FIRESIDE CHAT: THE TRANSFORMATION OF WALL STREET – FEBRUARY 26

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DONALD LANGEVOORT: Good afternoon, my name is Don Langevoort. I'm a professor of law at Georgetown University Law Center and host of the fireside chats of the Securities and Exchange Commission Historical Society. The SEC Historical Society is a non-profit organization, separate from and independent of the SEC. The Society preserves and shares the history and historic records of the SEC and of the securities industry through its virtual museum at www.sechistorical.org. Today's chat will be preserved in the museum so you can listen to the discussion and read the transcript later. Today's fireside chat looks at the third edition of a classic book The Transformation of Wall Street: A History of the Securities and Exchange Commission in Modern Corporate Finance, published by Aspen Publishers in New York. It's author is Joel Seligman, dean and holder of the A.H. Shepley University Chair at Washington University School of Law in St. Louis. Let me give a disclaimer before we begin. The remarks today are solely those of Dean Seligman and not representative of the Society, and our speaker will not be giving any investment or legal advice. I'd like to thank museum visitors, some of whom sent in some questions in advance, and I'll be including a few of these, not all of them, in this chat. I apologize in advance to them because I'm going to be paraphrasing some of those questions in the interest of time and may cut out what they consider some detail. So, welcome Joel.

JOEL SELIGMAN: Good to be with you, Don.

DONALD LANGEVOORT: Let's start off with what the third edition is about. The third edition focuses on Arthur Levitt's chairmanship of the SEC during the 1990's and yours is, I think, a fairly positive, favorable review of Arthur Levitt's tenure. Do you agree with that?

JOEL SELIGMAN: Yes, I do. I thought that it was the longest SEC Chairmanship in history and it had its ups and downs, but I thought he was very, very impressive in his ability to keep the SEC focused on priorities to address a number of serious issues during his time there, to use the bully pulpit with extraordinary effectiveness during a time when the opposite political party was in control of Congress, was probably not adequately funding the SEC, was engaged in legislation that many of the Commission including Chairman Levitt on many occasions viewed as hostile. And in effect, his Chairmanship was a little bit like navigating the rapids, and he did a superb job at it.

DONALD LANGEVOORT: What would you say are his one or two biggest accomplishments during the 1990's?

JOEL SELIGMAN: I think because he was Chair so long, you run through maybe more than one or two, but whether is was focusing on municipal securities, whether it was Regulation FD, whether it was taking a hard look at market structure issues, whether it was a series of issues with accountants, you had a number of different instances in which I thought his Chairmanship was particularly consequential.

DONALD LANGEVOORT: Let me ask you the hard question and I suspect you've been asked this quite a few times in the last year or two. Obviously, the last year or two have brought us a series of financial scandals - Enron, being the most notorious – WorldCom, Global Crossing, Tyco – and this past year, the mutual fund industry exploded in its own set of issues. And a lot of people, they, the SEC, must have fallen down on the job. Somehow , the SEC must not have been policing hard enough in the 1990's because in the 1990's the seeds of all these scandals were planted. What do you say to people who ask that question? Isn't Arthur Levitt's Commission to blame for this?

JOEL SELIGMAN: I think there's a lot of blame to go around. The most important factors it seems to me in the Enron period would include a Commission that was systematically under funded, and by that among other things, I refer to the period from 1995 to 1998 where not one staff position was added to the Commission at a time when activity subject to SEC jurisdiction was absolutely exploding. This meant, among other things, that the Division of Corporation Finance, which plays a crucial role in reviewing document filings with the SEC was not able to achieve its idealized goal of reviewing of Form 10-K every three years, but was ultimately reviewing them about once every six years. Some of the challenges with that Division were compounded by a managerial approach that Levitt did take that may or may not have been his wisest approach, and that was to try to focus on encouraging the largest number of 10-K's to be reviewed by the Division. This to some degree pushed the Division towards quantitative measures rather than necessarily taking on the toughest cases. So you saw for example that if you look at Enron, which you mentioned, the last partial review of the 10-K of Enron before its falling apart, late in 2001, had occurred in 1997, the last full review occurred in 1991, and that was a major concern.

I think the story with other aspects of which you referred to is somewhat different. Mutual funds, I think there was a general belief within the SEC and without of it that the capacity to injure investors was much less there, that because of the principle of diversification that reduced investment bankruptcy risk, they were less vulnerable. I think for various reasons, that Division developed a kind of culture of its own where some have suggested they may have become too close to the industry, some have suggested they may not have worked as rigorously as say the Enforcement Division had done in reviewing products subject to their control. At the end of the day you look at a combination of an SEC stretched very thin, a Congress not terribly sympathetic to investor protection during the late 1990’s, state corporate law and state securities cases which were probably less far-reaching during some of this period, a breakdown at some accounting firms in the integrity of audits, at least in some instances, and correctively, you had the perfect storm which led not just to Enron, but in a much broader sense, to a five-year period in which as much as 1100 earnings restatements occurred, many of which, but not all, were as a result of culpable conduct on the part of management.

