

SEC Historical Society
Interview with Mary Schapiro, November 2, 2005
Conducted by Kenneth Durr

KD: This is an interview with Mary Schapiro conducted November 2ⁿ, 2005, at her office at the National Association of Securities Dealers in Washington, D.C. by Kenneth Durr. I want to start with your background. I noticed that you went to a small liberal arts school for your undergrad, which is not far away from here.

MS: I went to Franklin and Marshall College in Lancaster, Pennsylvania.

KD: Right. Well I consider that not far away.

MS: It's not too far.

KD: I think it might be a little unusual for somebody coming from your field. How did that experience benefit you?

MS: That's a great question. I actually think the benefit for me of a small liberal arts college was the opportunity to do a lot of things, and be competitive, particularly in athletics, where I wouldn't have been competitive in a big school. For example, I played four years of field hockey and lacrosse, and got to be captain of the team, and do all those kinds of things that, I think, help you to understand and value teamwork and develop leadership skills, at an earlier age. That would not have happened had I gone somewhere where the athletics were much, much more competitive than my Division III school.

I don't want to overemphasize the role of sports, but I think team sports have a lot to do with my ending up where I have, at various points throughout my career. Franklin and Marshall was a great place for me in lots of ways. I had the ability to focus, with the real time and attention of great professors on specific areas of interest, and really drive into those, and get to know them well. I was an Anthropology major; which turns out to be a *great* background for going to law school, a great background for dealing with markets, actually.

KD: Why is that?

MS: I think you learn to understand what motivates people. I studied cultural anthropology, as opposed to physical anthropology. And so when you learn about societies, and you learn about groups, and sects within societies, you understand their value systems, their belief systems, what motivates them. And that's very useful in dealing with participants in a marketplace, the multiple constituencies of a government agency like the SEC, and with people who have competing objectives, generally. And I think it helps you understand what everybody brings to the table, and why they have different perspectives, and then how to try to balance those perspectives to get the best public policy result. So, I'm a big advocate of anthropology as a major, and a foundation, for people who want to go to law school, and people who want to deal in financial markets.

KD: Did you ever tell your colleagues that you were looking at them, perhaps, through an anthropological lens?

MS: No. I certainly never admitted it until I gave the commencement address at Franklin and Marshall a few years ago. I actually spoke to the graduates about how, whatever their particular major, the fact that they'd gotten a great liberal arts education was important for their future success, because they were well-rounded educationally; but that in particular, I found that my anthropology background had been really helpful in navigating through conflicting interests at the SEC, and later at the CFTC.

KD: Great. The best answers are the unexpected answers. I would have thought economics, or something like that.

MS: No, no.

KD: When did you start to get interested in futures, for example?

MS: I can't claim to have ever actually been interested in futures before I landed in it. When I was in my third year of law school at George Washington University, I was doing the usual third-year law student routine of interviewing with private firms and government agencies, and I interviewed with this little agency, the Commodity Futures Trading Commission, at a time when the Hunt brothers were manipulating the silver market. And

this little agency was in the front pages of the newspapers *every* day, and I was fascinated by the David and Goliath story that was there, with this tiny agency and these very wealthy, sophisticated and politically powerful commodities speculators.

And I was fascinated with the whole concept that there were people out there who thought that they could corner a truly international market like silver. And so I when I was offered a job in the honors program at the CFTC as a trial attorney, I jumped at the chance. Again, I think the anthropological perspective on it was very interesting to me. And so I went to the CFTC, and spent a year there, as a trial attorney; and then Susan Phillips, who subsequently became Chairman of the agency, was appointed as a Commissioner. She also went on to become a Governor of the Federal Reserve Board, and now is the Dean of George Washington University Business School, so everything seems to go in a circle.

When Susan was appointed as a Commissioner, and I was recommended to her as a potential Counsel in her personal office. She was later named Chairman by President Reagan. She was really the first woman to chair a financial regulatory agency at the federal level; and I became her chief of staff, and so ended up spending four years at the CFTC in a job that was much too important, frankly, for me to have. She put a lot of trust in me that maybe she shouldn't have, but I grew tremendously with that opportunity. To be that young, three or four years out of law school and chief of staff at a federal agency was pretty heady stuff.

KD: I would imagine.

MS: Yes. And having just a phenomenal time—great staff, very nimble agency, very expert agency, and really enjoyed that a hundred percent. It was a great experience, and she really gave me a great opportunity and truly launched my career.

KD: What kind of work did you do?

MS: Well, as chief of staff and counsel to the chairman, nothing really got to the Commission that didn't pass through my hands. So I was part traffic cop, a legal advisor, in some ways a personnel director. I was the person who dealt with really every issue before it got to the level of the Commission.

KD: And we know how important gatekeepers are.

