely. Are you limited to the four corners of what people are prohibited from doing? There are broker-dealers who back in the day would say that's exactly what you're doing. If it's not written down somewhere, don't tell me about it. And so those are the kinds of issues, I think.

And the goal ultimately was very consciously looking at other regulators and thinking what is the regulatory strategy? Like the Fed. And of course, and I was talking about enforcement being the big dog at the SEC, the Fed's the big dog among regulators. Absolutely. And I spent a lot of time looking at how they do business and thinking, what do they do that I like? What do they do that I dislike? And what can we bring back to the SEC that will work in our context?

Kenneth Durr:

Interesting. So, you've talked about what you were thinking, the rationale behind making decisions day-to-day, but let's talk about some of the day-to-day. How did exams change when OCIE came in? I know there were sweep exams, for example, that that came in fairly early. Talk about those and some of the other early landmarks.

John Walsh:

Yeah, I would say sweep exams. Why, I'll tell you, this is history now. In their day sweep exams were incredibly controversial. And it's funny when you think about it. And I actually think, going back to the narrative, the idea of a narrative, I think the markets were in turmoil, technology was changing, a lot of stuff was happening. And I think sweep exams became sort of the narrative that people could focus on. And maybe we did too good a job of explaining them so people could wrap their heads around them and say, yeah, yeah, yeah, that's what I don't like, the sweep exam. But the concept was pretty simple. If you go one by one, firm by firm, issue by issue, you're going to miss a lot of stuff. Because you need to contextualize things. And how do you contextualize things in an examination context? Well, one way is with a sweep. And that means that you select a sample. And so instead of it being one by one, it's everybody in the sample.

And you look at them, and of course you have the firm off on one leg that's just a model. And you go back to the office and say, hey, these people have it locked down. They're the benchmark. That's fabulous. And then you have in the middle, you know, everybody's doing whatever, and you might give them deficiency letters and say, we think you could be doing this better. And then off at the other leg, you have the firms where you come back into the office and say, okay, is there a violation here? Should these people go to enforcement? But because you're viewing this whole sample, not one by one, it should give you a much more sophisticated appreciation for what's really happening in the business that you're looking at. I think it was much more effective. It was much more efficient.

One immediate drawback that people didn't like was that if you were an early firm in the sweep, and the people who were running the sweep, the special review, waited to see everybody before they sent any letters out, which methodologically makes sense and that's the way it should be, well, if you're one of the first ones you're going, where's my letter? How come you haven't gotten back to me yet?

Kenneth Durr:

Ah.

John Walsh:

And there could be some delays there. But I actually think that the sweep approach is one of those things, and now, gosh, enforcement does it, the exam program does it. I think it's a really, really good idea. I actually did sweeps or special focus reviews out of the chief counsel's office. Because one of the things we decided early on was everybody's going to do exams. Nobody's going to sit behind a desk in Washington. So as part of the program, I was out running sweeps myself with chief counsel's office staff. Which was a lot of fun and really got me out in the field and, I don't know, not to tell war stories, would you like to hear about some of them?

Kenneth Durr:

Yes. I love war stories.

John Walsh:

Well, probably the best example would be the bank broker-dealer. Because one of the things I really tried to do throughout was spend a lot of time with my colleagues in the other divisions, like market regulation, trading and markets, and investment management, talking with the chief counsels. You know, what are you worried about, what's bothering you, what would you like us to look at? And the folks in, and I'm just going to call it trading and markets because that's what it's called today, though I think it was still market regulation at the time, said, well, you know, we're really worried about bank ... broker-dealers, sorry, that do business in the lobbies of banks. And we have this guidance, and we think there's this issue where we just don't have a clear view into how they're working. And so, I said, yeah, it's a great idea. So designed a sweep, pitched it to Lori, she approved, and sent teams from the chief counsel's office out to headquarters at broker-dealers that kind of specialized in this work. Came up with a list of branch offices and assessed them by various criteria. And these were the days before big data. So, this was a lot of manual input, figuring out what the criteria are. And came up with a list of branch offices that we wanted to visit.

And I go to Lori, and I say, Lori, we've got this list. And she said oh, that sounds great. And I say, we've done all these criteria. And she said, oh, that's great. I say, and these are the ones we really want to do. Yeah? I say, especially this one, this one right here, no matter how we slice the data it comes out in the top three. And she's like, come on. Come on, you're trying to tell me something, what's going on here? And I said, well, number two is in Honolulu. And she said, okay, show me the data, let's go over this more carefully. You know, let's look at this. And in fact, it withstood what I would call supervisory scrutiny. And we did that exam.

But that was a great sweep. Because we could then go back to our colleagues in trading and markets, say, here's what we found. Here's how people are complying; here's how people are not complying. Here's where the weaknesses are, and things like that. Another one we did, sales to the military. There was a hot war going on in Iraq, and service members were getting premium because of combat. And there was some concern that they were being sold products that they would not be able to sustain without their premiums. So, we went and did a lot of exams around military bases, worked closely with the Department of Defense. And I, again, did that out of my office, sales practice-type reviews with a special focus. We did one actually, internet-based underwriters. And again, these are ancient days here. The internet was really a brand-new spiffy thing and people were selling securities on it, and offering, making securities offers oftentimes in the private equity space. And so, we went out and did a review. We did outsourcing. I actually did a lot of reviews of securities firms that were pushing their functions off into outsourced vehicles, including onsite reviews in Mumbai, India. Going and saying, we're going to go look at the other side. We've been looking at the people sending the work. Now let's go look and see what's actually happening on the ground.

