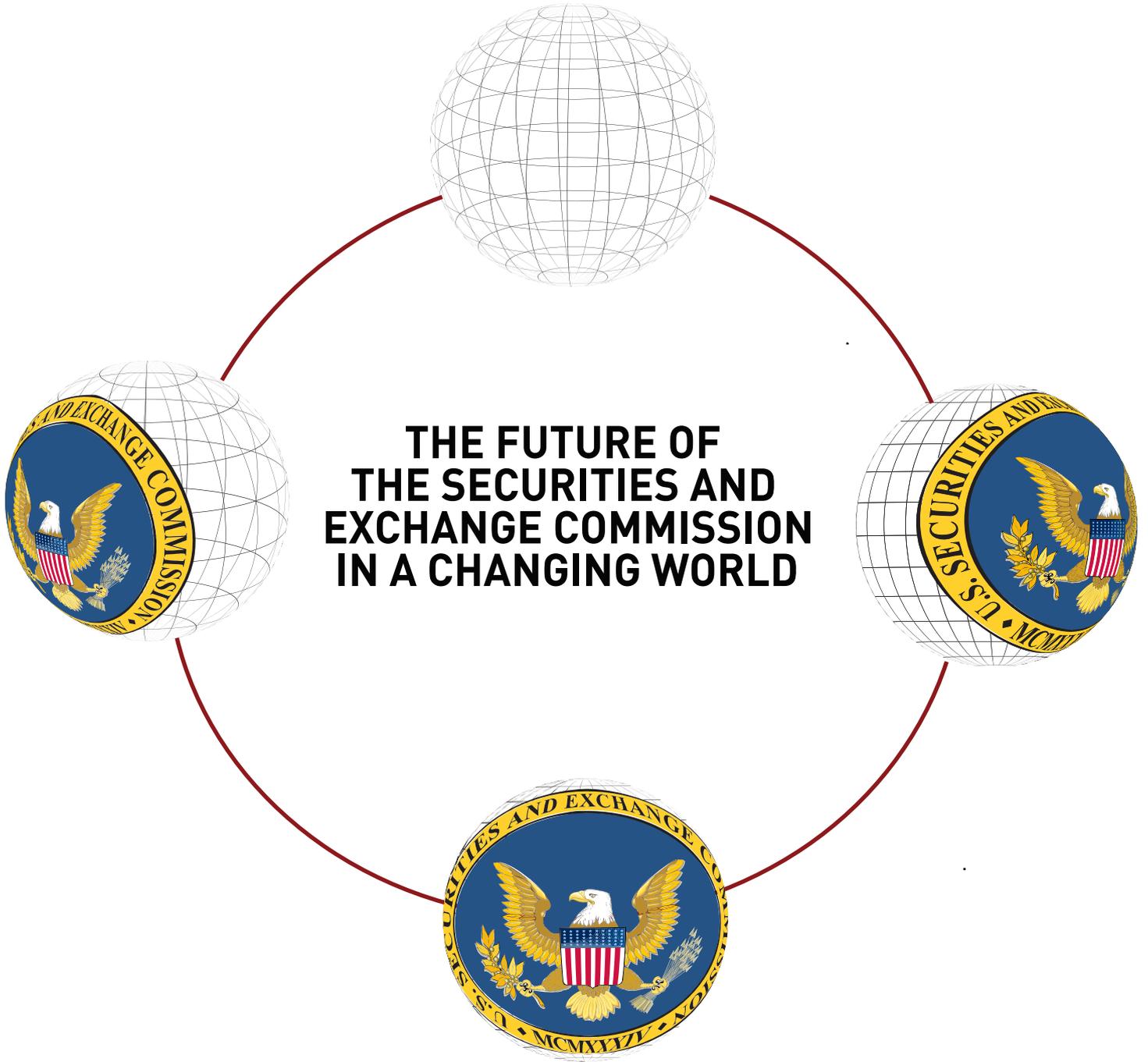


May 1, 2015  
The Center for Strategic and International Studies  
Washington, DC





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This report is dedicated to the memory of Roderick M. Hills, former chairman of the Hills Program on Governance, former SEC chairman, and long-time program director with The American Assembly.

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*A remembrance of Rod Hills by Charles D. Niemeier can be found on page 47 of this report.*

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## DISCLAIMER

On May 1, 2015 in Washington D.C. the Hills Program on Governance at the Center for Strategic and International Studies, the Carol and Lawrence Zicklin Center for Business Ethics Research at the Wharton School of the University of Pennsylvania, and The American Assembly of Columbia University convened an Assembly entitled “The Future of the Securities and Exchange Commission in a Changing World.” This report is the conveners’ best summary of what was said at the Assembly where no attempt was made to reach conclusions or achieve consensus. The participants did not review this report at the conclusion of the Assembly nor prior to its publication.

The participation of those who presently serve in a regulatory position should not be taken as an endorsement of any of the views or recommendations herein.

# AGENDA

## THE ROLE OF THE SECURITIES AND EXCHANGE COMMISSION IN A CHANGING WORLD

Center for Strategic and International Studies  
1616 Rhode Island Avenue NW  
Washington, D.C.  
May 1, 2015

<b>8:15 AM – 8:45 AM</b>	<b>REGISTRATION AND BREAKFAST</b>
<b>8:45 AM – 9:00 AM</b>  JOHN HAMRE GERALD HYMAN  <b>ON BEHALF OF COSPONSORS</b> DAVID H. MORTIMER WILLIAM S. LAUFER	<b>WELCOME TO AN AMERICAN ASSEMBLY IN HONOR OF RODERICK M. HILLS</b>  President, Center for Strategic and International Studies President and Senior Advisor, Hills Program on Governance  President, The American Assembly Director, The Carol and Lawrence Zicklin Center for Business Ethics Research
<b>9:00 AM – 9:20 AM</b>  HARVEY L. PITT DAVID S. RUDER	<b>OPENING COMMENTS: THE ISSUES FACING THE SEC</b>  Founder, CEO & Managing Director, Kalorama Partners Professor of Law Emeritus, Northwestern University School of Law
<b>9:20 AM – 10:40 AM</b>  <b>MODERATOR</b> CHARLES D. NIEMEIER  <b>PANELISTS</b> CATHERINE T. DIXON RICK FLEMING DAVID B.H. MARTIN	<b>SESSION ONE - PROTECTING INVESTORS</b>  Partner, Williams & Connolly LLP  Partner, Weil, Gotshal & Manges LLP Investor Advocate, Securities and Exchange Commission Senior Counsel, Covington & Burling LLP
<b>10:40 AM – 10:55 AM</b>	<b>BREAK</b>
<b>10:55 AM – 12:15 PM</b>  <b>MODERATOR</b> HARVEY L. PITT <b>PANELISTS</b> ANDREW CERESNEY DIXIE L. JOHNSON GARY G. LYNCH	<b>SESSION TWO - ENFORCEMENT</b>  Director of Enforcement, Securities and Exchange Commission Partner, King & Spalding LLP Global General Counsel, Bank of America

<p><b>12:15 AM – 1:45 PM</b></p> <p><b>SPEAKER</b> CHARLES D. NIEMEIER</p> <p><b>DISCUSSANTS</b> HARVEY L. PITT DAVID S. RUDER</p>	<p><b>LUNCHEON: THE SEC AT 81 RODERICK M. HILLS, AN APPRECIATION</b></p> <p><b>A CONVERSATION WITH MARY JO WHITE, CHAIR OF THE SEC</b></p>
<p><b>1:45 PM – 3:05 PM</b></p> <p><b>MODERATOR</b> ANNETTE L. NAZARETH</p> <p><b>PANELISTS</b> KENNETH BENTSEN BRANDON BECKER GREGG E. BERMAN</p>	<p><b>SESSION THREE - REGULATING INVESTMENT MARKETS</b></p> <p>Partner, Davis Polk &amp; Wardwell LLP</p> <p>President &amp; CEO, Securities Industry and Financial Markets Association Consultant, TIAA-CREF Associate Director, Office of Analytics &amp; Research Securities &amp; Exchange Commission</p>
<p><b>3:05 PM – 3:20 PM</b></p>	<p><b>BREAK</b></p>
<p><b>3:20 PM – 4:40 PM</b></p> <p><b>MODERATOR</b> DAVID S. RUDER</p> <p><b>PANELISTS</b> DANIEL L. GOELZER CRAIG M. LEWIS EDWARD GREENE</p>	<p><b>SESSION FOUR - THE ROLE OF THE SEC AT HOME AND ABROAD</b></p> <p>Partner, Baker &amp; McKenzie LLP Professor of Finance, Vanderbilt University Senior Counsel, Cleary Gottlieb Steen &amp; Hamilton LLP</p>
<p><b>4:40 P.M. – 5:00 P.M.</b></p> <p><b>MODERATORS</b> DAVID S. RUDER HARVEY L. PITT</p>	<p><b>CONCLUDING REMARKS: WHERE DO WE GO FROM HERE?</b></p>

# PREFACE

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On May 1, 2015, sixty-five prominent men and women from financial institutions, major accounting and law firms, academia, nonprofits, and government officials—including regulators and Securities and Exchange Commission staff members—gathered at the Center for Strategic and International Studies in Washington, D.C. for an American Assembly entitled “The Future of the Securities and Exchange Commission in a Changing World.”

The Assembly was conceived and initially planned by the late Roderick M. Hills, who organized a twenty person Steering Committee for the purpose of suggesting topics and speakers for the Assembly.

Following Rod’s death, planning responsibility was assumed by project chairs Harvey L. Pitt, Founder, CEO & Managing Director, Kalorama Partners and former Chairman of the U.S. Securities and Exchange Commission; David S. Ruder, Professor of Law Emeritus, Northwestern University, School of Law and former Chairman of the U.S. Securities and Exchange Commission; Mary L. Schapiro, Vice Chair of the Advisory Board, Promontory Financial Group, LLC and former Chairman of the U.S. Securities and Exchange Commission, and Charles D. Neimeier, Partner, Williams & Connolly LLP, former co-chair of the SEC’s Financial Fraud Task Force, former Chief Accountant of the Division of Enforcement, and former board member of the Public Company Accounting Oversight Board.

The participants met in plenary session and participated in moderated panel sessions. They examined policies, approaches, and strategies aimed at improving the effectiveness of the Securities and Exchange Commission in the new financial and global environment. The participants also heard a conversation with Mary Jo White, Chair of the SEC, and conference co-chairs David S. Ruder and Harvey L. Pitt.

This Assembly is dedicated to Rod Hills. Charles D. Neimeier gave a moving remembrance of Rod, which is printed in this report.

The program was cosponsored by the Hills Program on Governance at the Center for Strategic and International Studies, the Carol and Lawrence Zicklin Center for Business Ethics Research at the Wharton School of the University of Pennsylvania, and The American Assembly of Columbia University.