DONALD LANGEVOORT: One of the interesting thing in your discussion of Arthur Levitt’s chairmanship is your claim that you think he changed. The person who was sworn in as the SEC Chairman early in his tenure was a very different person from the one who resigned. Tell us a little bit about that.

JOEL SELIGMAN: Well, he had a reputation as a consensus builder. He is charming. He’s very eloquent. He’s someone who inspired friendship. He liked to do things not through confrontation when he arrived, and I think in part because of challenges, either in terms of his relationship with Congress, or with industry, particularly the accounting industry, he became tougher, he became firmer over time. The politics of the SEC, if you will, during the 1990’s polarized to a considerable degree, and he realized that the kind of leadership that the Commission needed was less just quiet and behind the scenes, and more using the bully pulpit and trying to rally the troops, if you will. One of the most interesting parallels in his chairmanship was the difference between his activity with respect to the Private Securities Litigation Reform Act of 1995 and the NSMIA Act of 1996 with the Private Securities Litigation Reform Act he was somewhat more quiescent. It’s in part because he’s not a lawyer, it’s in part because there were serious divisions in the Commission, and I think he learned from that experience that it was terribly important for the SEC to be able to articulate exactly what it would support with Congress to do it ex ante, to do it consistently, to speak with one voice for the institution. And this was an aspect of the change. He became just better at being Chairman throughout his eight years there.

DONALD LANGEVOORT: Give me an example of some of the successes later on that you think came from his learning to be more aggressive.

JOEL SELIGMAN: Clearly, Regulation FD is one that derived a lot of attention. It was one in which he was willing to live with a split vote among the Commissioners. There were moments before the final vote where it might have been three to two, ultimately it was a four to one vote. There were moments when he was excoriated by a number of individuals in the securities industry, certain newspapers, as well. He believed very strongly that selective disclosure was improper, inequitable, should be illegal, in some sense. He took clearly a great deal of solace, if you will, for that view from what he called town hall meetings with investors who simply were incredulous that principles like Reg FD were both in place and being effectively enforced before the regulation was adopted. So this was one where rather than being a consensus builder, he simply said this was a matter of principle. He clearly worked to try reduce opposition. He clearly took seriously comments from industry. He clearly had in Harvey Goldschmid, who was his General Counsel, a superb crafter of the ultimate regulation, but he was willing to push this one through and it's been fascinating. The initial concerns that Reg FD might chill disclosure of information don't seem to have been borne out. The rule is viewed as a quite positive one by many, though not everyone in the security industry today.

DONALD LANGEVOORT: I want to turn to some questions now from, that were sent in by some visitors to the virtual museum. A large number seem quite interested, and I suspect this is shared among a larger group, about the role of lawyers in the recent scandals and where lawyers stand today in terms of the balance between serving their clients and serving some measure of the public interest. The first question comes from Christopher Bonner and he asks you to think back a little bit to some of the history of some of the SEC's interaction with the Bar. I suppose that goes back to the National Student Marketing case, a little bit before. His question is back in the 1980's, the SEC was active in talking about what lawyers professional responsibility should be when they encounter some evidence of client fraud. Christopher points to the Carter and Johnson decision from 1981, and he points out that we're back at this. The Commission last year under the direction of the Sarbanes-Oxley Act adopted so-called up the ladder reporting rules. The Commission is still considering or has on its agenda the possibility of going further. So the question is where has the Commission come with respect to the regulation of lawyers? How do the regulations differ from where the Commission was in 1981?