What else? Sarbanes-Oxley codes of ethics. We did a special focus review of SOX codes of ethics, fed our findings into the process leading to the code of ethics rule. And so, it was things like that. And I think what made it interesting to me is it got me out in the field. And I really enjoyed that. But it also was part of saying, well, what are we really thinking about here? What's an issue that's of concern to the other divisions, to the Commission? And can we come back at the end of a sweep or special focus review and say, here's what's happening. This is not just a single firm, but here's a sample.

The one, and I always have thought it's kind of a will-o'-the-wisp, and I would love it if we could ever do it, is to figure out how to get a sample on a particular topic that would give you enough to make valid inferences about the firms you're not seeing. And never got there, though there was a period when we were doing random exams. And actually, doing a random sample, but that, it just never really worked out. Because they weren't really random, and they weren't done with sufficient consistency. But that was a goal. And that would've been, I think, the final step of the sweep or the special focus review, to actually be able to draw inferences about who you're not seeing. But I'll leave that to the people running the program today, if they can figure that out.

Kenneth Durr:

You also published reports. There were big public reports [inaudible 00:47:14]. Yeah. What was the rationale there?

John Walsh:

Well, again, as a compliance shop, the goal was to get the word out to the compliance community. What did we care about? I think Lori wrote a letter to the investment advisor community listing the most common deficiencies. You can take that letter out today, and it's still good guidance. It's really, I think, quite helpful. There were reports, there were, in what I would call an early phase of blogging, Gene Gohlke would do paragraphs. He'd say, here's an issue that we're seeing in exams. And then he would do a quick paragraph. So, there were a lot of things like that, trying to get the word out.

I think at a later stage of the process, an effort was made to formalize it. Formalize it, pull it together into a standard format, give it a name, and things like that. And I think that was a good idea as well. But there was a lot, really from the beginning, of trying to get the word out to people. And again, we were supposed to be the piece of the agency that worked with compliance. And compliance loves to hear, what are the concerns, what's the agency looking at, and what can they do better?

Kenneth Durr:

Okay. You mentioned that these sweeps are a good opportunity to take a look at the market and see things more broadly, perhaps, than some of the divisions did. Was there a formal process in working with the policy makers? The rule makers in market reg and IM?

John Walsh:

Yeah, I seem to recall at a point ... There was a lot of pushback on the sweeps. And again, I think ... There was a lot happening in the market. And I actually think the pushback came less from the sweeps and more from emails. Because suddenly, and I know it seems odd, the connection, but all in the same time period, there was tremendous market turbulence, and all of us, including the SEC and examiners and enforcement attorneys, started to appreciate the tremendous oversight capability that emails gave you. And initially, of course, people said, oh these emails, it's a whole new thing, it makes regulation impossible. And then a few years later, people are saying, well, wait a second, we can actually get past what people are saying publicly to what they're saying internally. And I think this was fueled as well by some scandals in the investment company space and the mutual fund space, where people were coming into the SEC and pounding the table and saying, you've got to do more about market timing. And it turned out they themselves, those very people, were market timing.

And that got everyone very concerned about, well, wait a second, we know what they're telling us, we know what they're telling the public. What are they really doing? And emails were a vehicle for doing that. And in the exam program, we embarked on a wholesale email review program with various different things. And of course, this was before the technology had caught up and it was possible to do the kind of searches that one does today. And so, I think people viewed this as a very burdensome and intrusive form of regulation that they just weren't used to. So you add it all up, you've got real turbulence, bubbles bursting, and major corporations going bankrupt, and a lot of scary stuff in the market, you've got this incredibly intrusive new type of oversight where people are reading your darn emails, and then the SEC exam program announces this sweep initiative. And I think the sweep initiative was something that folks could latch onto. And so, I think that really became a hot topic and people really pushed back.

And it came up in a number of different ways, both internally, which is, I think, you're right, there was a more formal process established, to go through certain hoops before a sweep began.

Congressmen proposed legislation, would've added sweep regulation to the securities laws, and things like that. So, it was regulation of the securities laws and things like that. I mean, at the end of the day, if you're a regulator and you look at all this stuff, you say, "Wow, this is really having an impact." Sometimes people do protest too much, and you know what I mean? So yeah, obviously it's effective in that they're responding.

Kenneth Durr:

Interesting. One of the most controversial ones was the research analyst's suite.

John Walsh:

Yes. And I'll defer to others to tell you about that, I think, and I apologize if you can hear my dog barking in the background. We have three dogs, only one of them has a really loud voice and I'm amazed we made it this deep into our conversation before he started to bark. Yeah, I will defer to others to talk about that.

Kenneth Durr:

Okay. Some special initiatives that are going on at the same time, Y2K comes up pretty quickly and [inaudible 00:53:03], tell me about the office geared up to handle those specialized tasks.