MS: Yes, gatekeepers are important.

KD: And then you moved on to the futures industry?

MS: I went from the CFTC to be General Counsel of the Futures Industry Association for four years. I did the kind of full range of association work—legal, tax, regulatory, policy,

international. I was, at that time, the one lawyer there. I dealt with the U.S. and international regulators, futures exchanges, dealt with the futures brokerage houses, called futures commission merchants, and had a great time—lots of exposure to lots of issues.

KD: Was there a lobbying component to this?

MS: There was a lobbying component to it.

KD: Something that becomes a pivotal moment—if I'm not mistaken—in your career is October 19, 1987.

MS: Yes.

KD: Tell me a little bit about that day, from your perspective.

MS: Well, actually, much of the futures industry was out in Chicago, at a conference, that still is held there the same time every year, called FIA Expo. It's a large trade show and educational conference for participants in the futures and options industry. And of course, that was the day the market crashed. The dramatic market declines really tested the trading mechanisms of the equity, options and future markets that day. It really did a

lot to set in motion a number of changes to the financial markets which would be studied and debated and discussed very intently over the coming year or two.

The Brady Commission was put together, and did a study of the market break, as we came to call it—although frankly, it was a crash—and a number of changes were made in the regulatory regimes of both the SEC and the CFTC as a result of that. It was a very intense time, yet incredibly intellectually stimulating: understanding what the market mechanisms were that had not operated the way everybody thought they would operate. Everyone thought that “Program trading” was this nearly perfect mechanism for protecting yourself against big market declines. Of course, nobody really had modeled what was going to happen if everybody headed for the door at the same time. And it was a great learning experience as well. But it was the hot seat for the next year, for sure.

KD: How did that affect your job at the FIA? What were you doing?

MS: Well, we were dealing with the Brady Commission; we were testifying before Congress; we were working with the CFTC and the SEC on policy issues. There was just a tremendous amount of activity coming out of that experience: understanding it; and then working to be responsive to the policy makers within the federal government on what kinds of changes to the markets needed to be made. We thought a lot about how futures and equity markets – primary and derivative markets – related to each other, in particular. We looked at what was happening in other countries, to understand whether they had

systems in place, or market mechanisms in place that would prevent a market from declining so dramatically in a single day period.

And as I recall—this is a long time ago now—the Japanese, for example, had price limits on individual stocks. That was something that was seriously considered in the U.S.

Hong Kong closed its market for a long period of time, so there was a lot of analysis as to whether it is ever a good idea to close a market – and if so, under what circumstances.

As I recall, it was pretty universally declared to be a bad idea. But it was something that was entertained briefly, at least, in the United States. So we tried to have a lot of input into the major policy discussions around how to modify the market systems to be better prepared the next time there was an event like that.

KD: Did you take a position on what had happened?

MS: Well we took a fairly free market position. I will say that we engaged a lot in the discussion. There were lots of perspectives to bring and lots of vigorous debate. Getting to the right answers really took a lot of study, and FIA was actively in that.

KD: Did some of your input end up in the Brady Report?

MS: Oh, without a doubt. There was a significant amount of input from the futures industry, much of it through the FIA to the Brady Commission.

KD: There's an underlying issue here, having to do with the interlinking between stocks and derivatives

MS: Well, it's interesting because it seems so simplistic and naïve almost now to look back at those days, and realize that while lots of people understood there was a connection between the derivative markets and the stock markets, I'm not sure anybody had really thought it through, and what the repercussions would be as news ricocheted between those two markets, and whether the futures would lead the stocks down, or the stocks would lead the futures down. I think it was, in retrospect, the first time in many ways people had *really* thought through the linkages that exist between those two markets, and how incredibly and intricately connected they really are.

KD: At heart, is it a matter of one leading the other down?

MS: I think that the conventional thinking at that time is that the futures markets reacted much more quickly and much more profoundly to the news than the stock markets did. Coming out of all those discussions we got shock absorbers and speed bumps, the program trading speed bumps that were put in place after dramatic market declines, and then the re-setting of the levels for program trading to be shut off, and all those kinds of things. A lot of concrete actions came out of that period of time.

But as I say, as you look back on them now, the markets have evolved *so* dramatically. The derivatives are so much more complex now. And frankly, the over-the-counter derivatives market is so huge now, as compared to those days when the derivative activity was really focused on regulated exchanges, with regulated clearing houses, so that it was relatively simple to understand what the exposures were. Now we have this very dynamic and enormous over-the-counter unregulated derivatives market. It's quite a different situation today. And it's interesting to see how the markets react differently today than they did then, because of this much more dispersed market activity.

KD: Was most of the action in Chicago at that point?

MS: Absolutely. In Chicago and on regulated markets.