JOEL SELIGMAN: Let me take you back even further because I think this is one of the great themes of SEC history. The adoption of the federal securities laws way back beginning in 1933 was in a sense consistent with the mores and practices of the best lawyers. It was the notion you wanted to put things in writing. It was the notion you wanted full disclosure. It was the notion that above all else, you wanted to prevent misleading or misinforming investors. Clearly the federal securities laws were drafted by wonderful attorneys such as James Landis and Ben Cohen and Thomas Corcoran with the '33 Act, but more than anything else, the Agency as a culture from its very start practiced law at a superb level, a level which is perhaps best personified by Landis with his insistence from the very beginning of the Commission that the SEC didn't want to put out a rule that couldn't survive judicial review, didn't want to put out a report that wasn't thoroughly based in fact. Now the culpability of lawyers, which is the question suggested by Mr. Bonner became a major issue with National Student Marketing and Carter-Johnson as you suggested. And this set up one of the most fascinating sagas I think in SEC history, which was the relationship of the SEC ultimately to the American Bar Association, which is responsible for the rules of professional conduct. Stanley Sporkin, one of the great figures in SEC history, largely through the Carter-Johnson case, in effect wanted to expand the type of approach suggested by the securities act by which you attempted to minimize or reduce fraud by placing joint and several liability on actors such as underwriters or accountants when they're experts, or even lawyers when they're experts in the preparation of a registration statement. In the Carter-Johnson case, he was particularly emphatic that whether you reviewed the alleged misconduct of the attorneys involved as aiding and abetting or as violation of professional standards. He ultimately wanted to get to a point where when a lawyer become aware of fraud, the lawyer would blow the whistle. And from Sporkin's point of view, this would have led to a reduction in fraud, this would have led to empowering the attorney within the context of dealing with sometimes pretty strong willed managers, such as the CEO in the Carter-Johnson case, to basically say I have a professional responsibility when I'm aware of fraud to report it. Don't go there. Let's rethink this.

Now the American Bar Association and some in the Commission, notably including Commissioner Karmel and others at the Commission level as well, gave great weight to what has clearly been a very significant principle of the American Bar and that's the confidentiality of clients' communications. And what you thought in part in response to the Carter-Johnson was I believe the 1983 adoptions of rules relevant to the confidentiality of treatment, which did not as a ABA matter empower lawyers to perform the kind of whistle blowing role that Stanley envisioned. What's interesting is the complex afterlife of the 1983 ABA rule. By the early point in this decade when the ABA Taskforce on Professional Responsibility, or rather Corporate Responsibility, took another look at those rules. Some 41 states, either on a voluntary or mandatory basis reached a point where a lawyer aware of serious financial fraud has a duty to report. In contrast, the ABA had maintained its standard, and what you saw in affect was where Sporkin in pushing the standard probably wishing in his heart of hearts to get to a mandatory point of view, ultimately helped very long after the initial facts to achieve a consensus which evolved with the recent adoption of new ABA standards that at least there is discretionary power for attorneys to report out, as the current terminology goes. And how much further SEC rulemaking under Section 307 of Sarbanes-Oxley will take this we'll see, but one of the points that I think is terribly significant is serious and fundamental questions at the SEC have a habit of recurring and repeating themselves and one of the great joys of the study of history, is by studying them over time you sometimes see a second, a third, a fourth look at issues and ultimately, hopefully you get them right.

DONALD LANGEVOORT: Let me do a follow up question on that and it's from another one of the people writing a question in, Joel Seidner. You do point in the final big chapter of the book to the Enron scandal and some of the lawyer-related issues, Vincent and Elkins' investigation after Sharon Watkins suggested that something needed to be looked into. Mr. Seidner says that what happened there with Sherron Watkins taking the issue in essence, up the ladder, causing outside legal investigation to be done was pretty much what the SEC so far has asked for, and he seems to make the point in his question that didn't seem to solve the problem. Do you think, and maybe I'm asking for your opinion on this, the Commission ought to go further with respect to its regulation of attorneys or should it take a deliberate approach as you suggested before, realizing this issue's been around for 20 or 30 years and see what each incremental step brings before we make radical changes?

JOEL SELIGMAN: I don't agree that what the SEC has asked for is what occurred in Enron. I think one of the basic criticisms of Vinson and Elkins conduct, at least in the Powers report, was it accepted such blinkers on its ability to study problems that it wasn't able to make the kind of investigation that I think the SEC would certainly want to encourage under its recently adopted rules. With respect to attorneys reporting out, I think the Commission is considering whether a different approach might be able to better support if you will with the standards of the legal profession and that would be somewhat similar to what you see with respect to accountants when you have in effect accountant shopping. There has been a long time in Regulation SK, which will require when an accountant is changed at a time of disagreement that the issuer itself file a report with the SEC explaining the disagreement and the accountant would have the right to comment on it. An approach like that presumably would be one by which the SEC would be notified when there were serious differences between the attorney interpretation of the law and the conduct about to be pursued or actually pursued by the issuer without running afoul of the confidentiality concept that has been so emphasized by the ABA in its adoption of rules historically. That type of approach is one the Commission might reach if it adopts additional rules under Section 307 and at least at the time it adopted its initial set of rules seemed to be the direction they were going.