John Walsh:

Actually, in Y2K, believe it or not, I don't believe in myself as I reflect upon it, I actually have a metal, the metal kind you pin on yourself, from it was somebody in the White House. I think it was the President's Council of Y2K preparedness or something like that. And as you go back, it was kind of one of these first gosh, the world's going to end tomorrow, what do you think we should do about it kind of initiatives. In retrospect, I actually think it was kind of a test run for the compliance roles because it was a really good example of preventive compliance, and we were out doing exams and we did a lot of them looking at are you ready? And it was always a two-step process, question one, are you ready? And question two was, how do you know you're ready?

And so, a lot of the same kind of preventive stuff that later went into compliance we were doing in Y2K. So, I don't think it was a waste, but in retrospect it's hard to say, would the world really have come to an end? I volunteered for the graveyard shift that night at the war room and we were watching Europe and gosh, Europe seemed to be doing okay then it kind of rolled over England. "Yeah, England hasn't shut down yet." So, it was kind of like, yeah, so we had volunteered to do the whole shift. So, I think we watched Saving Private Ryan and infomercials and things like that, but yeah, the world survived Y2K. But again, I don't think it was wasted, because I really do think, and while the topic may have been silly, it was a really good preventive rather than reactive exercise.

Yeah, you mentioned [inaudible 00:55:22] privacy is sort of a traditional regulatory area, rule, standards, disclosure. And out of the chief council's office we did a sweep on that, special focus review on that. Actually, we started that one before it went into effect and again, as a preventive type of approach, what are you doing to get ready? And then afterwards, what have you done now that it's supposed to be in place? The other piece of that [inaudible 00:55:52] is cybersecurity and boy, that's a tough one. I think we struggled with it, both figuring out what to do about it because it's hard to respond, to track people to the agency who have that expertise and actually encourage people to get the skills they needed in situ while they were working for the government, which I thought was a good way to do it and encourage them to get the certifications. But it has become an issue that everybody appreciates now. But I don't know that we're any closer to really solving it than we were then.

Kenneth Durr:

There are some more rules, but it's still a challenge.

John Walsh:

Yeah, it's so fast moving on both sides.

Kenneth Durr:

Yeah. Well let's move on a few years. Talk about the effect of the late trading and market timing scandals on OCIE. This is right in your wheelhouse, how did that affect how OCIE did business and how the exams took place?

John Walsh:

Yeah, I think it was a couple of different things. First off, I think it really fueled the understanding that risk assessments needed to be more formalized, and impressionistic risk assessments were just not viable anymore in this environment. And we were saying at the time, every examiner, probably every regulator walked around with a private risk assessment. Here are the firms I need to worry about, here are the firms I don't need to worry about or worry about less. And I think one of the things that really shook us all up, with the market timing in particular, was that all of that, and what I would call impressionistic risk assessment, turned out to be wrong. And it turned out that there were people who we thought were leaders of the industry who were, in their spare time, apparently market timing and complaining about market timing. It's a very strange situation.

And so, I think that the need for a better systematic risk assessment became apparent, I also think, as I was mentioning before, this really led to email reviews, heavy duty email reviews. One of the things that we did that I think people found most intrusive, exam teams would ask for every email to and from a set of people like the C-suite or the trading desk for a period of time, sometimes as short as a day and read them. And at the end of that exercise, they knew who the people were, they knew how they did business, they could form a better assessment of what they were up to and who they were. And rather than the outward impressions that those people chose to convey. And I think it was a great tool, made people crazy against the [inaudible 00:58:51] because they felt it was very intrusive. And in retrospect, if somebody were reading my emails like that, I'd find it intrusive as well.

Kenneth Durr:

So, going back a bit, this informal risk assessment sounds like it's just sit around a table and saying who do you think is a problem or who might be a problem? Is that what it was?

John Walsh:

Well, in its pure state, the exam program had two kinds of exams, routine exams and cause exams. And again, in its pure state, a cause exam was purely reactive. In other words, something came to your attention to make you believe there was a violation, and you went out and you'd looked for that violation. And routine exams were just general, you'd go through and check things.

Kenneth Durr:

On a cycle?

John Walsh:

Yes, generally on a cycle. And actually my first project in the new OCIE was I collected a sample of exams, including all the cause exams that had been done in a particular period of time and a bunch of routine exams and compared them and said, "What's one, what's the other and what are they doing?" I had boxes of exam reports, because it was all in paper in those days, everywhere in my office and it was actually a great exercise for me because it really just got me way deep into the exam program and who people weren't. I'm calling people, "Hey, remember that exam you did a few years ago?" [inaudible 01:00:32]. "Just out of curiosity, why didn't you look at X, Y, Z?"

And so, it was a great exercise, but that was the pure state, cause and routine, then the effort was made to migrate to enhanced risk based exams. And Gene Gohlke led this for the 40 Act, and Maryanne [inaudible 01:00:57] led this for the 34 Act. And a lot of what they did ended up in the public sector, I know Jane put a lot of stuff up on the web, Maryanne actually ended up issuing a joint public statement with the New York Stock Exchange and others. And so, you can actually go and see some of what they had to say, but the effort was to say, "We're not just going to react, we need to think where are the risks and how can we assess them?" And it often involved going into a firm and saying, "We're going to look at the same criteria in every firm." And say there, and I forget how many there were, but let's say there are 20 criteria. So, you would go in and you would say, "Well, we're going to look at criteria 1, 2, 3, 4."