The topics of the discussion panels were:

- Protecting Investors
- Enforcement

- Regulating Investment Markets
- The Role of the SEC at Home and Abroad

Each discussion session began with presentations made by panelists. The questions that were presented to the panelists are listed at the beginning of each section of the report. The names of the participants in the Assembly can be found at the end of the report. We are grateful to each of our presenters for their valuable intellectual contribution and especially to the moderators, each of whom guided a discussion between the panelists and conference participants, on which this report is based. This report is our best summary of what was discussed at the meeting. Throughout the report we have attempted to replicate the comments of the individuals involved without identifying any of them. While the meeting was intended to advance discussion and debate rather than come to specific conclusions or recommendations, individual participants did make recommendations, and it is our hope that the report will be the impetus for further discussion and study and perhaps action by the SEC itself.

The text of this report and other related material, is available on the web sites of the three cosponsoring organizations. The web addresses are listed on the back cover of this report. The Assembly co-chairs and cosponsors wish especially to acknowledge the Hills Program's Gerald Hyman, and former SEC Chairman David Ruder who drafted this document.

Neither The Hills Program on Governance, the Zicklin Center for Business Ethics Research, nor The American Assembly take a position on subjects presented here for public discussion. Comments by the panelists and participants were on a not-for-attribution basis. Participants spoke for themselves and not for the organizations with which they are affiliated.

It should also be noted that the current SEC participants in the Assembly did so not in an official capacity but as individuals. Their participation should in no way be construed as an endorsement of this report or its findings by the SEC.

We gratefully acknowledge the generous financial support of the Assembly by EY (Ernst & Young LLP) and The Muriel F. Siebert Foundation.

**Gerald F. Hyman**

Hills Program on Governance  
Center for Strategic and International Studies

**William S. Laufer**

The Carol and Lawrence Zicklin Center for Business Ethics Research  
University of Pennsylvania

**David H. Mortimer**

The American Assembly  
Columbia University

# OPENING COMMENTS: THE ISSUES FACING THE SEC

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## WHERE WE ARE AND HOW WE GOT HERE

The Securities and Exchange Commission has a three-part core mission: protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation.

Significant changes have taken place in the SEC's world during the last two decades. The securities markets have become truly international, and new foreign regulatory regimes have arisen. New, and materially different, alternative investment media have emerged, and the markets for securities have become increasingly automated. Technological change has affected traditional SEC activities not only in securities markets, but in disclosure and enforcement. The SEC needs to respond to and utilize new technology and to anticipate likely future technological advances.

In the Dodd-Frank Act and the Jumpstart Our Business Startup (JOBS) Act, Congress increased the SEC's responsibilities, altered its regulatory structure, and required it to share activities with other agencies.

It has required the SEC to gather information about systemic risk activities and included the SEC Chair as a member of the Financial Stability Oversight Council. It has expanded the SEC's responsibilities regarding credit rating agencies and hedge fund managers, and required it to establish a new system for regulation of security-based swaps. It has imposed upon the Commission the duty to regulate human rights related disclosures.

Congress has also made changes in enforcement deadlines, created several new SEC offices, required twenty Commission reports and approximately 100 new rules, including rules regarding corporate governance, standards for accredited investors, solicitation of private placement investors, and crowd funding.

Congressionally directed Commission cooperation with other government regulators now requires greater SEC cooperation with the Federal Reserve Board, the Department of the Treasury, the Commodity Futures Trading Commission, and other federal government agencies. Regular cooperation with international securities regulation is also expected.

In devising policies for the future, the SEC will need to confront not only the challenges arising from an increasingly automated and international securities environment, but also from its traditional task of balancing the needs of both retail and institutional investors.

It is from this background and shared interest that our colleague and friend Rod Hills proposed that we join him in designing a program and identify thoughtful leaders in their respective fields to come together to examine and discuss the future of the SEC.



# SESSION ONE

## PROTECTING INVESTORS

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The following topics and questions were contained in the agenda for this session.

### DISCLOSURE

- Can technology yield both lucid and comprehensible disclosures that are also detailed and intricate? Can disclosure reform ease regulatory burdens and assure full and fair investor disclosure?
- Should the SEC's disclosure regime be reconsidered? Is greater emphasis on standardization and horizontal comparability of data needed or should more flexibility be encouraged to give a better picture of individual companies? What progress is the SEC's Disclosure Effectiveness Project making in facilitating a comprehensive public company disclosure review?
- How should the Commission react to Congressional requirements that it use its disclosure policy to advance public policy goals not directly related to investor protection?

### ACCOUNTING AND AUDITING ISSUES

- Can global standards setters converge on uniform standards and approaches? What should the SEC's role be in an effort to create worldwide accounting standards?
- Is audit quality being effectively improved by the Public Company Accounting Oversight Board in the United States? Are the SEC and the PCAOB taking effective steps to increase the quality of auditing and the oversight of auditors in other countries?

### CORPORATE GOVERNANCE

- What is the proper level of activity for the SEC in matters of corporate governance? Should the SEC or the PCAOB assume responsibility for various corporate governance issues involving auditors, such as auditor rotation and auditor committee relations? Should the SEC make changes in the rules governing shareholder activists?

### TOPICS DISCUSSED IN SESSION ONE

In this first session the participants concentrated primarily on how to improve the current disclosure regime.

### THE OFFICE OF THE INVESTOR ADVOCATE

The Office of the Investor Advocate was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Its primary mission is to be a voice for investors. On behalf of investors it examines proposed rules, makes recommendations, and advocates for provisions beneficial to investors. In addition to participating in the creation of new rules, it intends to examine the existing rulebook in order to suggest adjustments that will benefit investors. The Advocate makes recommendations to Congress about legislation that would benefit investors. Although housed at the SEC, the mandate of the Office is broad. While hired by the SEC and reporting to the Chair of

the SEC as an independent voice for investors, the Investor Advocate is required to report directly to Congress twice a year, and to send recommendations directly to Congress without any prior review or comment by SEC personnel outside the Investor Advocate Office. The Advocate must also report on products that may be harmful to investors and name financial service providers that are especially problematic for investors.

In its first year, the Office focused on six policy areas. One focus was the structure of the equity markets, through participation in the Commission's Market Structure Advisory Committee. A second focus was on research regarding whether retail investors have left the equity markets and are investing more in real estate, gold, and other areas rather than in securities and, if so, what policies might draw them back into the markets. Given that a large number of investors have chosen to invest in municipal securities, a third focus was the reform in municipal securities regulation being suggested by the Municipal Securities Rulemaking Board (MSRB) and the Financial Industry Regulatory Authority (FINRA). A fourth focus was cybersecurity, urging firms and exchanges to do everything they can to protect the data and assets of investors. A fifth focus was elder abuse, including providing investment advisors and registered representatives better tools to protect clients with diminished capacity. The sixth focus was the area of effective disclosure. The Investor Advocate Office is engaging with the Division of Corporation Finance, helping it to consider changes that would improve the disclosure system for investors.

## **THE DISCLOSURE CHALLENGE**

It is easy enough, noted one participant, to get unanimity around the broad proposition that the SEC's disclosure system has problems, is old, and needs reform. But on closer examination that unanimity begins to fray a bit. The current SEC disclosure system is an American treasure and is probably still the gold standard for securities regulation and disclosure. It requires disclosure regarding offerings of securities. It keeps the public informed about companies' business and finances on both an annual and quarterly basis. The system incorporates a very nuanced set of requirements for both financial and narrative disclosures and contains more disclosure about governance than in any other country. It has been electronic for a long time and contains big data for anyone who wants to mine it. It is administered by a talented pool of specialists within the SEC's Division of Corporate Finance. It is enforced very thoroughly and well by the Commission, by the Department of Justice, and through the actions of private litigants. Nevertheless, the disclosure system has become immense, too complex, perhaps too redundant, not current enough, and in some ways obsolete.

Chair White is committed to reviewing the system and has announced a Disclosure Effectiveness Project. The Project is fine for making small changes, but is not designed for the full-blown review that may now be necessary. If handled internally, the full review would compete with the Commission's other priorities. It would be a long, complicated, and expensive project, and would not be very flashy. A broad mandate may require hiring outside people who would be fully dedicated to the Project, not just the regular staff doing the full review on the side. Many good ideas have been put on the table, but many people are sitting around that table, and they don't necessarily agree. The solutions could require changes in the Commission's own rules and also in legislation. Is this a project the Commission should take on? How urgently? Now or later? With what priority compared to other challenges?

One participant argued strongly against a full-blown review and reform. Changes should distinguish

between things readily susceptible to modification and things which are not, and should start with the low hanging fruit. The SEC staff report to Congress in December 2013 raised provocative questions about the current utility of the Integrated Disclosure System and—especially—of the line item requirements. The Chair’s statement in October 2013 raised questions about whether or not, in an effort to satisfy all constituencies, the Commission has promulgated line items that are obsolete. But there are problems. One problem is to require disclosures that will be considered material and sufficient by both large institutional investors and small retail investors. What does the reasonable investor need to know when buying, selling, and voting securities? Different stakeholders have different priorities and different perspectives. The current system provides a marvelous vehicle for disclosure of just about anything in the world you would want to know about a public company. As a result, there is a possibility of disclosure overload. Members of Congress and different constituencies disagree on the nature of the needed reform. It is extremely important to decide whether or not the content of disclosure as elicited by our rules, by case law, by interpretation, and by staff guidance is ripe for reexamination and, if so, how to tackle such an enormous project.

Another participant observed that the Division of Corporation Finance will focus in the near term on the line item requirements of Regulation S-K and the financial statement line items set forth in Regulation S-X. The lowest hanging fruit apparently is third party financial statements set forth in Regulation S-X, said one participant. Many comments have been provided to the Commission, including innovative efforts to reconcile the disclosure and the management discussion and analysis of the financial condition and operations of public companies prescribed by item 303 with the financial statements and the footnotes that essentially cover the same subject. This information is the meat and potatoes of financial reporting, which is what many investors want to know in making fundamental investment decisions. In addition, quite a few very specific and detailed governance-related disclosure items (including oversight of a company’s accountants and certified public accounting firms) have been added to the disclosure regime after the collapse of Enron and WorldCom, and the passage of Dodd-Frank.

Finally, Congress has directed the SEC to promulgate rules that follow the Congressional blueprint on certain humanitarian and social policy goals in a very prescriptive manner. While extremely laudable, these social issues raise fundamental questions about whether or not the federal securities laws themselves are being used to shine the spotlight on matters that perhaps aren’t central to fundamental investment decisions.

In the opinion of one participant, the disclosure effectiveness project should be trying to ascertain whether line items can be brought to a principles-based analytical focus centered on the definition of materiality and what is important to the reasonable investor rather than a rules-based set of specific disclosures. Should disclosure be governed by specific rules set by the Commission or general principles in which companies use their judgment about what is material to disclose in order to comply with the principles? In all of this, the most important issues to be addressed first should be those within the Commission’s most immediate existing mandate and competence. Looking first at the accounting rules of Regulation S-X, then at Regulation S-K (including its management discussion and analysis provisions), and then at a principles-based analysis with a materiality filter, the Commission should determine what information is material and what need not be disclosed. The Commission should leave to later the larger, more philosophical question of whether it should back away from prescriptive bright-line tests of significance or materiality, and basically untie issuers to use more

judgment on what they think investors would find important in understanding the business and financial condition of the company.