KD: You mentioned the recommendations that came from the Brady Report, and how those were acted upon. One of the big questions is: who acts upon them? And at this point, the SEC is looking around, and saying: "what can we do to make sure that this doesn't happen again." And the issue comes up of who is going to regulate futures.

MS: Right. Well, there's been a long debate—I guess it continues a little bit to this day.

Virtually from the time of the creation of the CFTC, which was born of a very different time than the SEC, there has been debate about which agency should regulate financial futures. The SEC was really born out of the market decline in the '20s, when there was

obviously a much more devastating impact on the economy from the stock market crash. The SEC was really created as an investor protection agency. CFTC was not created under the same circumstances, and it's always been an agency with a far greater focus on markets as fundamentally sound mechanisms for regulating behavior. Competitiveness and insuring market integrity and competition is much more of a CFTC focus; the SEC focused much more on investor protection. And, as a result of that, these two agencies have not always understood each other very well.

I think I'm probably one of the few people who's bridged both agencies, and I've done it at multiple times in my life. I was a staffer at the CFTC; I went to the SEC as a Commissioner; and then I went back to the CFTC as the Chairman. And so I've seen them both at different points in their development. But really, almost since the birth of the CFTC, the SEC has had a lot of skepticism about this agency, and whether it really understood what it meant to be a tough regulator, and understood that the stock markets should be viewed as pre-eminent, and the futures markets are derivative of the equity markets. And there's always been a tension between the two agencies because they have a different focus. SEC: very lawyer-driven, and legally oriented; CFTC: much more economically oriented, and really much more driven by economists than lawyers.

So as a result, the two agencies have never totally spoken the same language. And when you have an event that requires tremendous cooperation between the two agencies, as you did in '87, in '89, and then smaller events subsequently; they have sometimes had a hard

time breaking through each other's different perspectives to really do things cooperatively as well as they should.

There's been talk about whether the two agencies should be merged; take the best of each. I think there are lots and lots of reasons why it probably won't ever happen—very entrenched constituencies, lots of skepticism of each other, different congressional committees of jurisdiction. There are a lot of barriers to actually merging. I think the answer is really a close and tight cooperation between the two agencies, so that issues don't fall between the cracks. And I think that's how it'll go forward.

KD: Well, what was in place in '87 was the Shad-Johnson Accord.

MS: That's right.

KD: And, if I'm not mistaken, you would have still been at the FIA when David Ruder at the SEC started making noises about wanting to get regulatory authority over ...

MS: Futures—right. I went to the SEC during David Ruder's last year as Chairman of the SEC; so I was there for some of that. And, you're right; Shad-Johnson dictated the terms of engagement between the SEC and the CFTC for a long time. When I went to the SEC, I think I was attractive to the White House for that position in part because I had the derivatives background, and they wanted the SEC to have a more open mind to the CFTC

and its responsibility for regulating *its* markets. If you think about it, at the time, the CFTC obviously had financial futures to regulate - currencies, treasury securities, and stock indices - but it also had a huge portfolio in agricultural products—something the SEC had no experience with—and a growing responsibility for energy products, which of course are now enormous futures markets.

John Shad and Phil Johnson, I think, did a great job of negotiating something that made a lot of practical sense.

KD: When did you hear that you were in the running?

MS: I went to the SEC in 1988. I had a call from White House personnel—I can't even remember exactly—sometime in 1988; it was the end of the Reagan administration, or towards the end. I was General Counsel of the Futures Industry Association. The SEC had a vacancy.

And here were the criteria. They wanted a woman, because there'd always been a woman—or at least there had been three other women at the SEC—never more than one at a time until now. They wanted a woman to replace Aulana Peters, who was leaving. There were already three Republicans on the Commission at that time, so they had to have, because of the requirements that no more than three of the same political party populate the Commission, somebody who was not a Republican. I'm an Independent.

And they wanted somebody with a derivatives background, and I had that. I'd been at the CFTC for four years, and I'd been at the Futures Industry Association for about four years.

So, if those were their three criteria, there probably weren't a whole lot of people in the world who were women, non-Republicans—and preferably not a Democrat, with a background in derivatives. So I fit the bill, I think, for the White House. I was a recess appointment in the fall of 1988. It was, as I say, the waning days of the Reagan administration; there wasn't time to do a confirmation hearing, and so I was put forward as a recess appointee. And then, in the early part of the next year, 1989, President Bush came into office and I was renominated by President Bush for a full five-year term, and confirmed by the Senate. I served a full five years, plus some, and ended up spending about a total of six years at the SEC.

KD: Did you deal with Senator Proxmire?

MS: He left, I believe, at the end of '88, so by the time I had my confirmation hearing in '89, Senator Reigel was the committee chair.

KD: When you came in then, you were working in David Ruder's Commission.

MS: Right.