Well, there was some pushback from the examiners on that because they're going, "Look, I'm looking at these 20 criteria and I'm not finding anything." And the answer was, "Well, what we're trying to do is to get a defined set of risk assessments so that we then can take, say, category one, pull out category one and say, okay, we did X number of exams this year and how did everybody do in category one?"

It was kind of clunky and I think today, hopefully it's a lot easier to do this stuff with the kind of data and electronic exam records and things like that. Remember all of this is being done manually, which made it harder. But that was, I think, a major initiative of the program to think through, "Well, how can we really assess the risk?" And importantly assess the risk not a known fact, because once it's a known fact, well sure you can assess the risk. You can say, "Well, here's this presenting red flag, what does this mean? Does this require inquiry?" How do you assess the risk of a risk you don't know? And that was really the issue. So, when I talk about impressionistic to more formal, that's what I'm talking about.

Kenneth Durr:

Okay, yeah. So, you're describing the development of the risk based exam program that came in the 2000s. Okay. There

John Walsh:

And again, I'm sorry, I apologize for interrupting. And I do want to emphasize, there had always been risk in the program, people had always considered risk. And I don't want to suggest that, gosh, one day somebody woke up and said, "Hey, let's think about risk." It had always been there, the question is not did it think about risk, the question is how did it think about risk? And more importantly, how did it formalize the process to think about risks that it didn't know about before it found evidence that there was something there that warrant an inquiry?

Kenneth Durr:

Right. The nomenclature was big back in the time though, the risk based, it was kind of new.

John Walsh:

Well, I learned from my time in public service that there are people who become hysterical over everything. There was hysteria over risk, and remember speaking at conferences trying to explain, and in one conference some guy stood up and started heckling me about risk and I'm like, "Okay, carry on." And I remember someone who's actually a partner of mine now at the law firm, was at that conference, he came up to me, and he said, "That guy was heckling you." And I said, "Yeah, it's his right. He's a citizen, I'm with the government, so what the heck?" Well, no, and I apologize, I take that back, it was not about risk, it was about asset verification. But yeah, people get hysterical over these things, it's pretty amazing.

Kenneth Durr:

Yeah. So, in short, what was the complaint? What did people take umbrage to?

John Walsh:

I think that the most important thing was that people felt, correctly or not, that by identifying risks as opposed to just routine surveillance, the exam program was beginning to shift away from kind of everyday check the box oversight to more of an enforcement approach where you're actually focusing in on issues. And I've always thought you needed to have a routine program, you needed to have both routine oversight because you need a mechanism for looking for the risk you don't know about. And the program always had cause exams, it always had a reaction to presenting risks. It's just the way I would describe it is we wanted to become much more sophisticated in the kinds of things that would warrant a special response, like a cause exam in the past. And much more sophisticated and systematic in how we did the risk assessment for risk we didn't know about and what I would call a routine exam.

Kenneth Durr:

Okay.

John Walsh:

And really, it's funny when I think back to it, oh my gosh, you'd go to conferences, there were editorials, and everybody was just outraged about [inaudible 01:06:31].

Kenneth Durr:

- a congressman after the SEC on this, Vito Fossella.

John Walsh:

Yes, Mr. Fossella, Congressman, he represented Staten Island, he's still active, I understand, in Staten Island politics. In fact, I think he might be, I forget the title, it's not bureau, but he's like the president of Staten Island within the larger New York City area and I forget what it's called. To tell you the truth, I totally understand what he was doing. He represented Staten Island, there are a lot of people on Staten Island who work in the financial sector, and many of them in what I would characterize as middle management. Responsible positions, managers, professionals, but the people who probably, more than anyone else, felt under threat by examiners. They were the ones who were going to be called in and said, "How come we got this deficiency?" And I think the congressman sort of acted out their concerns and also by standing up for them, he did what a congressman should do.

He was taking on the part of the federal government that was most worrisome to his constituents, just as you can go out West and there are congressmen out there who take on the Bureau of Land Management the same way that Congressman Fossella took on the SEC exam program. And that's what the constitution's all about, that's the checks and balances. And the crazy thing is, as I recall, and I may be wrong about this, I don't think so, I don't even think he had any formal authority. I don't think he was on any of the oversight committees or anything like that, he was advocating for his constituents, and he did a good job of it.

Kenneth Durr:

[inaudible 01:08:25] was going to read their emails, I guess.

John Walsh:

Yeah. Laurie Richards and I spent some quality time in his office listening to him, and he had things to say to us. But he did, I think, and you mentioned earlier, was more formality wrapped around the sweeps, yes. And as I think about it, I believe it was his efforts that led to a lot of that. But checks and balances, that's what it's all about, he's represented by people we were examining, and he made darn sure both we and they knew that he was watching.

Kenneth Durr:

And a very different kind of response came from the GAO. And talk about the increased oversight that's happening at this point.