DONALD LANGEVOORT: Let me switch subjects a little bit and I'm going to continue on with some questions, but you mentioned before and certainly a big part of Arthur Levitt's tenure as Chairman of the SEC in the 1990's was taking a hard look at the regulation of the accounting profession, the audit function in particular. Arthur engaged in a long and somewhat bloody battle on the question of auditors' independence. Patrick Daugherty asks a good historical question. With the benefit of hindsight, should we conclude that the SEC erred in its earliest years by declining to regulate public accounting directly, would we not have had to fight many of the battles and so on in the 1990's had that decision been made back in the '30's?

JOEL SELIGMAN: Well, during the chairmanship of William O. Douglas, there ultimately was a three to two vote with Douglas in dissent that the Commission essentially would look to the accounting profession for the promulgation of generally accepted accounting principles. And it was a decision at the time in part that was based upon how broad the SEC's jurisdiction was, based upon I think some legitimate judgments on the part of Commissioners that this wasn't necessarily the best expertise, based further upon the sense that most accounting principles were technical in nature, that the accounting profession itself could play a very important role in promulgation of principles. The Douglas Commission didn't focus directly on auditing standards, although there were cases that developed within a few years that had the SEC as an enforcement matter look hard at auditing. Now the question, you know, posed is would we have been better off had the SEC taken on at least regulation of auditing directly or indirectly during the 1930's or '40's and conceivably accounting principles as well. And the challenge you always got when the Commission takes on additional missions is one of expertise and one of funding. At the time the Commission had been through an enormous expansion, one of the great, successful start-up agencies, if you will, in the history of the federal government, but by the late 1930's, enthusiasm for the New Deal was waning, enthusiasm for significant increases in Commission staff had declined, and you'd reached a point where there was appropriate anxiety on the part of the three Commissioners who outvoted Douglas that had the SEC tried to take this on they might not have done as good a job as the private industry approach did, they might have found themselves in effect running a kind of halfway house to serving investors.

The significance, when you look at Sarbanes-Oxley, was when you adopt new regulation in a sense of crisis, you tend to get two things that you can't get under more normal events. First you had a hard and very thoughtful look at the very nature of what it means to be a private or self-regulatory regulator. There have been critiques historically largely focused on stock exchanges and the NASD that self-regulation is a mixed blessing, that while it has the great advantages of private expertise that has the further advantage of more people to deal with problems probably not appropriately within the [unintelligible] view of government. There has been a tendency over time to engage in self-interested conduct, there's been a tendency over time not to be as enthusiastic about aggressive enforcement of standards. Something like that clearly was appropriately the basis of sharp questioning of the Public Oversight Board, which by the 1990's was responsible for auditing oversight with publicly traded corporations and their auditors. It was quite sobering that testimony was given in the late winter and spring of 2002 that in the greater than 20 year history of the POB, there apparently had been no adverse report on a public company with a public auditor, that because of the rules under which the POB operated, it didn't have the capacity to subpoena documents, it in fact didn't look at issuers when they were subject to certain forms of other investigations. And against this backdrop, Congress heard further testimony that the POB faced a kind of financing crisis when it had sought to carry on an SEC inspired review of independent standards and some in the accounting industry had threatened to withhold the financing necessary for the POB to function. Congress in response adopted a new kind of private regulator, the PCAOB, the Public Company Accounting Oversight Board. First, and this is dramatically different then any other self-regulatory or private regulator subject to the SEC has a funding mechanism, which is equivalent to self-funding. The PCAOB designs its own budget subject to SEC review. This meant in effect it can act more independently of industry, it also meant that periodic budgetary crises are less likely to occur. Second, in striking contrast to the other self-regulatory organizations under the SEC, the PCAOB's leadership is appointed by the Commission and this again is a device to strengthen the independence of PCAOB over time. Now these and other concepts that were developed against a very full hearing record early in this decade, would not have been apparent or would not have been focused on I'll submit to you by the SEC in the late 1930's. There was less a sense of crisis in accounting and auditing compared to much more banal forms of fraud in the marketing of securities. It simply wasn't a priority. And the SEC as an historical matter it's important to remember, by the late 1930's more than anything else was obsessed with the Public Utility Holding Company Act which restructured the public utility industry which was absorbing much of its litigation energies, much of its most talented attorneys and leadership. Clearly, Sarbanes-Oxley was a powerful reminder that at certain points auditing and accounting standards break through to the top of the agenda and it was against that backdrop, against a sense of crisis in the securities market that had fallen over $8 trillion at certain points that a very new, very forceful direction was developed by Congress.