Turning from these items, the participants discussed what disclosure challenges should be addressed and how.

### **FILED INFORMATION**

The first item revolved around the seeming consensus that the rules requiring information to be filed on the Commission's Electronic Data Gathering and Retrieval System (EDGAR) are too long, too complex, redundant, partially obsolete, and perhaps not relevant enough. They need to be reorganized to appeal to the modern reader. The first participant (who had reminded participants of the gold standard of the current system) concurred that the disclosure system can get out of date, leading to volumes of material that are going unread, unprocessed, and unused.

Before suggesting solutions, however, the problem of audience was discussed. Who are the targets for the EDGAR disclosures? What are their interests and needs in disclosure? Are they consistent with one another or are there choices to be made? Only then, it was argued, could we design a disclosure system to address those interests.

### **DISCLOSURE TO INDIVIDUAL INVESTORS OR TO INSTITUTIONAL INVESTORS AND ANALYSTS?**

Two constituencies for disclosure were identified: individual investors; and institutional investors and analysts. Their interests and needs often intersect, but not always. One participant argued that the individual investor is the right target, and that the disclosure system needs to take into account the old fashioned person who wants to do some homework on EDGAR to make an investment decision. Companies should be asked to provide all the material information such an investor needs to make an informed investment decision. The material is now essentially just entered into EDGAR which is available to every investor to slice, dice and triangulate. But based on that target audience, EDGAR needs to be modernized, easier to navigate, and made more user-friendly. In fact, individual investors are not using EDGAR. They are going to the raw company filings required by Regulation S-K or Regulation S-X. But those filings with their mandated forms, are too cumbersome and cluttered for the individual investor. Many individual investors are just going to company sites that provide the desired information and are easier to navigate. So EDGAR is becoming increasingly irrelevant to the decisions of the many individual investors.

Another participant argued that the more important audience for disclosure is the analyst community. Analysts try to mine the data, not only in one company but across companies, and track trends through the full field of open data. Moreover, even from the individual investor perspective, the analysts have a critical role in setting prices that are fair for the market as a whole, including individual investors who are not going to plumb EDGAR whenever they want to buy or sell. Individual investors benefit indirectly from disclosure through the prism of the analysts. Another participant stated that the disclosure should be geared to the analysts and the institutional investors who make the markets efficient, but there needs to be a focus on the needs of the retail investor. So the disclosure should be simple enough to allow analysts to assist retail investors in navigating the system. However,

the analysts aren't concerned about the overload of disclosure or repetition, said one participant. They just want more data, as much data as they can get.

One participant observed that designing the right interface is not the Commission's comparative advantage. Others, like Google or Microsoft or Yahoo, may well be better at that task. The Commission's comparative advantage is in ingesting the information. Other players can focus on how to disseminate it. "Should the Commission try to do both, it will probably wind up not satisfying anyone."

But do the two constituencies have different and divergent needs and desires? There may not be distinctions between the two because most people are investing through a mutual fund or a pension plan. Many institutional investors are just pools of moms and pops.

There was some concern about whether investors are leaving the market altogether, abandoning both individual investments and mutual funds. According to a recent Gallup poll, noted one participant, the number of households owning any kind of security directly or indirectly through mutual funds is declining. Another said that the number of households owning any kind of security continues to trail down. Another participant disagreed. Although individual investors are making fewer and fewer direct purchase of stocks and bonds, they are replacing them with mutual funds and their exposures to securities actually are larger now.

Unexplored, and only briefly mentioned, was the distinction between short-term and long-term investors and whether their interests in the amount or structure of disclosure and investor protection differ. For example, do their definitions of materiality differ, as one participant suggested? Several participants noted that congressional overseers rather than any investors may be deciding what is material.

## **EDGAR REFORMS**

Irrespective of whether the audience for disclosure should be the individual investor or the institutional investor, there was almost universal dissatisfaction with the mechanics of EDGAR. EDGAR is a digitized paper filing system, noted one participant. Its developers decided that EDGAR was going to be a digitization of the existing paper disclosure system. The filing cabinet analogy is very apt, noted another participant. EDGAR is treated as nothing more than a repository for Commission filings in which people can access those filings. It is very hard for even an equity research analyst to use the information in EDGAR in a constructive manner.

Needed now, almost all commentators agreed, is a dynamic system for research and analysis using the underlying EDGAR data but in a new format or with new technology. Two elements were the subject of discussion. First, how should EDGAR be modernized to serve contemporary purposes? Second, should EDGAR's data be available on a specific, periodic basis—quarterly or annually—or on a continuous basis?

Some argued that EDGAR should make new information constantly available. One participant observed that the Commission should do more than tweak and upgrade and slightly improve the paper filing system on the margin. It needs to make a reality out of a truly electronic digital corporate disclosure system. Every company should periodically update its S-K items when there is a reason to change them. The paper age is dead and disclosure at a fixed point in time—quarterly, annually, or a fixed num-

ber of days after a transaction occurs—is not helpful. The system should require companies regularly to update discreet data elements and then fundamentally change how the information is disseminated.

Another participant believed that no progress will be made until EDGAR is abandoned entirely, rather than modernized. EDGAR is based on a paper format surviving from the 80s that none of us use now. Microsoft changes its data every 15 minutes. We need a disclosure system that provides more continuous and immediate data and in a usable, researchable format.

Another participant agreed, stating that the EDGAR infrastructure needs to shift from the filing cabinet model and instead provide a dynamic platform for disclosure.

However, another participant vigorously disagreed with the continual disclosure concept, stating that what is really important is reliable, thoughtful, good data, not continuous disclosure. Reliable quality data is developed through a periodic reporting system. When you have disclosure committees and audit committees, you have disclosure that percolates up through an organization. Most of the quality disclosure we have comes from a very thoughtful periodic system, not a continuous or daily system that is filed into EDGAR. The current system should not be discarded.

## **DISSEMINATION**

But how should EDGAR be retooled to provide a dynamic platform for disclosure? A number of participants noted that the challenges of the current disclosure system go beyond technological fixes. Several possibilities were suggested.

One participant observed that there should be a more simplified initial web page which would be buttressed by additional linked and tiered web pages that, between them, would contain all or most of the data in EDGAR. The collection would allow an interested investor to penetrate the various tiers of linked web pages, to find, and then slice and dice all of the data through a structured set of web pages. But those investors who have no interest in the full array of data could stop at any level.

Another participant advocated for an improved search function for the website by which the investor could enter a question or a key-word and the search engine would produce results. The Commission's Division of Economic and Risk Analysis has begun to develop such an interface that would allow the potential investor to query the EDGAR databases and would deliver the result to the investor's laptop or desktop in some congenial format, for example an Excel spreadsheet.

A third participant observed that Europeans are mandating that retail investors receive from issuers no more than three pages in a prospectus, the most important part of which is a "risk rating number" produced by the issuer in consultation with the underwriter or distributor. We have prospectuses of enormous length that people don't read or navigate. The Europeans allow the investor to compare company to company or issue to issue.

A fourth suggested following the General Electric Model. Working with the Commission, General Electric has designed a layered disclosure mechanism under current rules for both its annual 10-K report and its proxy statements. Core information is provided prominently, with bullets that allow users to link to fuller and more detailed underlying information on financial performance and operational results. This participant observed that EDGAR is outdated and not user-friendly, and would have to be dramatically updated to deliver information across the entire board as GE has done.

# SESSION TWO

## ENFORCEMENT

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The following topics and questions were contained in the agenda for this session.

### SEC ENFORCEMENT

- Has SEC enforcement been sufficiently improved by reallocating enforcement personnel, creating specialized units, establishing the whistle blower program, providing computer processing of tips and complaints, revising internal case management processes, delegating authority to issue formal orders, removing the requirement of prior Commission authorization before the staff can engage in settlement proceedings, increasing use of data analytics to identify potential law violations, and other steps? Should other changes be made?
- Should insider trading be further defined as in Rule 10b5-2, if courts reduce strictness (e.g. *U.S. v. Newman*)?
- Are new enforcement policies (such as broken windows, requiring admissions of wrongdoing, prosecutorial discretion and deferred prosecution agreements, and increasing administrative sanctions) successful? Would other new policies be useful?
- How can the enforcement process be improved?

### TOPICS DISCUSSED IN SESSION TWO

The second session was devoted to the Commission's enforcement policies and operations.

### AN ENFORCEMENT OVERVIEW

The Enforcement Division, now with 1,300 staff members, has undergone “pretty radical” changes in the past five to ten years, with “tremendous impact” on how it functions. The Division now has industry experts that allow it to cover a broader swath of the securities markets and to do so fairly. For example, the Division is now able to use “big data” to help identify insider trading through the blue sheet data it collects and, again using big data, to better assess issuer risk by identifying anomalies in an issuer's financial statements. Its increased litigation capacity has permitted increased aggressiveness. Its whistleblower program has been transformative in supplying information not previously available. The Division has improved its efficiency so that cases move more quickly, and its investigations are conducted with the possibility of litigation from the start. Current investigations take, on average, twenty-two months, so the Commission is considering whether the process can be expedited without sacrificing the protection of investors and whether modifications could help companies and individuals better manage the process, including burdensome and costly document demands.

### INSIDER TRADING

Perhaps the most burning current issue is insider trading in light of the Second Circuit's recent decision in *United States vs. Newman* (773 F.3d 438, 2<sup>nd</sup> Cir. 2014). If the decision survives a Supreme Court review or the concurrence of the other circuits, *Newman* would substantially narrow the re-

quirements for liability. The Commission would not be able to win a case unless (1) the tippee knows of the personal benefit the tipper obtained as result of the tip in exchange for the disclosure and (2) the benefit would be more than the result of a preexisting friendship or association. Not yet clear, even under *Newman*, is whether there must be a full quid-pro-quo between the tipper and tippee. The vast majority of the Commission's cases involve people close to one another, but the Commission still retains the advantage that, unlike in a criminal matter, a reason to know of the personal benefit is enough without proving actual knowledge, so inferences from the relations and the transactions should still be sufficient for liability even under *Newman*. Other circuits seem to be narrowing *Newman* and there are indications that some disagree with the decision and that *Newman* may be "rolled back" by other circuits or the Supreme Court. Congress could create a legislative "fix"—as could the Commission in a new rule—restoring some or all of the status quo ante *Newman*. In any case, the Enforcement Division has now developed increased internal capacity to identify insider trading by mining the billions of lines of blue sheet data it has accumulated for patterns that demonstrate insider trading. The Division can work backwards from the data to identify the particular source—say a lawyer or an investment banker—for information on traders who, operating alone or in unison, are making huge profits. As a result, the number of cases developed internally, rather than through outside referrals, has increased dramatically.