John Walsh:

Yeah, GAO, I think has always loved the SEC, I mean, they come back, and they review the SEC a lot. In a way, it's good, I mean, everybody's examined by somebody and just as OCIE or now the division of examinations would go out and look at the people in the industry, GAO had come and examined the SEC and the examination program. And I have to say that I recall one audit, as I recall they described it, in particular, that was meaningful to me. And we were in a conference room, I forget if it was at GAO or the SEC, and the senior manager of the audit said, "I totally get what you're trying to do with these risk based exams. I get it, and I respect it. I just don't see that you have the risk targeting methodologies in place that you need to make this work." And he was probably right. And the more I thought about it, that meeting is probably, and

I think I was just saying this a few minutes ago, that converted me to the view, "We don't want to give up routine exams, we need routine exams."

And I even think I talked earlier about random exams, random sampling, which if it had worked, would've been both a test for the methodologies we were using across the board, both risk-based and routine. And also, would've been a method for finding the things we didn't expect to find, which, again, is always, "How do you know what you don't know?" And one way is to look in places you don't expect you don't know anything about. And that was a GAO comment, and I think it's a pretty good one. If you're going to have a risk-based program, you're betting on your methodology and how do you hedge that bet? And I said then and later, I'm all in favor of risk-based, but we got to hedge the bets. We can't put everything into one methodology. And that came out of GAO, but they studied all kinds of different things, and they had good comments. We got to know the GAO examiners, just like people get to know the FINRA people who are assigned to them and things like that, and they had a lot of good comments.

Kenneth Durr:

One other landmark from that period, the compliance rule comes in, and we talked about your working with the rule makers. What was OCIE's put on that one?

John Walsh:

Well, I think OCIE, we felt it was great, I think we both institutionally and individually were really gung-ho and in favor of it. And I really applauded the people who wrote that rule over in investment management, FINRA, of course, did something similar for broker dealers. And that was really a huge step forward. And I think, actually, if you go back and you were to reread the release, you'll see it came out in sort of an atmosphere of crises where people are saying, "Well, what are we going to do? How are we going to prevent these kinds of problems from arising in the future?" And the idea of taking what was already done, a fairly mature type of idea, this internal compliance and saying, "Well, let's go with this, this seems to work and let it run." I think was really a great idea. I think everybody should have a three by five card on their desk that says prevent, detect and correct. And that was really the philosophy of the compliance rules. So yeah, it was a really good thing.

Kenneth Durr:

Okay. Well, speaking of atmospheres of crises, we get to the-

John Walsh:

I'm going to stop you for a moment. I bet I know what's coming next.

Kenneth Durr:

I was going to talk about the Great Recession.

John Walsh:

Okay.

Kenneth Durr:

Kind of get into things that way.

John Walsh:

Okay.

Kenneth Durr:

When the economy tanked and the headlines are so bad, was that something that OCIE took a look at and said, "Okay, do we need to recalibrate in a time like this?"

John Walsh:

Yeah, I think when you look at what happened in the great financial crises and the great recession, I think everybody was gob smacked. I mean, there's just no question. Across the financial sector, across the business sector, Congress, for example, I think did a really smart thing by setting up a bipartisan Commission. The National Commission, which issued a, I think, fabulous report, both in the majority and in the minority views, it's a good exposition on what happened. And there were a lot of other investigations as well, and there's just no question that the exam program had to sit down and think really hard, "What do we need to do differently to respond in this environment?" And there were some weak points, rating agencies, for example, how do we oversee rating agencies?

And before that time, there had been some oversight of rating agencies, but because some had been registered as investment advisors as I recall. And how do you look at the connections between registered entities and unregistered entities? And a lot of what actually happened that was really destructive took place outside of registered entities. And then the question was, contagion. If you talk with [inaudible 01:15:43], and I don't know if you are, if that's part of the project, Mike will gladly point out that no one subject to the net capital rule blew up, it was the other entities that blew up. And so, yeah, did people make a hard look? Yes, but at least initially, I would say the first year or two in just a crisis atmosphere as rushing to try and put out the fires and figure out what needed to be done immediately.

Kenneth Durr:

And then the Madoff scandal hit.

John Walsh:

Yes, I have heard that name before. And again, not to tell war stories, and I won't say who the other person was, but I'm walking down a corridor and someone, who had some importance in the agency walks up to me and says, "John, do you know Bernie Madoff." And I said, "No, I don't." I said, "I think I've heard the name, but I've never done anything with them." And she goes, "Good answer."

Yeah, I actually feel that the Madoff scandal, and again, this goes to the narrative, the Commission report that I was just talking about, it's like, what, 600 and something pages, in depth analysis. Do you want to guess how often it mentions Bernie Madoff in its assessment of the financial crisis? My recollection is none, not once. And that was a painstaking assessment through mortgage origination, through securitization, through distribution, through you name it. And so, I think Bernie Madoff was someone that people could understand, again, mortgage origination that was inconsistent with the originator's own compliance standards. Boy, what does that mean? Bernie Madoff stealing money from his friends and family, I can understand that.

Kenneth Durr:

It's a story.

John Walsh:

Yeah, it's a great story. Understand that.