KD: This idea of getting regulatory authority over the futures market, was that one of the big things on the agenda?

MS: It really wasn't. There was some discussion about it, but it was not—from my perspective at least, unless I was not really observant enough—a big deal. There were still issues that were being followed up on, and of course we had more market issues in '89 that needed to be dealt with. But I wouldn't have said it was the highest priority at the SEC in those days.

KD: How about the fallout from the mergers and acquisitions of the '80s. Was that still working its way through?

MS: Not as much. What issues were we confronting? You're really testing my memory. We were dealing with a lot of resource issues for the agency. Obviously, a lot of issues in my early time there related to the Drexel Burnham fallout, EF Hutton and other firms. There were some very fundamental issues; the problems in the government securities markets, and the Salomon Brothers case. There were a lot of large issues that actually came out of enforcement cases, interestingly, that we were dealing with in those days, as well as the implementation of the SEC's new remedies, including civil monetary penalties.

KD: One of the questions that I wanted to throw in here at some point is, from your position on the Commission, how much of the agenda bubbled up from below, and how much were the Commissioners able to set?

MS: You know it's evolved over time. I think in those days, the agenda was largely staff-driven. But Richard Breeden came in, which was in my second year, as Chairman, and Richard came from the White House, fresh from the S&L crisis, with some very strong views about issues.

Some of Richard's agenda had to be dictated by the events that we were dealing with in the markets, as it should be, in my view. The agency needs to be proactive, but the agency also, importantly, needs to be reacting to what's happening in the marketplace. Richard came in with an agenda to facilitate capital raising for smaller companies, which was a White House priority; but he was also very cognizant of the massive problems in the S&L industry, and had a strong desire not to see those kinds of problems begin to proliferate in the brokerage community, or among other regulated entities for the SEC.

He had a lot of experience with financial markets in related financial areas that I think helped to shape his agenda, and some of the excesses he'd seen in the S&L area became very important to shaping all of our views.

KD: Can you be a little more specific on what those excesses were, and how they might have come to your attention?

MS: Lots of the issues were about accounting fraud; the SEC's focus on accounting fraud really started under Richard's leadership. On the deregulatory side, he had a focus on trying to facilitate, as I say, capital-raising by smaller businesses. But on the enforcement side, I think he was very focused on accounting fraud and really started the agency down that path in a pretty fundamental way. We had our share of insider trading issues, the Drexel problems, issues in the government securities markets and penny stock fraud. Those became big issues for us to deal with from the policy-making, as well as an enforcement prospective. A lot of internationalization was going on in those days too.

You might recall that the Latin American markets were *very* rapidly growing, and increasingly popular for U.S. investors. There were a lot of questions about accounting standards, and why wouldn't the U.S. abandon U.S. GAAP, and go to international accounting standards? The Commission had very strongly-held views about that.

KD: Which were?

MS: Which were that the U.S. had the premier accounting standards, and we ought not lower our standards just to allow multi-national companies from other countries to list on the New York Stock Exchange, for example, and make it easier for them, if the end result of

making it easier was going to be less transparent, less reliable financial accounting. He had very strong views about that. We worked very hard through organizations like IOSCO to further the U.S. view that transparency in financial statements was critical.

Richard had tremendous energy, and the Commission was really involved in a lot of things, for example, as the tax laws changed, we had an increasing focus on individual investors—IRAs, 401Ks, pension plan participation in the markets. A lot of those issues were really just beginning to be the focus of the SEC's attention during that period. So it was a pretty exciting time to be there.

KD: What were the meetings like?

MS: Well, the meetings were interesting. I stayed through all of Richard's term, so I saw other Commissioners come and go during that period. But they were pretty collegial. There were different perspectives, for sure, and *very* different personalities on the Commission. Joe Grundfest, and Ed Fleischman, Phil Lochner, Rick Roberts, Carter Beese—I'm going to leave somebody out in this. We were all quite different but there was a lot of respect among the Commissioners.

And people specialized a little bit, not in terms of being responsible for an area, but people had their areas of focus and interest. Carter, for example, was particularly interested in some of the derivatives issues, as I was, but also 401K issues, and pension

issues. Ed Fleischman was particularly interested in corporate financing issues. Joe Grundfest had a tremendous interest in the intersection of law and economics, and the issues that would derive from that.

I was very interested in enforcement and administrative process and during that period produced a report on improving the administrative process at the SEC, because it was taking us, at the Commission level, really an unacceptably long time to release Commission decisions and opinions in enforcement cases.

KD: Why was the length unacceptable?

MS: It was taking years in some instances. As trite as it is, justice delayed is justice denied. It was really not appropriate for us to take two and three years to hear an appeal.