DONALD LANGEVOORT: Let me continue on with the discussion of auditing. Mike McConnell, another person who has sent in a question, asks you whether what has been done with the creation of the PCAOB is enough. Is it going to create a situation where the audit profession lives up to market expectations given that we are still in a system where auditors are compensated by the companies they audit and have to compete for clients? And then he goes on to ask, and I think this you can talk about with respect to auditing but I suspect we could extend it to nearly all of securities regulation because it's a question that's been bumping around for a good portion of the SEC's history, what about the impact of increasing layers of securities regulation on smaller businesses, whether it's the new accounting standards or the new compliance rules or whatever else. Talk a little bit about both your reaction to where we are with respect to auditors, and then that question of how the SEC over time has dealt with the special problems associated with smaller businesses.

JOEL SELIGMAN: I treasure a story of when Henry Kissinger met Zhaoxing Li in China in the early 1970's and Kissinger asked Zhaoxing Li what his opinion of the French Revolution had been and Zhaoxing Li's response was it's too early to tell, a mere 180 years after the revolution had occurred. When you look at the PCAOB, I think it's way too early to appraise how effective it will be, whether or not it went far enough or went too far, whether it gets the balance just right. History or good policymaking in part has to be based upon consequences and experience, and the PCAOB is still just cranking up. The concern though, articulated in the second part of the question, is a real one and historically has been one that the Commission has struggled with from the very beginning when it adopted diminutive exceptions in the securities act. How does one deal with the reality that SEC regulation costs disproportionately more to small and medium size issuers than to large ones? How do you deal with the reality that as a practical matter the best practices and best standards for large corporations may be so expensive or may be so difficult to participate in for small firms that you may in fact be frustrating capital formation. And the Commission has used a variety of approaches ranging from a significant number of exemptions, lesser standards for compliance, a sense in no-action letters that when you have new firms in an industry there'll be real encouragement of their growth, but it's been a perennial challenge, and what makes it, focusing on the security issuance process for a moment, particularly acute has been considerable evidence that the small and medium size firms that do bear a somewhat disproportionate burden in terms of compliance cost have also fairly consistently been found to have a higher rate of fraud in issuances such as initial public offerings. So the challenge of the Commission is to balance on the one hand a goal or protecting investors from fraud with another goal that's been now recognized statutorily in encouraging capital formation and getting the balance just right is something you never can stop looking at. It changes over time. It's one where after a fraud wave you may want to move a little bit back towards focusing on the investor protection side. It's one where when the costs of new issuances or other aspects of compliance seem to be frustrating the ability of firms to bring securities to market or encouraging them to go private, you may want to rethink your approach. I think it's a terribly important question under the Public Company Accounting Oversight Board to focus on a whole host of new compliance burdens for small and medium size firms. I think as a practical matter, the act was designed focusing on firms like Enron and WorldCom, really multibillion dollar frauds with types of dysfunction that were complex and almost multi variant. The reality with smaller firms is they sometimes struggle with things as simple as how do we attract good outside directors or how do we afford new standards such as Section 404 which will create a potentially quite expensive mechanism for complying with internal accounting controls and certification, and I think whether or not the PCAOB succeeds as much as a lot of us hope it does will turn on its sensitivity and ability to balance factors with these types of questions.

DONALD LANGEVOORT: Let me see if I can jump to a related issue, and this is not a question from any of the visitors to the museum, but I think it builds on what you've just been talking about. A good portion of what the SEC has been dealing with in the last 20 years, and certainly is on its plate today has to do with the rapid internationalization of the securities markets, and we have that same kind of question as we for example radically reform some aspect of domestic securities regulation in the United States. To what extent should that policy choice be extended to foreign firms that have some presence in the United States because they made a public offering ten years ago, or because they decided to list on one of our exchanges? Talk a little bit about how the Commission over time has approached that question of making the United States form of securities regulation fit with what's going on elsewhere in the world.