Kenneth Durr:

It's the story.

John Walsh:

Yeah, it's a great story. It's a great story. I think it had a huge impact on the SEC because we really were, as an investor protection agency, we were worried about fraud, and we were an anti-fraud agency. And here's one where somebody was running a big fraud and for a long time got away with it.

And so, I think it had a big impact on us. I think I've always felt bad for the folks who were doing exams where they were doing their procedures, they were looking carefully at the things they were supposed to be looking at. And including one exam, I know, where they could tell something was wrong and they were saying, "How is he... There's something wrong here." And they were doing these very sophisticated tests of looking at trading. Is he front running the order flow through his automated? And things like that.

And unfortunately, if they'd just stopped and said, "Is it possible the whole thing is a fraud?" It would've been different. And I feel bad for them. And boy, I spent a lot of time... When I say GAO came to see us, the various Commissions came to see us, the investigative committees on Congress came to see us. A lot of people came to see us to comb through what happened.

And my position always was, we never did see, at all, any kind of misbehavior by the staff. We never saw anyone cutting corners. We saw people applying the procedures that they thought were the right procedures to apply.

Now, in the event, they didn't ask a question that unfortunately could have been asked. And our job, and I think going forward was, let's make sure people ask the questions that needed to be asked. But I had total respect for the people who did the reviews and actually found myself in more than one conference room defending them, saying, "Look. I understand, but don't take it out on the staff. They were doing what they thought was the right thing to do."

And they did. And I'm really pleased. There was never any suggestion of misconduct or misbehavior on the part of the staff.

Kenneth Durr:

Right. The big issue is what's the SEC going to change going forward?

John Walsh:

And I went around telling people, I said, "There are two kinds of people in a crisis. And the one kind says, who's to blame? Let's figure out who's to blame. The second kind is what can we learn from this?"

And there were plenty of people doing the 'who's to blame' things, so I decided I wanted to be the 'what can we learn from this?' And I think we learned a lot. I think the exam program learned lot. It's a tough way to learn, but it did.

Kenneth Durr:

Was Lori Richards undertaking any changes during that period, when she's still in the seat?

John Walsh:

Yeah, I think there were really kind of... Yes. Short answer is yes. And Lori, I think there was an immediate response. At a certain point it became necessary for Lori to step back a little bit. And then I was officially named acting director.

But I think from... It's funny. It must have been a holiday party, and I should probably go back and see what the exact calendar is, but I think there was a party of some, and it was a holiday party when I got this word. And I'm like, holy smokes.

And I'm going and pulling people out of the OCIE holiday party or whatever the party was saying, "Hey, you got to come and talk with me. There's something going on."

And from that moment through, I don't know when, maybe two years later, it was crises mode the whole way through.

Kenneth Durr:

What were some of the things happening during the crisis mode? How did it start and how did you work your way through it, if you can give me a sense of that?

John Walsh:

Well, two questions. What were some of the things happening? Major financial institutions blew up and went under, most pulling everyone else with them. Several billion dollars of assets under management were found to be missing, but we don't need to rehearse that. Let's talk about what we were doing.

We looked at, well, what do we need to do here to make sure the exam program can actually function? And I thought, well, there are four things that we can do today that will have long-term repercussions and actually help us address what we're doing. And one was fraud. And we formed an alliance with the Association of Certified Fraud Examiners, ACFE. That's an organization that is dedicated full-time to finding and preventing fraud.

We got a lot of our examiners certified by ACFE. You have to take a test and they're continuing education requirements. I took the test. I was scared to death. I said, "This is the toughest test I've taken since the bar. What if I fail?"

And I actually asked him, I said, "If I failed this test, is anybody going to find that out? Do I get a second chance?" I passed. I'm glad to say I passed. But I think that kind of fraud infused the whole program. And not just in getting people certified, but going out and looking at entities in which exams were done. A lot of exams were done during that time period where the mission that was given to the examiners was, don't worry about this or that. Just tell us, is this entity a major fraud and about to blow up?

And I don't know if you follow, I think this is all in the public realm. I'm pretty sure this was reported at that time. I don't know if it still is. I think they stopped reporting it in the SEC's annual report. But examinations, not finding any violations, hit their all-time high during that period of time. It was like 30 something percent.

And the reason for that was that if your only mission is, are these people a fraud and about to blow up? And luckily, I'm glad to say most financial institutions can pass that test with flying colors. And we had a thing called the Director's Rewards, and I don't even know if they're still given out. But it was an annual event and the Director of Enforcement, and I would go to regional offices and hand out awards for good service.

And I actually gave out a lot of awards for not finding anything. And I said, "Look. It takes a lot of moral courage when the world is burning around you to go into a shop and to say, no. I don't think we need to worry about these people. Let's move on to the next one." And I gave people awards for having that courage and moving on to the next one.

So, there's fraud and expertise. People said we lacked expertise and established a thing called the Senior Specialized Examiner to try and bring some industry expertise into the program. And we did other things, as well, but it was really, what can we do right now to make sure that we're responding?

Kenneth Durr:

There had always been an issue, or at least in the recent past, about the SEC can't pay people enough to bring the real experts, the people who really have this extremely valuable experience on Wall Street. How's the SEC going to get those people in? And how did you do that? How did you get those kinds of people in for the SEC program?