## **PROCESS IMPROVEMENTS**

One participant described the Enforcement staff as extremely diligent, very thoughtful, and almost always trying to get answers in an efficient way, but offered some observations and suggestions that the Division move more quickly, more efficiently, and more effectively. First, the whistleblower program provides a great opportunity to move more quickly through the targeted information it provides and consequently to focus on the critical issues it identifies. Second, the staff should draft narrower subpoenas, including a document preservation request at the very outset. It should not draft a broad subpoena just to protect the availability of the documents and of its rights, without any intention of actually gathering all of the documents it identifies in the subpoena. Third, the Division should subject the process to more sunshine, for example statistics about speed and transparency. Fourth, it should include less hyperbole and inflammatory allegations about violations of law, and it should address mitigating factors. That approach would be helpful in explaining to people who thought they were doing the right thing why the Enforcement Division has determined that a violation has occurred. Fifth, the staff should continue to allow a list of documents that are "scrubbed" without a line-by-line analysis for material that is withheld subject to attorney-client privilege. The staff is later able to request a more detailed real privilege log of a smaller universe of documents, thereby saving much time and money. Finally, the staff should continue to make fewer indiscriminate requests for multiple years of emails without subject matter limitations. More work could be done in that regard. In short the staff should be more thoughtful and creative about data privacy, more thoughtful about targeting information in the hands of privileged custodians, and more thoughtful about narrower time periods. Early conversations with defense counsel could improve the process.

## **SLOWNESS**

Another participant noted that too often the Enforcement staff is sitting forever on old, stale cases of little importance. The staff has too many investigations and is not sufficiently focused on seizing the important investigations and moving them expeditiously from beginning to end. After six or eight years, a case may not matter much anymore. Real-time enforcement would be good for the Commis-

sion and good for those who have to deal with enforcement problems. It would also help to enable companies to resolve certain concerns more pragmatically so that some matters could be disposed of more efficiently without overlooking more important violations. Sometimes a company is prepared to agree that there was a violation, that it dropped the ball, and that it wants to settle. However, more and more times now, the company may be aware of the conduct but disagree, based on the facts and the law, that a violation existed. Those matters tend to drag on with more subpoenas and different theories of the case by the Division as time goes on. Moreover, there seems to be less and less opportunity to have a meaningful dialogue with the staff, especially in the regional offices. Supervisors used to be willing to have those conversations as part of their supervisory responsibilities, but counsel representing the individual or company is now much more reluctant to raise an issue to the leadership itself without involving the staff attorney. That kind of conversation seems now to be seen as inappropriate. It may take a year or more of discussions with the staff before a supervisor gets involved. Moreover, in the past, the Division might claim a violation but issue a kind of “no action letter” in exchange for the company’s devising a program to remedy the violation, with the proviso that the Division would reexamine the behavior in a few years. That solution no longer seems to be acceptable.

It was asserted that the Enforcement Division is trying to do better about disposing of old cases. The financial crisis cases are done for the most part. There are still some cases four or five years old but sometimes there are delays, for example in the production of documents. And sometimes before the original conduct can be resolved, the investigation exposes “new” conduct which needs resolution, or conduct that looks problematic but turns out not to be so. Of course, some cases are important enough to send a message even after four or five years. Meetings with supervisors occur regularly. It is good to have the staff present if only because the staff has more detailed information than the supervisor. It is true that the Division is probably seeking more significant remedies than perhaps it did in the past and so settling may have greater consequences than it did before and takes more consideration. However, the Division often declines to bring cases against public companies when it believes a violation is not significant enough. When it does bring cases, it needs to fashion remedies that also work or apply across the board.

## **CRIMINALIZATION**

Another participant observed that the criminalization of violations bothers judges and juries and that the Commission sometimes faces results it does not like because it encourages the Justice Department to seek criminal rather than civil sanctions. Judges and juries may believe that even when conduct is wrong, or even reprehensible, a defendant should not go to jail for an undefined crime like insider trading. Perhaps the SEC should support statutory definitions of crimes for which it supports incarceration. Even if the statute were not the one preferred by the government, the Commission would have a better chance of prevailing in the cases it does bring, unlike *Newman*. Moreover, the Commission might then be in a better position to deal with the criticism that it brings cases against big companies, elicits large fines that the companies can well afford to pay, while the corporate officers at the top do not get punished. In fact, they retire with large bonuses.

Another participant noted that the absence of a statute prohibiting insider trading had dissuaded other governments from following the U.S. practice. They have enacted statutes that move to a parity of information standard as opposed to conduct under which there has to be a violation of duty of

trust or confidence to gain a conviction, leaving the U.S. as the only market that uses the latter standard. The Commission should get over the concern that since a statute may be too narrow to capture all of the illicit behavior, a common law approach would be preferable. The courts are skeptical about that approach in criminal cases and are simply not going to sentence people on a common law approach, especially one that is constantly changing. We should learn from other markets. In fact, the Commission was not always opposed to a statute. It was Chairman Dingle who opposed a definition in the late 1980s, because he was afraid that if insider trading were defined in law, there would inevitably be loopholes. He believed people would know what constitutes a violation and would work around it. Still, another participant noted, there should be some clarity as to what constitutes the violation if criminal liability attaches to it. If you have a good definition, those who do not fall within it would not be convicted. If you have a leaky definition, you should fix it.

A reply was that the events surrounding Sarbanes-Oxley have changed corporate behavior. Now decisions in corporations are more often made by groups and committees after extensive vetting, so it is harder to identify a particular, individual decision-maker to hold accountable, giving individuals a kind of “process defense.”

## **MEASURING EFFECTIVE ENFORCEMENT**

Turning to a different topic, a participant asked how effective enforcement should be measured. Should it be based on the number of cases brought and the number of convictions? If so, that number could be driven higher by bringing easily winnable but relatively insignificant cases rather than those that raise big systemic concerns of the kind behind the financial crisis. Some big frauds, like those of Bernard Madoff, have been missed. The big fish are hard to beat because they can hire the best lawyers, so if significant rather than minor but “winnable” cases are brought, the numbers for effective enforcement may go down. Should not the Commission concentrate on major problems and try to bring cases that really protect investors? Another participant concurred that the financial crisis, perhaps the most pervasive investor fraud in history, was one in which big fish, primarily securitizers, provided very inadequate disclosure about the risk and the very poor quality of the underlying securities they were selling. The participant observed that failure to pursue the big fish raised questions regarding the adequacy, thoroughness, and effectiveness of the SECs enforcement role.

A reply was that the Enforcement Division is not afraid to take on big cases. It has successfully brought financial crisis cases against many senior officers, including some cases with large litigation risks and substantial headwinds. It takes on institutions of all sizes, including the largest. However, some cases take a lot of resources so the Division has to balance its use of limited resources, the value of prevailing as a deterrent, and the likelihood of prevailing. As to measurement, Congress mandates reporting of the cases brought and won. How to measure effectiveness is a good question. The Division has tried to measure its success in a number of other ways in addition to the ones mandated by Congress. It rates each action from a quality standpoint on a scale of one to five in four different categories: the nature of the investigation, the nature of the conduct, the nature of the parties, and the impact on the market. The rating sometimes entails a subjective evaluation by one person or committee but it is useful on a Division-wide basis and also on a group basis (although regions differ in the cases they raise). A second measure of success is whether the Division is bringing significant cases across the broad spectrum of the securities industry. Is it making progress? Is it sending a strong message of deterrence across the industry? Those criteria are hard to measure especially since the Commission reacts to violations of law so its focus depends much upon what is going on in the securities world.

## **COMMISSION LOSSES**

One participant raised a question about a string of losses for the Division of Enforcement including the Enron case, some jury verdicts, and some administrative law judge rulings, perhaps suggesting an over-aggressive approach.

It was asserted that consistent with not being afraid of big cases, the Division believes that if it is not losing some cases, it is not being aggressive enough. Moreover sometimes it loses the top count but wins others. For example in *SEC v. Life Partners Holdings Inc.* (87 F.3d 536, D.C. Cir. 1996) where it lost the fraud charge it also won three of the fourteen other charges it brought at the same time, including remedies of \$47 million, which bankrupted the company, another \$6 million penalty against two individuals, and the dismissal of senior management. In cases like that, the Division has to decide on a litigation strategy, including whether to bring serious counts it might lose or leave them out. Sometimes it does take on too much.

## **USING ADMINISTRATIVE PROCEDURES VS. FEDERAL COURTS**

Another participant asked about the Commission's choice in bringing cases before the five administrative law judges (ALJs) at the Commission rather than before the many Article III judges in federal courts. Does the ALJ route look like the Commission is selecting a favorable forum and favorable judges?

In reply, it was asserted that the Commission has been using administrative procedures for many years. This is not new, although it has been receiving more scrutiny recently. But under Dodd-Frank, the Division can obtain penalties against unregistered entities and individuals in administrative procedures, instead of just in district court, which is a change. Second, many of the administrative procedures are used for settled cases where both parties agree on the disposition. Under Dodd-Frank, the administrative law judge can provide the same remedies as available in the district court using an easier procedure. Third, the Division has been very successful in district court, winning twelve of the last fourteen cases. There is not a trend of using administrative procedures to avoid the federal courts. In fact, last year a majority of cases were brought in district courts. As to forum selection, the Division looks at each case individually, including whether claims can be brought only under administrative procedures (for example a "failure to supervise" charge) or only in district courts (for example "controlled persons" cases or requests for emergency relief). All those who register as securities professionals essentially agree to be bound by the administrative procedure process and some even prefer that. Fourth, it takes fewer resources to try a case under administrative procedures because they are speedier. That avoids the protracted litigation, faded witness memories, and stale cases mentioned earlier in the discussion. But in other instances, for example if certain types of discovery are needed or a claim of privilege is asserted, there is reason to go to a district court. Fifth, it depends on the complexity of and technical nature of the subject matter of the case. There are a lot of very technical issues in some of the cases. The ALJs have become experienced with those technical issues and are better than other fact-finders in dealing with them, whereas district courts may have expertise in other areas. So the forum chosen depends on a variety of factors like the violation alleged, the remedy sought, the agreement of the parties, the efficiency and simplicity of the procedures, and the experience of the respective adjudicators. However, even in administrative procedures, the Commission cannot choose the particular judge.

## **ADMISSIONS POLICY**

A participant asserted that the Commission's new policy on admissions may be changing the way defendants approach the Commission. Has the new policy been constructive? Has it provided desirable outcomes? Has it prolonged cases? When does the Commission decide that an admission will be required?

The reply was that the Commission believes the admissions policy has been successful, but it is just one remedy in its arsenal, providing an additional way to increase accountability and acceptance of responsibility. So far there have been more than twenty admissions. An admission has to contain certain broad factors to be considered, for example egregious conduct, harm to a large number of investors, risk to the markets, and important messages to the securities industry and the public. Moreover within the particular case, the Division looks at factors like litigation risk (since the Division will litigate, absent the admission), whether accepting the admission is worth doing, and whether the admission will increase accountability. In general the new policy seems to have had a good impact on these factors. The individual defendants don't necessarily have funds to pay for a penalty, but they are admitting publicly to conduct that needs to be dissuaded. Institutions undertake a different calculus, but there too the policy has been successful. There has been criticism about randomness but, again, admissions are just one remedy on which the Division exercises its judgment and discretion, like negotiating penalties.