KD: So you're putting companies in deep freeze, not knowing which way—

MS: Individuals and companies in deep freeze. If we were going to affirm an ALJ decision of a finding of liability, we weren't serving investors by not having taken action quickly. If we were going to reverse a finding of liability, we weren't treating either individuals or companies very fairly by taking two, three, four years to render a decision.

During that period, the Remedies Act passed. The SEC had a lot of new authority to implement and part of the report that we generated dealt with effective implementation of the Remedies Act. The first time for the SEC to have the authority to assess civil monetary penalties, for example, came about during that period. But it was a time when the Commission, I think, operated really quite well, and reasonably collegially, although we had our issues where we disagreed.

KD: So there wasn't a recurring three to two split. ...

MS: No, absolutely not. In fact, there were *very* few split votes, and I would say there were not consistent alliances when there were split votes.

KD: Tell me a little bit more about the task force on administrative proceedings. Were you able to draw from the staff to a large degree?

MS: Sure. I had a staff person in my office—Dan Hirsch—who was the primary scrivener of the report. We worked closely with Enforcement, with the General Counsel's Office and with other parts of the agency to understand the full scope of the administrative process, including the Secretary's office, and to be able to really dissect it, to analyze what was taking so long in each step of the administrative process, and why; and then drive some recommendations out of that, that were very specific to the particular areas that seemed to be most prone to delay and indecisiveness on the part of the Commission.

KD: So you're really doing a management study.

MS: Yes, in a lot of ways it was a time and motion study. A lot of it concerned due process and legal policy. What are the parties' rights in an appeal to the Commission? What does due process mean in an administrative context? What happens when a case is appealed, and what takes so long in the General Counsel's Office; how often are oral arguments held, and should they be held more often; and just really from A to Z of the enforcement and administrative appeals process. What could we do to make it operate more effectively, to give parties better notice of what to anticipate in the process, to make sure we were delivering due process every step of the way.

KD: And, the result?

MS: I was afraid you were going to ask me that, because I should have gone back and refreshed my recollection. The result was a report that was very widely acknowledged as being a great analysis with great recommendations for improving fairness, speed and efficiency. And it's interesting because—I think there are SEC documents to this effect—the process was dramatically speeded up.

KD: Another special project that you worked on was with Commissioner Roberts; you looked at credit rating services.

MS: Yes.

KD: What had changed to make you and Commissioner Roberts think that the SEC needed to take a greater interest in this?

MS: I shouldn't speak for Rick, but we both shared a concern about credit rating agencies, from two perspectives, for me at least. One is that they are gatekeepers to the capital raising process; they're *incredibly* important to our securities markets. They are gatekeepers. And the SEC has responsibility for oversight yet did very, very little to really understand—particularly in those days—how credit rating agencies operated, what kinds of conflicts they faced, what other services were they providing to issuers. Were there conflicts between those services and the rating function? How were the employees of the rating agencies supervised? We had a lot of concerns about that.

The other side of the coin was: it's a very, very valuable moniker to be a nationally recognized statistical rating organization under SEC rules. And we had a lot of concerns about our process for designating a rating agency. In those days—I may get this wrong, but there were only four, maybe five, rating agencies that had been designated by the SEC. To become designated was a process that was not terribly transparent, and there were entities that were clamoring to be in the business, and we didn't have a really good way for them to understand what was expected of them, what were there prospects for

being designated as NRSROs, and it didn't seem to me to be fostering competition in that area particularly well.

So Rick and I both had a lot of concerns about the entire area, and we proposed some rules that the Commission considered in that regard. But it wasn't an issue that a lot of other people seemed to take tremendous interest in until recently. And now, of course, it's a big issue again.

KD: It seems like the influence of Moody's and Standard & Poor's was in some ways a throwback to the old club days.

MS: These are important issues that are still getting a lot of attention now because of their importance to our capital markets.

KD: Another issue was corporate governance. Of course it's always coming and going, but it was pretty hot at that point.

MS: It was very hot at that point. It's hot again now, obviously. One of the areas that was particularly hot at that time was access to the proxy and shareholder proposals. That was the time when the Cracker Barrel decision was issued by the Commission. I actually dissented in a couple of Commission actions—and I was a *rare* dissenter—but a couple of actions in those days, where I thought issues should have been presented on the proxy,

that were deemed to be in the ordinary course of business, and therefore not appropriate for shareholder votes. My views have changed actually a little bit in that way over the last ten years as I've watched how this area has evolved.

But those are very important issues. Executive compensation was a very important issue in those days, as it is today. And the Commission at that time promulgated some very valuable rules for disclosure of executive compensation. And now, again it's being revisited; Chairman Cox has stated it's an area he's got particular interest in, as I guess did Chairman Donaldson. But we focused a lot on executive compensation, and the importance for investors to understand how executive compensation changed in contrast, for example, to stock price; so that investors could understand whether executives were really being compensated for performance—one measure of performance being stock price. So those were interesting—*very* interesting debates in those days.