John Walsh:

Well, the goal was... Yeah, you're not going to get a guy or a woman who's making millions of dollars a year managing a portfolio. But they're not the only ones who understand what's going on in the portfolio. And if you can set it up, and I know people talk about the revolving door is a bad thing. And yeah, anything in human society, no matter how good it is, can also have bad consequences. And the revolving door is one of them.

But managed properly, if people want to come to the SEC and learn about the regulator and bring their expertise to the regulator and inform and train people, that can be a really good thing for both sides. I think the senior specialized examiner thing...

I initially said, why can't we have fellows? There's a fellowship program in some divisions. Turns out, apparently, most of those programs are supported by statutory grants. You go to Congress and ask for it, so didn't work for us. But that was the concept. It's a good thing for you and it's a good thing for us. You learn about your regulator, we learn about what's happening in your world.

And you come in for a few years and then you move on.

Kenneth Durr:

Okay.

John Walsh:

And there are people... I'm aware of people who came in as a fellow and said, "Hey, I really like it here," and applied for and became a full time employee of the Commission and are adding value over the long term. So, you have to work around it. Also, you can't compete with what law firms are paying right out of the box.

But if you can get a young person just out of school to come in and start their career at the SEC, and if we -- I almost backslid into 'we,' -- if the SEC does its job and trains them, gives them good experience and inculcates them in investor protection, well that's a good deal, as well, if the time comes for them to take their career off to the private sector.

So yeah, you can't compete on dollars, but there are things you can compete on.

Kenneth Durr:

Where did OCIE put these Senior Specialized Examiners organizationally? Were they in Washington, reviewing what's coming in from the regions? Or how did that work?

John Walsh:

Well, actually the goal was to have them directly involved in examinations, not just reviewing work. And I seemed to recall... Well, there were some in Washington, some in New York. And I think by the time the program was more fully rolled out, I think they're all over the place.

The ones I have seen more recently tend to be in New York and Washington. And I'm not sure why that is, but the goal was to have them everywhere embedded within the programs.

Kenneth Durr:

All right. We got through two of the things you said. There were four things you were focused on. We talked about fraud and expertise.

John Walsh:

Let me see. There was... I think one was verification. Asset verification, which is again, going back to people getting hysterical. People were hysterical about that. I'm not sure why, in the industry. But that was a very simple concept of doing what auditors do all the time, which is if you say you have assets under management, prove it.

And reaching out to firms for them to confirm their third parties, for them to confirm. And then also, and this is one of the things that Dodd-Frank did that I thought was really good. Dodd-Frank, there were some disappointments in Dodd-Frank, but one that I thought that actually made it all the way through the process was an express grant of statutory authority to examine custodians. And there's an exception. You send a confirmation and if they respond and they're regulated by a bank regulator that does it.

But if you need to go and examine them, you can do it. And so, the idea was if it turns out that assets are often a place where they shouldn't be, then the SEC has authority to go knock on their door and examine and say, "What the heck is going on here?" And I think that was a really good thing.

And I have noticed in recent years, the exam program today is publicly reporting the assets that it has verified through this program. And I think that's a really great idea. I think that's a really important statistics to say, we've done X number of exams and had these outcomes. And by the way, we verified umpteen trillion dollars through this process.

And I think probably the fourth was just getting the different offices to work more closely together.

Kenneth Durr:

Yeah.

John Walsh:

And that, I think, was a major step. When we did the priorities, exam priorities in the year that I was acting director, during the setting it up for the fiscal year while I was acting director, I had a round table of the other offices and divisions and said, "Come on in and tell us what we should be looking for."

And IM played an important role. Trading in markets played an important role. And had senior examiners and senior staff from other offices saying, "We may have different boxes in the organizational table, but there's no reason you can't come to a round table and tell us what we should be looking for."

And then I told him, and my expectation is, "When we're done, we'll come back to you. We'll tell you what we found." And so, I think those things, the fraud training and the fraud attention, the senior specialized examiners, asset verification, and trying to break down barriers between the different offices. I think those are things we worked on. And of course, while that's going on, a lot of very, very intense examination work as people are out looking at firms and thinking, 'uh oh.'

I think, who is it, that someone said it's when the tide goes out, that's when you find out who's been... Yeah.

Kenneth Durr:

Right.

John Walsh:

There was a lot of that going on in those days.

Kenneth Durr:

How about retraining, moving staff around? Was this something... Obviously, one of the things that needed to be done was to get more boots on the ground for examinations.

John Walsh:

We had serious talks with FINRA about how we could shift responsibilities around between broker dealers and investment advisors. And frankly, that's just something that we didn't get done during my tenure.

Kenneth Durr:

Okay.

John Walsh:

We had the conversations. We talked about how could we break this up? And one of the things we had on the table was, "Well, should we turn broker dealers below a certain level over to you, FINRA? And you just do them?"

"We don't do them anymore."

And we retain the bigger broker dealers in terms of joint oversight, the theory being that if these really big ones, they could have a systematic impact, even though they're not designated as a systematic entity, but are big enough that they could have an impact on a contagion effect on the market, either starting it or spreading it.