JOEL SELIGMAN: The immediate backdrop of the New Deal federal securities laws was, among other things, very serious fraud in the sale of foreign bonds, and because of that, the federal securities laws were quite demanding in terms of compliance burdens under the '33 Act, and while they developed new forms over time and while there was some sense that there might be somewhat different disclosure patterns for foreign private issuers, the reality was you started off with a Congress and an SEC which was focusing on how do you best protect American investors. Over time it's become very clear that the reality of protecting American investors is much more complex than protecting them from false prospectuses or offering circulars. By the late 1970's, early 1980's, we were beginning to see a very significant Euro bond market, we were beginning to see an increased number of United States equity offerings being offered in part abroad or solely abroad. And this caused the Commission in the integrated disclosure releases of, I believe, 1982 to recognize there had to be some accommodation to how you raised capital and reviewed filings at the SEC or American investors were going to be deprived of opportunities to invest in securities generated by American issuers, let alone would not have the opportunity to invest in foreign issuers that might be quite attractive to them. The Commission in part in the integrated disclosure process not only developed or at least formerly enhanced pre-existing truncated forms like the Form S-3 and extended the shelf registration process as mechanisms to try to deter, if you will, capital flight and issuers issuing abroad, but also, from about that period onward has coexisted with an increasing level of activity that crosses boarders. And it's been activity in part that you see in purchases of foreign securities by United States investors and vice versa, it's in part been between linkages which are not terribly well developed to date between United States securities exchanges and exchanges abroad, it's in part been focusing on efforts to see if we can better harmonize accounting standards throughout the world and ultimately move towards a single type of registration form that would at least be available to leading, sort of blue chip securities that could simultaneously, in theory at least, be offered not just in the United States and Canada, but in the United States, Europe, Asia, and so on. This is an effort that's very much a work in process. We've learned as we advance that this kind of effort typically begins with idealistic bursts, you know, you see a period where the International Accounting Standards Board is formed, where it's got some very, very effective leadership, where it seems to be developing standards and things like stock options, expensing, which are more demanding than those in the United States, and you sort of grin and you say maybe this is easier than we thought. And then you step back and you realize the funding of the IASB is a lot less secure now than the funding of the FASB or for that matter the PCAOB, that having developed some interesting standards, there seems to be some resistance to them in Europe, that the concept of convergence among disclosure systems throughout the world is not as easy as we thought it would be and that the enthusiasm for convergence particularly seems to emphasized during periods where as a policy matter, we're stressing capital formation and seems to diminish during periods when we're concerned about fraud and investor protection. By the late 1990's, after sustained growth in transnational activity on the part of United States securities markets and our issuers and our investors, one might have foreseen within a reasonable period of time that we would be much further advanced towards some form of international securities regulation, that we would be much further advanced towards harmonization of standards, that we would be focusing hard on how you distinguish securities which would participating in a kind of global way in new international regimes from those that were more purely domestic or local. The Enron, and now if you will, the Parmalat scandals I think very powerfully reminded us that this was a lot harder to achieve than we sometimes wish in our most idealistic moments, that when the rubber hits the road on these type of issues, you're dealing with countries with very different investor communities, very different regulatory structures, very different, if you will, fraud risks, and while this is clearly a direction in which I would anticipate securities regulation will proceed over time, it's going to take a considerable period to get there.

DONALD LANGEVOORT: One of the characteristics of the history of United States securities regulation that in some ways distinguishes it from regimes elsewhere in the world was the choice made in the 1930's to create a federal agency with largely civil enforcement authority over the securities industry. The history of the SEC has been it goes to court using civil remedies and occasionally makes reference to the Justice Department for criminal prosecution. Sarbanes-Oxley to some extent suggests a redirection of that historic emphasis on civil enforcement. One of the people asking a question, Mary McCue says that some say Sarbanes-Oxley has criminalized the federal securities laws. In your view, will criminal authorities assume more and more of what the SEC traditionally has done? And I'll add, is that a good thing?

JOEL SELIGMAN: I hope it doesn't work out that way. I think it's a bad thing, and let me explain why. I thought the real genius of the SEC during the 1930's focused less on civil authority and more on preventing fraud from occurring in the first place. The registration process, the no-action letters, the reliance of self-regulatory organizations, each of these was devices to prevent fraud from occurring at all. I think when you look at the 1990's, the breakdown in part that led to multibillion dollar frauds was based upon dramatic weaknesses in the SEC's pre-review, if you will, of securities coming to market or of 10-K's and so forth. Relying upon criminal authority to some extent, as well as relying on civil authority is kind of trying to deal, you know, with where is the cow after it's fled the barn. The key is more than anything else, you want to prevent fraud from occurring in the first place, and I would much rather focus on the deterrence models that the Commission popularized during the 1930's. When we get to saying, you know, we've got to put everyone in jail, or we've got to bring lots of criminal cases, we're acknowledging that we're not preventing enough fraud in the first place.

DONALD LANGEVOORT: We're at a time where we are seeing more and more criminal prosecutions, Martha Stewart and Tyco and Adelphia and quite a few other companies have generated their criminal trials. I understand what you're saying about the need to regulate prophylactically rather than wait until something bad has happened and clean up the mess, but I'm curious what your reaction is, and again with an historical perspective, on whether criminal prosecutions with the high burden of proof and the complexity that many securities fraud cases generate factually is likely to be a useful mechanism, even with respect to the cleaning up the mess phase.