KD: This is a classic disclosure approach to compensation.

MS: Yes.

KD: I want to get a sense of what the Commission's view was of where it stood between the shareholders and the board of directors. When was it appropriate to become involved?

MS: I think the basic view was that if shareholders sought a vote—or a group of shareholders sought a vote - on a matter that was deemed to be in the ordinary course of business, that that was not an appropriate thing for inclusion in the proxy; but beyond that, issues were. That doesn't tell you very much, because we had lots of debate over, for example, whether requiring a company to do a study of the effectiveness of affirmative action at the company was in "the ordinary course." Is that something an HR department at a company would normally do in the ordinary course of business? Or was that an extraordinary thing that shareholders ought to have the right to vote on? That was really where we had our debates.

And everybody brought quite a different perspective to that. We were sensitive to the need for the board of directors and management to be able to run the company without having to take shareholder votes on lots of issues; you can't function that way. The debates were all about where to draw the line. And those are the debates that continue to this day, frankly.

KD: What about social issues versus economic issues?

MS: Yes, social issues were, I think, ones that were generally deemed more likely to end up on the proxy, economic issues generally more likely not to. But I'm not even sure that's a crystal clear line. They were all considered individually. We took a lot of time to really look at the pros and cons of the individual proposals.

KD: Are you talking about a case by case ...

MS: Case by case. This company's proxy, this proposal—in or out.

KD: So this could be a long-term job, handling these one at a time.

MS: Yes. And there's an argument that the SEC shouldn't even have been in that business. And we had those debates as well. Why are we deciding what should be in the proxy and what shouldn't be? But there was a great reluctance by the companies to let the SEC off the hook, because I think companies felt that the SEC provided sort of a neutral arbiter of what was appropriate for inclusion and what wasn't.

One of the interesting things we did - to go back to our discussion on executive compensation - was propose rules that would require that the CEO's compensation be measured against stock price and an appropriate index of companies.

That concept came back to me, actually, as we negotiated just a couple of years ago the global settlement on research analyst investment banking conflicts of interest. As we and the New York Stock Exchange were working on rules to try to bolster the integrity of research, one of the things we proposed, and is now in the regulatory requirements, is that a company that's going to issue research—let's say a brokerage firm is going to issue

research on Amazon.com; there's a requirement in every research report that the company give a graph of the stock price of Amazon, and superimpose on that graph all of the company's ratings with respect to Amazon, so that you can see every time they had a price target change, every time they had a buy, a sell, or a hold recommendation, as compared to how the stock price was moving.

It's useful to investors, because if you've got an analyst who's saying 'buy' as the stock's going higher and higher and higher, and 'buy' as the stock's going lower and lower and lower; it tells you something about how discerning that analyst was. The idea for that graph came directly from the compensation rules that we did at the SEC, back in the early '90s.

KD: Do you remember where the initiative for the compensation rules came from?

MS: They came from the Corporation Finance Division of the SEC, but I have always thought it was a very effective form of disclosure, because it gave investors some objective measure against which to compare CEO compensation: the stock price, and a recognized industry index for that company, or the S&P 500, or whatever would be appropriate. I've always thought that that was a pretty good rule, and so transported it into the rules on research.

KD: I guess one of the good things about having problems that never go away is you've always got tentative solutions hiding in the closet somewhere.

MS: Right. And a lot of problems never go away, unfortunately.

KD: Who was in charge of Corporation Finance at that point in time?

MS: Linda Quinn, who was a great director of Corporation Finance. And her deputy was Elisse Walter, who is an executive vice-president, here at NASD.

KD: Did you have anything to do with that?

MS: Yes. I had a lot to do with that. She was also General Counsel at the CFTC, and is just a brilliant lawyer.

KD: This gets to something that we should discuss. You've just named two top staffers at the SEC, both of whom are women. Then on the Commission you have the woman's position, as you pointed out. And I think when you came in, the Broderick case having to do with discrimination had just been resolved or was working its way through.

MS: It was working its way through, yes.

KD: Can you talk a little bit about where the glass ceiling was in the finance industry, and in the SEC?

MS: Well it's interesting. I could frequently—this is still the case occasionally, but much less so—be giving a speech in a room of a hundred people, and there wouldn't be any other women in the room. This is back in the '80s; most of the women came up on the legal side of the securities industry. I think that's probably still, to an extent, true now. But what is different today is that even if women have started out on the legal and compliance side of the industry, more and more of them will jump to the business side of brokerage firms than ever used to be the case.