Another participant criticized the Division for not backing down once it seeks an admission but finds later that it should not have done so and for not negotiating the terms of the admission, arguing that everything should be negotiable. However, another participant cautioned against negotiating the penalties of admissions, observing that the policy does incur some risk, like penalties which some people call "paying ransom" especially if the CEO is named in the proceeding but not charged. A negotiation policy cannot be reduced to a precise formula. Perhaps the Division would be better off with an iron clad policy of not backing off and not negotiating so nobody will accuse it of having used the threat of admissions to obtain a better settlement.

## CONVERSATION WITH MARY JO WHITE, CHAIR OF THE SEC

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The Conversation consisted of questions by Mr. Pitt and Mr. Ruder followed by responses by Chair White.

**Mr. Ruder.** After two years as SEC Chair, what are your general thoughts about your experience so far? What accomplishments are you most proud of and what have been your biggest challenges?

**Chair White.** First, the SEC is a great agency with a spectacular staff and a range of critical responsibilities, quite daunting in comparison with the resources it has to further its mission. We have a staff with expertise and dedication beyond anything I have seen in the government. And it is not easy because no matter what the SEC does, 50 percent of the people will dislike what we are doing, and it's not usually the same 50 percent. I am proud of many things. We have moved some very significant rule-making that was stalled or delayed, for example in money market funds. As you know, we have over 100 rule changes mandated by the JOBS Act (the Jumpstart Our Business Startups) and the Dodd-Frank Act, such as the Volcker Rule, the new credit rating agency rules, and the regime for municipal advisors. As part of our discretionary rulemaking, we have promulgated the SCI (Systems Compliance and Integrity) regulation, which is enormously important for enhancing the resiliency of our market structure. The Enforcement Division has done a great job in different arenas, different ways of proceeding, and different ways of using technology. So too has our exam staff. I am also very pleased that our morale is better. Last year in the annual survey of federal agencies, we had the most improvement in engagement and morale of all the mid-sized agencies.

There are lots of challenges. Finding the space to do everything, whether mandated or not, in furtherance of the SEC's agenda is a real challenge. Resource constraints are a tremendous challenge, as is the current regulatory landscape after the 2008-2009 financial crisis. In this era of systemic risk regulation where does the SEC fit in with the banking regulators? But net/net this is a terrific job and I could not be prouder of the staff and the agency.

**Mr. Pitt.** One of the greatest challenges for the years ahead has been the growing need to coordinate the SEC's regulations and policies with global counterparts. Are there things you would like to do that would provide the Commission with assurances that its rules are being effectively and consistently enforced abroad?

**Chair White.** Following the financial crisis, the number and extent of global participants in international financial regulation, who talk and work with each other, has really increased, a sea change increase. That needed to happen in a global market. The SEC needs to find its precisely right place in that global market. It is a voting member of the Steering Committee of the Financial Stability

Board (FSB) created by the G-20 and is a long-time member and leader of the International Organization of Securities Commissions (IOSCO), the international organization of securities regulators. Because their agendas are so crammed full, I worry that globally the securities regulators are not as strong a voice as they might be if they prioritized a little better. In a number of areas the FSB comes to mind. Within the FSB there are really only about two capital markets regulators and lots of central bankers, and we do see things a bit differently. There should be more participation in the FSB by capital markets securities regulators from around the world. Bringing us all together in a way that did not happen before to share information and risk assessments is working well. Although one size will not fit all, clearly there does need to be some standardization to prevent or limit regulatory arbitrage. Still, everyone needs to understand that the SEC is an independent agency and must proceed independently. So while the FSB may publish uniform standards, none of them is binding on host country regulators. The US participation, including the SEC, in the international space is also meant to raise the international bar and to avoid a race to the bottom. All of this is very helpful.

**Mr. Ruder.** Both the Financial Stability Board, and the Financial Stability Oversight Council (FSOC), created under the Dodd-Frank Act, have been dealing with the systemic problems that asset managers could pose to the financial system. What are the SEC's responsibilities under Dodd-Frank and otherwise to deal with systemic risk? How does the SEC respond to regulations or suggestions of other financial regulators in dealing with its historic, as opposed to systemic, responsibilities?

**Chair White.** First, in the United States, the SEC is the primary regulator of asset managers. It has regulated the asset management space for over seven decades. I don't think that will change, but since the financial crisis, all of the financial regulators, including the SEC, view our missions through a lens that includes systemic risk. The two are not inconsistent however. Indeed, the problem of systemic risk is complementary to the core mission of the SEC, which is to protect investors, assure fair, orderly, and efficient markets, and facilitate capital formation. If there were a systemic meltdown, all three of those pillars of the Commission's mission would be compromised. An example of the overlap is where the SEC fits into the new systemic risk regime in the regulation of asset managers and the asset management space. That area of our regulatory regime is part of our core mission but it also touches systemic risk concerns.

Both the FSOC and FSB are pivoting towards reviewing the asset management industry for activities that might pose industry wide systemic risk. I believe that if such risks are identified, the SEC should consider and decide what should be done in terms of policies, rules, and regimes to address those risks. FSOC is enormously important and is growing stronger. It brings together all of the major U.S. financial regulators once a month to share views on potential risks in the market and the financial system and how to address them. Its members come from different backgrounds, with different perspectives, and we recognize and benefit from one another's expertise. But the SEC is not waiting for FSOC or the FSB. We are proceeding with our decades-old mission in regulating asset managers and the asset management space. There are different views of whether the SEC should be a systemic risk regulator at all, and systemic risk can mean a lot of different things to a lot of different people, which is one of the problems with that term. Dodd-Frank tells us and other agencies—most of them banking agencies—that joint rule-making is required and you need to deal with *excessive* risk where the incentives may be misaligned in a way that creates systemic risk. Clearly it is not the goal of the SEC, or the other regulators either, to eliminate risk. The capital markets are built on risk to some degree.

**Mr. Pitt.** Is FSOC creating more formal procedures?

**Chair White.** Yes. Formal procedures were put out for notice and comment three times and have been in place for several years. Since then, FSOC has increased transparency, but there remain issues yet to be addressed and solved. For example, when can companies that are being considered for possible designation as a SIFI (Systemically Important Financial Institution) actually talk to the FSOC principals, not just the staff? Is the first time only when the company is appealing a preliminary designation? And how does a company get out of the SIFI designation? What is the exit ramp if it has been designated as “systemically important”? The procedure is not yet clear because it hasn’t happened yet. And how does a company avoid such a designation? FSOC’s objective is to reduce systemic risk so why not tell companies how to reduce their systemic risk? All of that will evolve with the exit ramp process. And what does “systemic prudential oversight” mean for a designated non-bank SIFI? All of these issues are being figured out.

**Mr. Pitt.** What challenges related to policy development and consensus building has the Sunshine Act created for you and your colleagues?

**Chair White.** The post-Watergate Sunshine Act is a third rail of sorts. The SEC definitely embraces increased transparency, which was the purpose of the Act, and is quite observant of the Act’s restrictions. But as a practical matter, it means that commissioners, including me, can talk to only one fellow commissioner at a time about a policy issue, unless we are in an open meeting following public notice about its date and time. By the time of that open meeting, everyone already knows what he or she will say and even how the vote will come out. That is not the most efficient way of proceeding. Often commissioners deal with their fellow commissioners through their counsel rather than directly, with a lot of potential for misunderstanding of their respective positions. There are some photos in my office from pre-Sunshine days of the five commissioners around a table undoubtedly discussing policy issues. I am very envious of that era. If there were any gamesmanship in rule making, it would not manifest itself directly when all five are conversing around a table. More importantly, the best possible, most cost effective rule making procedure would include a discussion among all five commissioners.

**Mr. Ruder.** We have been discussing the use of technology by the Commission. What in general is the Commission doing about technology?

**Chair White.** The Commission is doing as much as it possibly can with technology. I raise information technology at every Congressional appropriations hearing, including long-term mission-critical projects like restructuring, revamping, and modernizing EDGAR. It is impossible to overstate the importance of technology to the Commission’s ability to do its job, both in terms of basic infrastructure as well as data analytics, which allow us to identify risks, for example outlier financial statements and hedge funds that seem to be making too much money quarter after quarter. The Enforcement Division is using a number of data analytic tools that make it smarter and faster. The Office of Compliance Inspections and Examinations is using the National Exam Analytics Tool (NEAT) it developed. NEAT allows it to take the trade blotter and review 17 million transactions over 24-48 hours. That process would have taken months and months without NEAT, if it could have been

done at all. Similarly, in disclosure effectiveness, technology should be used to help us identify the most meaningful material information to investors and to deliver it in a way that is less overlapping, more meaningful, and meets the needs of a broad range of investors with different interests and capacities to analyze the information. The huge challenge is resources. Our IT budget has significantly increased over the years and is a less controversial area of spending to Congress, but we still don't get enough IT resources. Annually, some of our registrants each spend some \$10 billion each year on IT, while our entire proposed budget this year is \$1.5 billion. I don't see a significant solution to the IT resource problem in the near term. We are spending a lot of money on IT, including data security, doing so prudently and wisely, making more and more use of technology which is making us more effective and efficient, but there is a lot more to do.

**Mr. Ruder.** We had considerable discussion this morning about whether the Commission can appropriately protect both retail and institutional investors through its disclosure program and how best to do so. One interesting thought was whether the Commission should just decide what information should be disclosed and let the private sector, say Google, take care of the dissemination of that information.

**Chair White.** I will avoid commenting on Google but, to take disclosure effectiveness for example, some large institutional investors have said in major financial publications, "Don't give us any less information whatever you do." Obviously, they have the technology tools to analyze all that data and don't want less of it. The purpose of the disclosure effectiveness review is not less data but more meaningful data delivered in a better way. One focus is layering the data with links that allow the investor to drill down further. We want to decrease the burden where we can, and make disclosure no more costly for companies than we have to. We want information useful to retail and institutional investors still to be available, but in reality retail investors without the technology and resources of some institutional investors are not able to read or process, say 500 pages of material, and they don't do so.

**Mr. Pitt.** Especially after the financial crisis, a lot of concerns are being raised over the so-called "revolving door," about people moving back and forth between Wall Street or law firms and the Commission, in fact government in general.