JOEL SELIGMAN: Well, in a certain sense, perhaps the most important single recent federal securities action, even though it wasn't technically federal securities law was the obstruction of justice case that the Justice Department brought against Arthur Andersen. This was a criminal case in the background in part with the Enron frauds, rather solely the Enron frauds, but this was a criminal that perhaps more than anything else has led to very substantial changes in the profession of auditing, set the backdrop in part for Sarbanes-Oxley and demonstrated how powerful and yet how crude criminal prosecution can be. Clearly it sends a very powerful deterrent message, clearly criminal prosecution can make an enormous difference quickly, but it can't be used that often as a practical matter. One of the things that's been striking when you look at the Enron case in chief were now some years after the underlying frauds were first revealed, were first in an investigatory process in part, we're seeing a lot of defendants, we're probably going to see a lot of pleas before it's all done and what you become very much aware of is by relying as heavily as we have on criminal prosecution, your ability to bring lots and lots of cases is reduced when you deal with complex federal securities frauds such as those in Enron to really investigate them so you can put together the kind of complaint, for example, the kind of indictment that was recently offered up with respect to Jeffrey Skilling takes years. And again, if you look at it in a different way, in terms of the most efficient use of resources, you've got a trade off. Criminal law undeniably sends a very power signal, and undeniably in many instances will encourage very good behavior. There's no question white-collar defendants are signals to boards and signals to managers that they want to be on their best behavior. On the other hand, precisely because it is so expensive and crude a device, I've always favored the prophylactic approach as you put it, trying to see how much fraud we can prevent in the first place. To link this to a prior question, the basic approach of the SEC was by in effect empowering underwriters, empowering accountants, empowering lawyers to do their job to try to prevent fraud always to focus on this notion, let's stop it from getting to market at all. When it gets to market, we can bring the criminal actions later, but by the time we get there, there's going to be an awful lot of harm that investors will have suffered.

DONALD LANGEVOORT: I want to turn to an area that I guess right now is as hot an issue posing the question you've just been talking about – how should we rethink the regulation to prevent abuses from happening, and that's in the mutual fund area. Cathie Saadeh of IA Week asks another historically oriented question. We're hearing right now on Capitol Hill and from lots of investors, a great deal of anger about the mutual fund industry and suggestions like eliminating 12b1 fees, banning fund-directed brokerage, eliminating soft dollars, it's highly emotional and highly contested. And she asks, how do you think this kind of emotional cry for blood demand for regulation plays out? Can you think of situations in the SEC's history, I guess going back all the way to 1933 where regulation has occurred in the midst of emotional, rather than rational times? And would you at least pass historical judgment on how good the regulation has been? Have we tended to over-regulate in reaction to anger?

JOEL SELIGMAN: We certainly do a lot of it. I mean there are really two models for the enactment of federal securities laws and I suspect more generally. The first is crisis reaction and that's really what the '33 Act was, that's what the '34 Act was. You had tremendous investor losses, there were hearings, there were cases which generated and sustained the popular belief that investors had been taken advantage of by frauds. Congress had to do something and they adopted laws, and one of the things that's, you know, a great happiness if you will, when you look at the federal securities laws is they worked as well as they did. The '33 Act was brilliantly drafted, but it was drafted under tremendous time pressure. And the other model which is illustrated by the Investment Company Act of 1940 is less a response to crisis, more a response to consensus building. This was a law that was passed on the very eve of World War II. It was one where some very talented SEC attorneys worked closely with both sides of the aisle in Congress, worked well with the securities, or rather with the investment company industry to try to find common ground. And when you look at these two models, you realize there are strengths and weaknesses to both. The concern that you posed with respect to the crisis reaction is you over-regulation, you overreact, you tend to as a prior question put it, try to criminalize everything and act crudely. On the other hand, the challenge you have when you have more consensus building legislation is you under-regulate, you're too quiescent, you don't address this fundamental questions as effectively as you should. And to give you an issue that hasn't received the kind of attention that it deserves to in the investment company arena, one of the things that's quite striking is that investment companies generally are one of the very few areas subject to SEC jurisdiction where there isn't a real form of self-regulatory or private regulator who plays an important ancillary role to the Commission. The major force, if you will, in the industry is a trade association, the Investment Company Institute and it's very good at defending the interests of its members and that what trade associations are expected to do, but whether it has been as effective as let us say the NASD or we hope the PCAOB will be over time, I think is a fundamental question which deserves to be explored and examined by Congress now at the same time that both Congress and the SEC are looking at specific questionable practices.