But there were not a lot of women, and I was often in meetings or in forums where there wouldn't be any other women, or maybe just one or two other women. The SEC, in those days, was one of the great places to work where there were talented, creative, hard working senior women. And while there might have only been one woman on the Commission at a time until recent years, there were women in senior positions in divisions, which was great, and was a very important signal to the industry that they were going to have to deal with women as division directors, and chief counsels, and trial attorneys. That was great.

KD: Did it affect the personality of the institution?

MS: I don't think so. I think these were and are incredibly professional, talented people. They took the positions they thought were right. So I'm not sure it changed the personality of the agency very much.

KD: You became acting Chair for awhile

MS: Right. The woman's job: *acting* Chairman. I think there've been three: Laura was acting Chairman after I was and then Cyndi Glassman was acting Chairman most recently.

KD: That can't happen too many more times.

MS: Yes.

KD: Did that change your day job?

MS: It changed my day job for sure. It was not a long period of time, and actually was an interesting period, because Richard Breeden had left; Arthur Levitt had actually already been nominated, so I was acting Chairman, but with a Chairman-in-waiting. And so I knew I had a limited amount of time in that role, and I viewed it as a responsibility to keep the agency operating on an even keel. I did some Congressional testimony and other things during that period, but I really viewed my responsibility as stewarding the agency along the same path that Richard had set it on, until Arthur Levitt came on

board—and just keeping the trains running on time; not to go out and plow a lot of new ground.

KD: Right. Because you'd likely get brought back.

MS: I didn't need to set people off in a different direction when they were just going to be responsible to a new Chairman coming in; it wouldn't have been fair to the staff.

KD: I just want to run through some of the things you did later on in your career. I also want to touch on anything else that you dealt with as a Commissioner at the SEC that you'd like to talk about.

MS: You mean like morning sickness, and all that?

KD: This is right when you're getting nominated to the CFTC, right?

MS: Yes. I don't know how personal I should get in an SEC archive. Arthur Levitt came on board and I stayed for most of Arthur's first year; I loved working with him. My term was up so I was preparing to leave. And I had a call from Bob Rubin, who was White House Economic Adviser, asking me to come over and talk.

I was nine months pregnant. I, in fact, was due the week that I went over to the White House to talk to Bob Rubin. He wanted to talk to me about whether I'd be willing to extend my time in government and go back to the CFTC as Chairman. I was a nervous wreck and he was clearly a nervous wreck when he saw me, because I think both of us thought I could go into labor at any minute. In any event, I jumped at the chance to go back to the CFTC. I'd gotten to know Bob Rubin through the President's Working Group; during that period while I was acting Chairman, we had a number of President's Working Group meetings; and we held very similar views on a number of issues.

And so I was told I was the President's choice to chair the CFTC. It took a number of months to get the nomination out of the White House; there were all sorts of issues with respect to the politics in Chicago, and the politics on the Hill; but I ultimately was nominated, and then got held up in my confirmation hearings a couple of times over unrelated issues. I believe marketing orders for Spearmint held me up at one time, because the CFTC Chairman's nomination goes through the Senate Agriculture Committee, and then I was held up by Jesse Helms also at one point, over an issue he was having with USDA in the Atlanta region, so completely unrelated to me as well. In fact, it was the subject of a cartoon in the *Washington Post*.

KD: You're one of the chess pieces.

MS: Yes. I'm one of the chess pieces - Jesse Helms is playing chess with the Secretary of Agriculture over several appointees. But I was ultimately confirmed as CFTC Chairman, and went over there and stayed for about eighteen months only. I was anxious to get back to the securities industry. I had a great time at the CFTC. We managed the collapse of Barings Bank in the U.K. which had tremendous implications for futures markets because Barings was largely brought down by the trading of Nick Leeson on the Singapore International Monetary Exchange, which was a futures market; and obviously had reverberations in Chicago and New York.

And we had a tremendously exciting time, frankly, managing that. At the President's Working Group meetings during that time, Bob Rubin had since gone to Treasury and Frank Newman was largely responsible for the President's Working Group. Frank made the CFTC the primary agency responsible for Barings. And so we had the support of Main Treasury, the Fed, the Treasury attaches in Japan, Singapore, Hong Kong and in the U.K., and for the CFTC it was a very exciting time to be responsible for something that had international implications. That all worked out extremely well, from the perspective of U.S. markets and U.S. investors.

And the one story I would tell from it is that a lot of U.S. firms had large positions in Singapore, and the Singapore International Monetary Exchange was making a margin call—the clearinghouse was—for significant additional margin on those positions. And the U.S. firms said they would not put that margin money up, that they would rather

default on their positions, unless they could get assurances that the additional funds were not being used to bail out Barings Bank.” In the middle of the night, Singapore time, my staff at the CFTC; including Elisse Walter, who’s here; Steve Luparello, who’s here; John Ramsey, who’s now at Citigroup; and Andrea Corcoran, who’s still at the CFTC; called directory assistance in Singapore, got the home phone numbers of everyone in the book who had the same name as our point person at the Singapore Monetary Authority and dialed every one of them until we got the right fellow.