And we talked about it, and I think something like that ended up, but it took a period of time. It took several years to get that done.

Kenneth Durr:

Right. Well, are there any other things we should talk about from your time at the SEC or any other good war stories?

John Walsh:

Well, war stories. I don't know. War story. No, probably not. I'm going to get myself in trouble with war stories. No.

Kenneth Durr:

I don't want to tempt you too much.

John Walsh:

No, no.

Kenneth Durr:

So, did you go to Sutherland right after the SEC?

John Walsh:

I did. As I recall, my last day at the SEC was September 30th and my first day at, then Sutherland, was October 1st. Sutherland is now Eversheds Sutherland, and I have been there ever since.

Kenneth Durr:

And are you doing compliance work mostly?

John Walsh:

Yeah. I would describe it as, yes, it has a compliance theme to it. I serve on executive compliance committees; firms' established compliance committees. I do preventive work, advising people.

Probably the bulk of my work though, is on internal inquiries. Somebody has a compliance problem, and they need an internal inquiry to look into it or defense work when the regulators show up and have an interest in whatever the problem is.

So, I would describe it as soup to nuts, from prevention through you think you have a problem to the regulators think you have a problem.

Kenneth Durr:

Okay. And you've been able to look at the SEC from the other side of the fence. Obviously, it's important for you to know what's going on over there.

John Walsh:

Well, having spent so much time there, like 20 plus years, I still have a certain level of commitment to the agency.

Kenneth Durr:

And what's your assessment from what you've seen? What's been interesting? What's been most... Seems most important about where the SEC has gone recently?

John Walsh:

Well, let me do the good and the bad.

Kenneth Durr:

Okay.

John Walsh:

I'll say the good. I am really impressed with their data and how they use the data tools. Here's a war story for you. When I was acting director, I stopped buying BlackBerrys and I said, "We're not going to buy any more BlackBerrys." And I used the money we saved from not buying BlackBerrys to try and fund some analytics. To say, can we develop some analytics that might help us spot risks or understand risks? And actually, and oddly enough, the stopping buying the BlackBerrys upset people, because BlackBerrys were a status symbol.

Kenneth Durr:

Yeah.

John Walsh:

I'm sure many people who are watching this will say, "What is a BlackBerry? I don't know who BlackBerry is." But the notion that you're taking small dollars out of one account to try and fund some kind of... Today, it is so far beyond that. It's really impressive, and I think that is something where I would give kudos to the agency. They've really... They spotted it. They've invested in it. They're doing it, and good for them.

A bad thing that I would point to, that I'm concerned about, is I think that the compliance program and the compliance role in particular has been pulled too deeply into the enforcement docket. And back in the day when it was written, when was published, I think there was a very clear understanding that that was going to be an examination role. And examiners would have no qualms about writing deficiencies under the compliance rule, good strong deficiency letters, if necessary.

In recent years, it has become more and more of an enforcement program. And I worry about that. I worry that's diluting the impact of the compliance rule, because now the SEC has compliance professionals looking over their shoulder and thinking about personal liability instead of just diving into problems and solving them.

So, there's a good for you and a bad. I would say kudos to the SEC on data. Gosh, fabulous. Keep it up. On the compliance rule, I would say, I sure wish you'd stop citing every violation. Stop citing the compliance rule in every case you bring. Now, if there's some horrific violation, like the CCO who was off in a foreign country for years instead of doing his job, okay. Yeah, sure, I can see that.

Or the CCO who was, herself, stealing the money, yeah. Of course. Of course. But not in every single case, is kind of a throwaway add on. I think that's a mistake.

Kenneth Durr:

So, is the hazard there that compliance will just become part of enforcement?

John Walsh:

Yes. Well, I would put it somewhat differently. I would say the hazard there is that the compliance professional who, like all of us, needs to work in an imperfect world, rather than jumping into a problem and fixing it as much as they can.

Well, to use a narrative image, will stand on the threshold and say, "Hey, could I get... What's my stake in this?"

Not, "What do I need to do to fix this?"

But, "What's my personal stake in this?"

And you're starting to create, I think, bad incentives. So, I would say that's really what I'm concerned with. Yeah, internally. Sure. I think you end up... But look, the exam program has always supported the enforcement program. And it's not, are they supporting it? It's what are the consequences out in the regulated community of their relationship?

And I think it's meaningful to everyone to know that an exam can always end up in an enforcement referral, but it's dysfunctional to have compliance professionals second guessing their personal liability instead of fixing the problems at the firm. And that's why I'm concerned about the compliance role.

Kenneth Durr:

Okay.

John Walsh:

So, there you go. A good and bad. I always spoke up when confronted with things I didn't like when I was at the SEC. I'm not shy about doing it now. But if you're asking, where am I and what are they doing today, I would point to those two things as, gosh, that's great. Needs some attention.

Kenneth Durr:

Terrific. Anything else we should talk about before we wrap it up?

John Walsh:

How do you like being a historian?

Kenneth Durr:

I like it very much.

John Walsh:

Good.

Kenneth Durr:

Sessions like this make it all worthwhile. Thank you very much for the talk today. It's been great.