**Chair White.** The "revolving door problem" is not, in my view, an accurate description of movement between private practice and public service. For example, I did pretty well in law school, went to practice in a good law firm, went to the US attorney's office, and then returned to private practice. Others did the same. I never thought of that as a "revolving door," just what you did if you could to become a better lawyer. And, I think both the private sector and the public sector are benefitted by that kind of career path. There is, of course, some need to worry about regulatory capture and being sure that regulators are as objective as possible. But that is different from the revolving door. A policy prohibiting government agencies from bringing in experts from the private sector, from the markets, would redound to the significant detriment of the public. For example, when the Commission was considering its policy on admissions and requiring admissions in certain kinds of enforcement cases—an important policy and process to increase accountability and deterrence—my private sector experience provided me with knowledge about how much leverage the SEC had in using its power in appropriate cases. I would not have known that had I not been in the private sector. Similarly, at the

U.S. Attorney's Office I was very tough on companies and financial institutions under investigation because, among other things, I focused on genuine and thorough cooperation, including requests to waive attorney-client privilege. I was able to do that because of what I learned about how the private sector works. We do have to be sensitive to appearance, and we have all kinds of restrictions on what people coming from the private sector can do at the Commission, depending on their respective prior positions. That is good. But I think we need to step back and focus on whether the public is ill-served or better-served by the "revolving door," and be clear about precisely what we are taking about.

**Mr. Ruder.** Swaps and security-based swaps represent one of the new areas for the Commission, which is charged not only with erecting a whole system for their regulation but is also required to cooperate with the Commodity Futures Trading Commission (CFTC) in doing so. How is the Commission progressing in its relationship with the CFTC?

**Chair White.** From the staff level to the principal level, the Commission has really had an excellent relation with the CFTC. In all areas the staff and the chairs are talking often and at great length. The SEC regulates about 5% of the swaps – the securities-based swaps – and the CFTC regulates the rest. In many areas, the CFTC completed its rules and guidance before the SEC did, but it still has moving pieces as well. The SEC needs to finalize all of our mandates in the securities-based swap area, and we have made a lot of progress. We decided to build the roadmap for the entire regime for securities-based swaps before requiring compliance with the individual rules. In doing our rules, we definitely take into account the rules of the CFTC. For instance in the cross border area, we put out a release with a number of questions including asking whether we should proceed in a certain way given that the CFTC was doing it another way. Would it be better to proceed as we had proposed or would it be better in terms of workability and cost-efficiency if we were more consistent with what the CFTC has done? Since we have different market spaces, our rules will probably not be identical, but we are cooperating and have closed a lot of the gaps and differences.

**Mr. Pitt.** One of the differences between the SEC and other financial regulators is that the Commission is not self-funded. Given that disparity and the increase of responsibilities imposed on the Commission under Dodd-Frank, are there any solutions or approaches the Commission should pursue to self-funding?

**Chair White.** No doubt, any chairman of the SEC would want self-funding like the bank regulators have, but I don't think that's in the cards at least in the near-term. The SEC is deficit-neutral and costs the taxpayers nothing. While we are totally respectful of the appropriations oversight process, we would hope there is no reason not to fund the crying resource needs at the SEC, including those existing before the new responsibilities were added by Dodd-Frank. We did get a modest increase last year, but not enough to carry out all of our many responsibilities. For example, with current resources, the Commission can examine only about 10 percent of the registered investment advisers each year and those represent only about 25 to 30 percent of the assets under management. Our responsibilities cry out for more resources. Without sufficient boots on the ground, something will happen and Congress will blame the SEC—"Mary Jo, you missed it"—without remembering that we noted what we really need to fund our operations. This is a broken record about lack of funds, but for example Dodd-Frank gave us oversight over private fund advisers. Although some people think we shouldn't spend time on those advisers, we have been very efficient doing what we call "presence

exams” in that area. And when we go to firms, we find pretty significant issues at some of them that we would not find if we did not conduct examinations. So what do you do as the head of the agency? One of the ideas, hardly new and in fact dating back first to 2003 and then again to 2009, is the imposition on the registrants of third-party exams to ensure a higher degree of compliance. I would prefer that we were fully funded to be able to undertake these exams ourselves, but in the absence of that full-funding, the staff, to ensure stronger compliance, is preparing a recommendation for a rule in that space, because it is very important. I wish, of course, I had a silver bullet for sufficient funding.

**Mr. Ruder.** The Commission is also dealing with the regulation of municipal securities markets. What do you see for the future in that area of regulation?

**Chair White.** The SEC is making a lot of progress in different ways and in different spaces in that enormously important market for retail investors. The Commission’s direct disclosure authority over municipal issuers is not extensive, but we do have a separate, albeit small, Office of Municipal Securities focused on the municipal space. The Commission has also been focusing on enforcement regarding really significant disclosure abuses and I think we have positively affected behavior there. The Commission has undertaken its voluntary Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, a voluntary program for issuers and underwriters of municipal securities to report failures in their disclosure obligations. It has already changed behavior even putting aside enforcement. We are also focusing more on the fixed-income markets, which don’t get nearly the attention they should. Putting aside our different scopes of authority, the SEC is working with the Municipal Securities Rulemaking Board (MSRB) and Financial Industry Regulatory Authority, Inc. (FINRA) to increase transparency in those markets. There have been good rules adopted regarding best execution, and greater disclosures of mark-ups, mark-downs, and in riskless principal transactions; we are also focusing on pre-trade price transparency.

**Mr. Pitt.** We have asked you a lot of questions. Do you have any questions for us or any other topics we should cover?

**Chair White.** I have one question for you or the audience: Where should the SEC be as a systemic risk regulator? Where should we be with respect to systemic risk, however it’s defined? I know there are different definitions of systemic risk and different views about it.

**Mr. Pitt.** I think we should give you a quick answer to your question. There is a tension because on occasion systemic risk seems to be used in a way inconsistent with the scope of the federal securities laws. In my view, it’s fine that banking regulators worry about systemic regulation and about serious and material threats to systemic risks, and to mandate disclosures about that. But there is a real concern, I think, that sometimes in the guise of dealing with systemic risk we see a shifting of responsibilities that properly belong to the SEC and should follow the usual pattern, for example with money market fund regulation. It strikes me that safety and soundness is great for the banking industry, but taking reasonable risks is what the capital markets are supposed to be about, and under the guise of systemic risks, it is becoming harder to differentiate between the two.

**Chair White.** I have tried more than once to distinguish for my fellow regulators between system risk, reasonable risk taking, and excessive risk. What is the effect of regulating the risks we are talking about? Clearly there is a concern about the result of imposing enhanced capital and other requirements like the Volcker rule on banks, causing activity to go elsewhere, to what is incorrectly referred to as the shadow banking space. But those alternative spaces are not under the purview of the banking regulators. There are highly regulated entities in business and industries in the so-called “shadow banking” space and we are regulating that space. But the two get folded together in a way that adds to the confusion. There is an uneasiness on the part of the other regulators about what has gotten away from them.

**Mr. Ruder.** The banking regulators and the European regulators have come up with the concept of “interconnectedness,” that all of these pieces of the banking system, banking and shadow banking, are interconnected, and if one piece fails they may all fail, so they seem to believe the whole system should be regulated. That is something you will have to deal with at some point.

Chair White. Definitely. That is the landscape.



# SESSION THREE

## REGULATING INVESTMENT MARKETS

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The following topics and questions were contained in the agenda for this session.

### **OVERSIGHT OF MARKET PROFESSIONALS**

- Does the SEC need a significantly larger and more specialized capacity to deal with the examination and regulation of investment advisers? How can the SEC enhance its ability to examine and increase the frequency and regularity of its examinations of investment advisers? Should a self-regulatory organization like the Financial Industry Regulatory Authority or a special entity like the PCAOB be created to assist the SEC in its oversight of such advisers?
- Should the SEC, as authorized by Dodd-Frank, impose fairness standards on broker-dealers similar to those currently imposed on investment advisers?
- Are the tools the SEC has been given to deal with investment professionals adequate for today's markets and investment management vehicles? If not, what additional tools and resources should the SEC obtain?
- Is the SEC's increased authority over investment advisers sufficient to assure proper supervision of hedge funds and private equity funds?

### **REGULATION OF EQUITY MARKETS**

- How should the SEC address problems in securities market operation, fragmentation, and fairness in the context of new market phenomena such as "high-frequency trading"? How should the securities markets be regulated to prevent price manipulation and minimize market volatility?
- Will the Commission's new rules cabin the unsettling effects of market disruptions caused by technological glitches?
- Should the SEC engage in a comprehensive study of the current securities markets or should it engage in targeted rule-making such as the proposal to widen spreads for smaller stocks?
- What efforts might prevent global markets from creating difficulties for domestic equity trading oversight and regulation?

### **MUNICIPAL SECURITIES AND CORPORATE BOND MARKET REGULATION**

- Do the SEC and the Municipal Securities Rulemaking Board have the tools they need to enhance market transparency in municipal securities markets and ensure maximum professionalism of advisers and dealers? Are municipal securities disclosure standards adequate?
- What steps should the SEC take to increase disclosure and fairness in the corporate bond markets?

### **TOPICS DISCUSSED IN SESSION THREE**

The third session was devoted to the recent developments in and challenges to the Commission in regulating investment markets.

## **CONSTANT, RAPID CHANGE**

With the markets constantly and very rapidly changing, the Commission is required to keep pace in order to protect investors; ensure fair, orderly, and efficient markets, and facilitate capital formation. The past 30 years have seen huge changes in the way markets are regulated and the way buyers and sellers come together. Transactions now occur at lightning speed, including new and mutually competing trading platforms, algorithmic trading, technology that reduces the cost of transactions, and competing and fragmented markets domestically and globally (for example the E-mini futures market and the international swaps market).

## **FRAGMENTED MARKET, COMPETITION, AND TRANSACTIONS COSTS**

One participant argued that the SEC cannot step aside and let the markets resolve these developments on their own. The Commission needs to be involved, is involved, and will continue to be involved. The question is how it can act as a catalyst without smothering competition and innovation. Some ideas like minimum tick size and trade-through issues are sensible for the Commission but, for example, it is not a meaningful public policy objective now to protect the ability of the “little guy” to day-trade (say to trade in a co-location structure with large players at the same nanosecond). However protecting a fair pricing mechanism, whether in derivatives, the valuation of mutual funds, or the allocation of capital, is critical.

Another participant asserted that somehow the Commission has lost control of the dialogue on all of these developments. It has been promulgating rules and regulations but not participating in discussions about these matters as actively as is required. It should get back into the dialogue about issues like fragmentation and the disruptive nature of how we trade, not just equities but also swaps and fixed-income securities. There are many different players with incredibly diverse needs. Strangely, the first request that seems to come to the Commission is not whether the investor is getting a fair price or the right price, but peer competition: whether the price is better than everyone else’s price. Obviously, it is not possible for everyone to get a better price than everyone else, but the competition is intense between exchanges, over-the-counter markets, broker-dealers, dark pools, hedge funds, and asset managers. Everyone seems to be ranked and judged not on some kind of absolute basis, but compared to the nearest competitor. The intense competition lies beneath the concerns about the fairness of high-frequency trading (HFT) and co-location and day-trading, for example. Everyone wants to be as close as possible to the exchange, or pay the exact same amount, for any given trade. Clearly day-traders working from home cannot be co-located, but they want precisely the same access and platform. Market participants come to the Commission asking not so much to pass or block a rule that will help or hinder them in some concrete way, but to pass or interpret a rule that will hinder their competitors. The intense competition creates a lot of mechanisms and the Commission has tried to analyze them, but it needs to take back some of the dialogue.