We found him; we got him out of bed; he drove down to the Monetary Authority; we worked out together a statement that the Singapore government would release, making it clear that no margin payments being put up by U.S. FCs to cover positions would be used to bail out Barings Bank, and would be solely used for the purpose of margining their own positions. We hammered that out; he sent it to us; we approved it. The Singapore government sent it out; we faxed it to every U.S. brokerage firm that had a position; they made their margin calls; and we really averted what would have been a major default of on the SIMEX, which would have brought down that exchange, and had reverberations in Japan where there were large positions; and potentially in Chicago.

KD: How many hours away were you?

MS: We were probably twelve hours away from a very serious problem. But by calling a number of Singaporeans until we hit the right one, using directory assistance, we were

able to get the right person and ultimately the right result. Not very sophisticated, but very effective! Subsequently, we brought all the international regulators for futures markets together outside of London, in Windsor, and hammered out the Windsor Accord that would deal with information sharing when there were very large positions in markets, or changes in positions in markets that really required another country's regulator to be informed about what was going on. And that was a very successful multilateral agreement that a lot of countries ultimately signed onto.

KD: So you jammed a lot into that eighteen months.

MS: Jammed a lot into eighteen months. We brought some major cases that irritated lots of people involving over-the-counter derivatives transactions. But after eighteen months, I was really ready for something different, and this opportunity came up to run a new regulatory group at the NASD, and I jumped at the chance.

KD: Now, something that you had to deal with pretty quickly was what began as somebody noticing the business about not trading odd eighths.

MS: Yes.

KD: Had that come up while you were still at the Commission?

MS: That had not come up while I was at the SEC, but it had come up during the time I was at the CFTC; and when I came here there'd been a group convened by the NASD, chaired by former Senator Warren Rudman, to really look at NASD's operations and NASDAQ's—it was all combined at that time—and how to do a better job of separating market operations from market regulation. And one of the key recommendations of the Rudman Commission was to create a separate entity—NASD Regulation—wholly and solely responsible for regulation of brokerage firms, and oversight of trading on the NASDAQ stock market. The NASD did this because it was under investigation by the Justice Department for the odd eighths, as well as by the SEC for the trading conduct.

So NASD Regulation was created, and I came in as the first head of NASD Regulation, and frankly, the only head of it, because I'm still here. And we rebuilt the regulatory program in pretty profound ways over the last nine and a half years.

KD: What kind of things did you address? What was slipping?

MS: Well, we added a lot more staff and we added a lot more technological capability to do market surveillance. Things we take for granted now really didn't exist at that time—an order audit trail system that's fully automated, a lot of surveillance capability to look for the potential for market makers to be engaged in harassment or collusion—technologies that enable us to determine whether best execution has been achieved, whether trade

reporting has been done in a timely way. We spent hundreds of millions of dollars developing new regulatory technology to oversee the NASDAQ stock market.

KD: Do you have people who argue to leave the regulating to the regulators? To the SEC?

MS: We are a regulator – we are not the SEC, but we are a regulator, nonetheless. I think there was a question at one time whether self-regulation really added value to the market's integrity, and having been a governmental regulator, and a self-regulator, I will tell you that it absolutely does. There are things self-regulators can do more effectively. One of them is dedicate hundreds of millions of dollars to developing very sophisticated market surveillance systems. Government has never really been very good outside of the intelligence and defense area at deploying massive technologies, and that's really what we did. We had the money to do it, we had the flexibility to do it, and we were able to hire and retain the skill sets to do it.

So I think while there was some argument at the time that maybe the SEC ought to be doing it all, my experience of the last ten years tells me that there is an important role for SEC oversight; there's a critical role as well for self-regulation.

KD: So does it feel like you've found your niche, as far as overseeing enforcement and self-regulation?

MS: I love what I do. I loved my time at the SEC; I loved my time at the CFTC; and I love my time at the NASD, to be perfectly honest. And they're all variations on a theme; it's all about public policy, investor protection, market integrity. That's the common theme, I think, in all of those positions. Each entity has done it a little bit differently, but they have all written rules, they've all brought enforcement cases, they all do examinations and oversight. At NASD, we have a bit more flexibility to do some additional things that are also very important, like education and training, preventive compliance assistance for brokerage firms, investor education. But at the end of the day, the common theme really is doing what's in the public interest.

KD: Is there anything we haven't talked about?

MS: I don't think so. We've covered a lot.

KD: You remembered more than you thought you would.

MS: Yes, I wish I'd remembered even more.

KD: Well I appreciate your taking the time.

MS: Oh, it was my pleasure.