DONALD LANGEVOORT: I'm going to come now to a question that may be my favorite of all the ones that anybody's sent in. This is from Ryan McConnell who asks if you are the czar of the SEC, what would you be looking at in terms of the Commission's agenda?

JOEL SELIGMAN: Now Ryan was a student, and he knows that would be a demotion because in my classes I often pose the question if you were czar of the universe what would you be looking at? And I think the challenge before the SEC at the moment is in a sort of post-Enron period, in a period where there has been systematic dysfunction revealed in a number of different arenas, to look deeply enough. At some level, I'm concerned with a very major change in style which has occurred with the SEC over time. During the 1930's, this was an agency which focused on learning the fundamental facts of an industry, publishing detailed reports, holding public hearings, trying to articulate alternative approaches to problems. It was a much more self-consciously engaged effort to look at whichever industry they were addressing in a fundamental way. In more recent decades under SEC chairs of both parties, there's been much more a sense of firefighting. There's been a sense if the immediate issue is revenue sharing on the part of investment companies, we'll try to adopt a rule there, but much less a sense of how do we get to a point where this became the issue. What does this tell us more broadly about the way investment companies are regulated, or the way in which oversight of investment companies is addressed by the SEC and by the industry, and I think that the lack of a willingness in recent years for the SEC to engage in the kind of study that was perhaps most effectively done in 1961 to 1963 in the famous Special Study of securities markets is a very significant weakness. I would more than anything else like to take a tough, hard look at issues such as market structure and market regulations, at issues like the oversight of the mutual fund industry, at issues such as the potential globalization of securities trading and its relationship to the Securities Act of 1933. I think I'd like to, if you will, try to develop the facts before trying to propose solutions, and I think one of the tough questions as we live in a world where the financial press is increasingly vigilant and more short-termed in their attention span, and where Congress tends to be moved most by the type of scandals that are on the front page of The New York Times, for example, is we do we any more have a political culture that can sustain and support the depthful look that the SEC took, has historically taken at problems. I am absolutely convinced that when the Commission has taken this broader and more depthful look it's been at its most effective.

DONALD LANGEVOORT: Well, we're running out of time, but let me ask one last question that makes you turn around, resign your czarship and look backwards a little bit. This new edition of Transformation of Wall Street I think does identify Arthur Levitt as something of a hero in securities regulation. Go back in time over the last 60 or 70 years. Who are some of your heroes in securities regulation?

JOEL SELIGMAN: You know, Don, I don't like to think in terms of heroes. I like to think in terms of how effectively people performed and I like to see them warts and all, if you will. Clearly in the SEC history, there were some very effective Chairs, James Landis and particularly Bill Douglas, during the 1930's were perhaps the two great role models for all SEC Chairs afterwards. No SEC Chair accomplished more on more fronts in a shorter period of time than Bill Douglas. He remains, you know, decades later probably the most historically significant SEC Chair. In the post-World War II period, there have been a number of chairs who performed really outstanding work. I'm very partial to Bill Cary, in part because of his work with Rule 10b5 and with the Special Study, but as you go forward, there have been several really outstanding Chairs who've risen to the challenges of the day. One for example, who I don't think has received as much acclaim as he deserves is Ray Garrett, who was as Al Summer once put it, the reluctant dragon who led us to the unfixing of brokerage commission rates in 1975 and presided over the SEC during the questionable payment period as well. Another who I don't think has received the due he deserves historically was Richard Breeden. Breeden was the Chair just before Arthur Levitt in terms of spawning ideas which have enduring significance, he was a tremendously creative Chairman and he was one who achieved some real success on the budget front. When I look at Levitt, I look at him less as a hero than as someone who again rose to the great challenges of his time. Levitt had as difficult a political context as any SEC Chair during six of his eight years as Chairman, political control was in the rival political party and it was during a period of a bull market when enthusiasm for regulation is considerably dissipated, if you will. That he performed as well as he did was an extraordinarily effective achievement. I'm not going to suggest he performed perfectly. There's never been a perfect SEC Chair, but like Douglas, like Cary, like other if you will, very effective Chairs of the past, he met the challenges of his time.

DONALD LANGEVOORT: Well, Joel, we've run out of time. I want to thank you for being our guest today and remind all the listeners that today's chat is now archived in the Society's virtual museum so you can listen to the discussion and read the transcript and also say that next time, our second fireside chat will focus on municipal securities regulation. Guest will be Christopher Taylor, Executive Director of the Municipal Securities Rulemaking Board and Michael McCarthy, Chair of The Bond Market Foundation. The chat will be sponsored by The Bond Market Association on Tuesday, April 20th, at 2:00 PM. Thanks to everyone for being with us today.