Another participant noted that three different things are going on. First, it is important to distinguish equity markets from fixed-income markets because they are different. There is no way to keep current with the constantly changing technology that fundamentally affects equity markets, for example in co-location. Second, regulations such as Regulation of the National Market System (NMS) need to be updated. Third, some retail investors and the firms close to them believe that something is wrong with the markets, citing, for example, the advantages of the HFT firms. Despite the replies by HFT firms that they are making markets on behalf of retail investors, there is still a strong perception of

unfairness. These differing views may be another example of losing control of the dialogue among investors, dealers and issuers, including misunderstandings of how the markets operate. Regulation NMS was designed in great part to address fragmentation and create a national market system. But if investors have the perception, rightly or wrongly, that the markets are broken or not working in their favor, that is a problem quite apart from the substance of their perception. It can have a deleterious effect on the market. Confidence in the markets is very important.

Another participant observed that the equity markets are working much better than in the past. Notwithstanding fragmentation, equity markets are unbelievably competitive and efficient today compared with the past, but the participant also echoed the distinction between equity markets and fixed-income markets. Fixed-income markets will never be like equity markets. The issuers are the important parties in the debate. They enjoy tremendous liquidity and access to the markets. Both Europe and Asia are moving toward the U.S. fixed-income markets, which they think will remedy some of their problems.

## **TRANSACTION COSTS**

The Commission has spent considerable time reviewing transaction costs. Private firms have also done transaction cost analyses. Transactions have never been cheaper. It is possible today to buy several hundred shares of an issue for less than \$10, less than the price of a large cup of coffee. There has never been a better time for a retail investor. Yet the investors complain that they can't buy 300 shares because they are competing against high-frequency traders. Most investors don't realize how the market actually works and think that they can compete with people who co-locate, but in fact they are on a completely different playing field. Generally, transactions costs have come down, both for institutional and individual investors although there is some difference between the two costs.

A participant argued that transaction costs are not, and should not be, the only measure of the quality of markets. Regulation NMS was adopted to foster competition among individual markets and competition among individual orders and, therefore, to assure that investors receive the best price executions for their orders. Although perhaps transaction costs themselves have not changed very much as a result, investors are getting much more for their money. For example an exchange-traded product gives the retail investor instantaneous access to international stocks, commodities, futures, active management, and a whole host of things that didn't even exist seven or eight years ago.

So perhaps the right question is not why transaction costs have not come down—although in fact they have—but why they have not risen dramatically to support all of the new things that have appeared in the markets. The tools and technologies that investors now use have kept the cost about the same as they were even as investors have been offered more and more. Transaction efficiencies should be an important part of the dialogue.

## **VOLATILITY**

Another participant asserted that the way in which the quality of the markets is measured is important and that transactions costs are only one measure. A lot of transactions can now be processed much more quickly. Nevertheless some of the stabilizing forces that we used to have in the markets have been lost and that does contribute to volatility. Although the half-hour “flash crash” of May 6, 2010 may have contributed to lack of confidence, there are broader non-market micro-structure

issues that probably do more to reduce confidence. For instance, market scandals may reduce confidence. The billion-dollar settlements related to the manipulation of the London Interbank Offered Rate by leading institutions in the financial markets, the routine violations of anti-money-laundering rules, and the unrelenting set of headlines about billion dollar settlements for fraud might lead to the conclusion that the markets are not a fair game even though these events aren't directly market micro-structure issues. Dramatic volatility in the market may reinforce the view that the markets are rigged—and that there is manipulation. But that view hampers the conversation. The issues with the markets tend to be structural, not that markets are rigged.

Some believe volatility spikes are smaller now than they were before automation. We learned from the flash crash that there are times when the market is trading in a disorderly fashion, when there seem to be sellers without buyers, and the market breaks down. No one benefits from the lack of a price-discovery mechanism, but market volatility and price-discovery occur for many other reasons. It is difficult in real time to ascertain why prices are moving in a volatile fashion, for example as a result of really large orders. There will be spikes and volatility. It is hard to determine in real time whether that volatility is good or bad. So the 2010 flash crash taught us that when the markets seem to be moving out of control, a five minute breather will calm things down and let humans come in, in case computers caused the volatility. We take for granted the far reaching market rules requiring that pause, but such rules would have been considered radical just five years ago. Market pauses have proven to be a good way to moderate volatility and perhaps even how to think about systemic risk, and they now command a consensus.

One participant noted again the need to differentiate between equity markets and fixed-income markets. There is growing concern that while the primary fixed-income markets are very good, the secondary fixed-income markets are not as good as they once were because of recent regulatory changes (although that cause is debatable since the availability of inventory and monetary policy also have an impact). The structure of the equity markets allows them to work through volatility while those mechanisms don't work as well in fixed-income markets. Another participant observed that interest rates and monetary policy in general pose the biggest risks to the markets, especially the fixed-income market, but the policies related to them are beyond the authority of the SEC to effect.

## **CYBERSECURITY**

Another participant argued that one of the biggest risks is a cyber-attack. Financial firms are doing a lot, as is the U.S. Government at all levels, to address the cyber risk, but it is an illusion to believe in a firewall of security that will never be breached. We need to be able as well to deal with breach and recovery. What if the cyber-attack is systemic to the market and systemic across various firms? What if there were a virus attack against one of the big custodian banks and the virus wiped out the bank's books and records? The firms and the government are working very collaboratively on that risk. Even more frightening, is a power sector crash. If the Fed wire goes down, it is possible to work around it, but nothing much can be done if there is no power. Another participant agreed: cyber is the biggest concern and especially an attack in the power sector. There would be riots if power went down for a long time, say a month. Not only would the markets close but people would be unable to access their bank accounts. Credit cards would be immobilized. In a temporary crash, like the flash crash, even one due to a cyber-attack, the markets would close. But even in normal times, the markets are closed temporarily more than they are open (for example at night and on weekends). Investors would

simply pause even if the markets were closed for a few days. Foreign regulators seem to be concerned about price moves during such a temporary problem, but investors will just stop trading and wait. However, if all the books and records were wiped out and were unrecoverable, investors would not know what they owned or owed. The different arms of government, not just the Commission, need to be engaged in dealing with this huge cyber challenge.

## **A COMPREHENSIVE MARKET STUDY**

The question was raised whether there should be a comprehensive study of the markets or whether particular issues should be handled through the targeted rule-making process.

One participant argued that a comprehensive study by an independent staff with independent funding and a multi-volume comprehensive report is neither likely nor desirable. A targeted look at a specific problem or an individual sector (like the structure of the equity market) is preferable. Another participant thought that the misperception among investors about market volatility and fairness and the role of the Commission in those areas might call for such a study, especially since so many other agencies are peering over the SEC's shoulder at what used to be the SEC's exclusive turf.

A third participant thought this is not a good time for a special study. People get lost in "study land" when special studies are commissioned. Moreover, the markets are changing too rapidly. A rule-making proposal facilitates the dialogue and increases the probability for fixing the problems. We need to move more quickly, and the rule-making process is better for dealing with these changes than a special study.

Another participant agreed. The world of equities and fixed-income securities is not falling apart. But there are a lot of other concerns, for example about the effects of trading off-exchange, or about how retail investors interact with over-the-counter markets, or about the difference between direct feeds and consolidated tapes. But these are better resolved through the rule-making environment. We need to consider tweaks even though that process is not as comprehensive as a special study.

Another participant agreed because the Commission is overloaded and doesn't have to time to undertake a comprehensive study. It has been dealing with new requirements under Dodd-Frank. Moreover, there are now overlapping market-regulatory authorities, for example the SEC and the CFTC, whose respective roles need to be identified. Similarly, what are the roles of the self-regulatory organizations like FINRA? The time for a comprehensive study is probably coming, but the Commission is too overwhelmed now to undertake such a study and to do it justice.

## **FIDUCIARY DUTY STANDARDS AND AGING POPULATIONS**

One of the growing problems for the securities industry is the aging investor population, including financial security after retirement and the ability of older people to comprehend ordinary problems and transactions that arise in any portfolio. Various stages of dementia affect the investors' understanding of their own accounts and also make them vulnerable to fraudulent sales pitches. If an investment proposal sounds too good to be true, it probably isn't true. Yet many senior citizens are defrauded. The rules we operate under today were not written for people living as long as they now do and with the levels of dementia and Alzheimer's disease. There are likely to be new rules and laws at both federal and state levels to address this problem.

One participant noted that although roll-overs of existing accounts and the sale of proprietary products may optimize the portfolio of the investor, they may instead be designed to increase fees of firms. These are hotspots, especially for older investors. Dementia will increase dramatically. The SEC is in one of the better positions to establish a regulatory regime to deal with these issues, but any such regime would need to mesh with the ERISA (the Employee Retirement Income Security Act of 1974) regime as well.

## **FINANCIAL LITERACY**

Investment literacy among the entire population is a major problem, said another participant. Theoretical understanding aside, the vast majority of individual investors don't really recognize that you can actually lose money for completely legitimate reasons. Most investors seem to have zero tolerance for pain and they are terrible at math. They don't really understand that a 20% risk of failure means that out of five investments, one will go bad. So when the markets goes down, people sell. Added to that is fraud. People, and not just seniors, seem to trip over themselves to invest money in schemes too good to be true. Human greed overcomes their good sense. Additionally, most investors don't really understand the products they have purchased, especially as the products get more and more complicated. Another problem is that most people do not realize just how much money they spend on fees. Even when the fees are small, they add up. Market structure and tick-size and co-location, important as they are, don't even get on the same page as this lack of individual investor financial literacy. Other than massive amounts of education, there is little the Commission can do about any of these problems. It cannot catch every instance of fraud.

Another participant disagreed about investor behavior and risk. The financial crash in 2008-2009 was severe. Yet we did not see people stopping their contributions to their 401(k) retirement accounts or changing their asset allocations or selling their equity positions and locking-in their losses. The data does not support a conclusion that generally investors behave irrationally when markets turn down. Moreover, institutional investors sometimes behave irrationally. For example, a lot of endowments and foundations sold their equity positions and converted to cash in 2008-2009. As to fees, the cost of investing in mutual funds has been declining for a generation because both market providers and investors have gotten the message about the importance of costs and fees in investment selection. Again the 401(k) world has some of the lowest costs in the world.

The first participant responded that the 401(k) data actually supports the problems he laid out. It is hard to pull money out of a 401(k) account and although the account can be re-balanced, investors have been trained not to do that. Moreover, although direct fees have come down dramatically, there are all kinds of service fees people keep paying. People should be more cognizant of general fees and the costs of transactions.

A third participant noted that the market is becoming increasingly homogeneous "on the buy-side." Between indexation of investments and the use of data and benchmarks for actively managed funds, huge pressure has built on investors to move in lockstep, diminishing the traditional concept of investment diversification. More important, lockstep investing creates a have and have-not market with small cap funds that are not in indices, do not have big portfolios, and have no buy-side support, so they do not fit into the indices. There are some initiatives, including changing tick-size, to get the small caps to trade better.

Another participant noted that when a stock or set of stocks gets included in an index, it becomes part of the buying homogeneity and that is part of the cause of volatility. The E-mini futures market has become a major influence in all of this.



# SESSION FOUR

## THE ROLE OF THE SEC AT HOME AND ABROAD

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The following topics and questions were contained in the agenda for this session.

### SEC FUNDING AND OPERATION

- Does the SEC have staff, financial, and technological resources sufficient to deal with its new and historic responsibilities? Are there potential revenue sources to aid the SEC, including imposing costs on self-regulators and their members?
- Should the SEC be self-funded? If so, should and can Congressional oversight be preserved? Should the SEC be given flexibility with its funding and other resources?
- Have the Commission's efforts to develop better economic and statistical analysis gone far enough? How can the SEC's ability to weigh costs and benefits be enhanced to make its rule-making more palatable upon judicial review? Are judicial standards placed on the Commission's rule-making untenable?
- Are the relationships of the SEC with the PCAOB, FINRA, stock exchanges, and other supervised entities well-managed and well-understood?

### INTERNATIONAL REGULATORY COORDINATION

- As global capital markets become ever more linked, cooperation among national securities regulators has become increasingly vital. Has the SEC afforded the right priorities to its international activities? Should the SEC be more willing to accept compliance with home country rules?
- To what extent should the SEC coordinate its rule-making efforts with those of its global counterparts?

### REINFORCING THE SEC'S INDEPENDENCE

- What, if any, role should the SEC play in systemic risk regulation? Is the historic independence of the SEC threatened by legislative and executive branch efforts to coordinate the financial regulation of financial institutions? Is the SEC's independence threatened by its Chair's service as a member of the Financial Stability Oversight Council? What relationship should the SEC have with the FSOC?
- Are there ways to improve coordination between the SEC and banking regulators in developing rules dealing with systemic issues?

### TOPICS DISCUSSED IN SESSION FOUR

The fourth session covered three separate subjects: the better use of data and economic analysis; the Commission's budget; and the regulation of securities internationally.

### DATA AND ECONOMIC ANALYSIS

Economic analysis and the use of data have recently been increasingly useful tools for the Commission, which has been moving toward a more data-driven approach to its activities, policies and

rule-making, including risk assessment and the analysis of financial statements. In response to a charge from Chairman Schapiro after a federal circuit court called the SEC's economic analysis arbitrary and capricious, the Division of Economic Research and Analysis (DERA) created a framework for converting large databases into meaningful, sensible, common sense economic analysis in order to inform its rule-making. That effort was described in the Commission's Guidance to Economic Analysis. A key piece of that analysis was to quantify to the extent possible the economic implications of a proposed rule and its reasonable alternatives. A number of significant SEC rules have relied heavily on the use of large databases, for example rules governing money market mutual funds and rules under Title VII of Dodd-Frank. The analysis of data, including EDGAR file data, has affected the Commission's assessment of risk and led to a more efficient way to approach inspections and examinations. Large databases and economic analysis were used to review hedge fund returns to identify unusual patterns of trading relative to their peer groups and to uncover possible bad actors like Bernie Madoff. These analytical tools have already resulted in nine successful enforcement actions. They have created an appetite within the Commission for the use of data analytics, including a better understanding of the discretionary accounting choices firms make when they file their Form 10-Ks. Using structured data, XBRL (eXtensible Business Reporting Language) data, that companies are required to file with the Commission, the Commission has developed the Accounting Quality Model to identify statistical outliers as well as their characteristics. This is a factor model that identifies the signature characteristics of firms that may be cooking their books or employing unusual treatments to smooth their earnings. These are signals to focus SEC reviews, not smoking guns.

One participant suggested that when the Commission flags an accounting issue for observation it would be appropriate to share that flag with the company's audit committee. It is important to let filers and the public understand the issues the SEC considers important and on which it will focus. For instance, if filers know the SEC is focusing on certain low cost techniques to manipulate earnings they will likely not use those techniques to manage their income. The markets would benefit if companies ruled out those techniques for manipulating their performance. So that slate of techniques would be increasingly costly, hard to implement, and more likely to lead to detection. The Commission should be concerned primarily about improving the quality of financial disclosure and making it more transparent, not about catching firms committing fraud. So let the filers know exactly what the SEC is looking at and thereby improve the quality of their accounting disclosures.

Another participant asked whether the Commission might have adopted one of the many existing commercial accounting quality and governance quality models designed to detect fraud rather than creating its own secret sauce. The reply was that the new model is an econometrically superior framework to those commercially available. First, the SEC-created model can identify accounting fraud. Second, the SEC model can be applied to all filers. The commercial data vendors are designed for the larger filers, while many of the problems exist in the data sets of the smaller firms. Third, the commercial models rely exclusively on past accounting and auditing enforcement actions, which is the tip of the iceberg. And while there are some interesting stylized facts that can be pulled from the commercial models, the Commission's model was aimed at detecting new fraudulent accounting practices, rather than practices the SEC has been able to discover in the past.

## **COMMISSION'S RESOURCES**

The three elements central to evaluating the Commission's budget are whether the Commission has enough resources, how those resources are raised, and how its budget is controlled. As to the amount of Commission resources, in 2015 the Commission received \$1.5 billion (with a staff of about 4400). It is seeking \$1.7 billion for 2016 (and a staff of 4800), a little over 10% increase. In 2010, the year Dodd-Frank was enacted, the Commission's budget was \$1.1 billion with a staff of about 3700. So if the 2016 request is actually appropriated, it would represent a dollar increase of about 55% over 2010 and a staff increase of just under 30%. By comparison, Rod Hills' 1976 budget was \$49.3 million (with a staff of 2081), which would be \$205 million in constant dollars. So, over 40 years, there would be an eight-fold increase in constant-dollar funds and a staff increase of about 230%. However, the staff increase is not proportionate to the increase in the Commission's responsibilities over those years. For example, in 1976, the volume of all securities transactions on registered exchanges was \$170 billion, while in 2014 it was \$67 trillion, nearly 400 times as much. Using other measures, each year, the Commission is able to inspect only about 9% of the 12,000 currently registered investment advisors and, if the Commission receives its 2016 budget, inspections would increase to the low teens, still a low number. The Commission oversees about 25,000 market participants, including registered mutual funds that have had large increases in their assets over the past decade. When Sarbanes-Oxley was passed, the Commission's budget was increased about 39%, but in the year Dodd-Frank was passed, the increase was only about 17% notwithstanding the disproportionate, quantum-level increase in the Commission's responsibilities resulting from Dodd-Frank. The Commission's eightfold increase in budget over the last 40 years has led to a staff increase of only two-and-a-half times, partly because of its use of technology, but the technology costs are much larger than they were in 1976. Most people think that the Commission needs more revenue.

A participant raised the Commission's problems in hiring. It is hamstrung in its ability to hire sophisticated financial staff. Many of the positions which it wants to fill do not fit into existing Office of Personnel Management exemptions. Instead, the SEC has to navigate the general requirements of OPM. For example, a candidate with a PhD in economics or a lawyer or an accountant can be cordoned off under OPM exemptions, but a candidate with 25 years of experience as a portfolio manager at the world's largest asset manager is classified in exactly the same way as a person who sets up email, and is subject to all the same OPM rules. It is very difficult to attract competent people under the OPM restrictions. Attempting to hire people with expertise in database management or database architecture or sophisticated programming skills is incredibly challenging, not because there aren't enough qualified applicants but because the technically qualified applicants cannot make the list of OPM-approved people who could qualify for the job. OPM cannot distinguish well enough between a person with rudimentary computer skills and those with sophisticated skills. Moreover, there is no clear path for justifying to OPM the people who represent themselves as having sophisticated skills.

## **SELF-FUNDING**

How should the SECs revenue be generated? The traditional answer is "self-funding." In fact the Commission is self-funded, since its budget is fully recovered through statutory annually-adjusted transaction fees from on-exchange and off-exchange transactions. But the budget could also be a "self-appropriating" budget, one set by the Commission itself, rather than one set as part of the annual federal budget appropriated by Congress. Congress is unwilling to relinquish the control and oversight of the Commission that it gains by retaining control of the Commission's appropriation.

In the past, the President has also sometimes wanted to exercise a budget check on the Commission. The Commission does have the SEC Reserve Fund, established in Dodd-Frank primarily for its long-term IT projects and raised by fees for securities offerings. These are funds it can spend as it sees fit. However the SEC Reserve Fund cannot be increased by more than \$50 million per year and cannot exceed a total of \$100 million. The Commission cannot obligate more than \$100 million per year from it.

## **PRIVATE FUNDING**

If the Commission cannot get additional resources, it could perhaps expand the number of self-regulatory organizations (SROs) to perform part of its work of investor protection, oversight of the markets, and some of the other functions it currently performs itself. The SEC already relies on, and has oversight over such SROs as FINRA, which regulates broker dealers, and the stock exchanges. It also has oversight authority over the Financial Accounting Standards Board, to whom it delegates power to promulgate accounting standards. A new creation, the Public Company Accounting Oversight Board, oversees the auditors of public companies and of broker-dealers. The PCAOB is external to the SEC, but is under the Commission's control since its members are appointed by the Commission, which also approves its budget. All of these entities are funded either privately through operating revenues, or through member assessments paid by those they regulate. So if the Commission does not receive additional appropriated funds, perhaps additional functions could be transferred to entities it regulates. For example, the Commission is considering whether, like requiring public companies to engage firms to independently audit their financial statements, the SEC should require third party examinations of investment advisors, paid for by the investment advisors themselves.

One participant noted that under the recently adopted Regulation SCI, alternative trading systems, plan processors, and clearing agencies are required to adopt policies and procedures designed to ensure that their technology systems operate effectively and that any problems are promptly corrected and communicated to market participants.

One participant commented that there seemed to be a proliferation of units within every operating division and office, with “mini-commissions” in each division and office. Wouldn't some consolidation create savings? The response was that it was not clear that, in general, a bigger SEC is a better SEC. In fact, it might be weaker because a bigger organization has a harder task retaining collegiality and common purpose, a historic hallmark of the Commission. Growth is inevitable as the Commission's responsibilities have increased, but it might be helpful to think about placing more activities in other organizations, with the SEC performing an oversight role. Still, once these entities are established, it would be virtually impossible to reverse course, if only because people will defend their new turf.

A participant noted that the two biggest SEC budget items are people and technology. Technology provides only what it is designed to do while people have motivations as well—to serve the public, for example—and can sometimes do extra work and punch above their weight when the occasion requires. The participant asked whether there are ways to offload some of the human elements. If SROs were to fund more, they would absorb additional costs as they arise. The Commission did transfer costs in securities markets enforcement surveillance, which SROs now do. If SROs were to take on more, they would more likely stay up to date. Offloading responsibilities to SROs would

allow the Commission to require that it have equal access to the SRO's data and its IT platform or to its framework, all without much cost to the Commission.

Another participant recounted the difficulty of making changes in the way that the Commission's divisions operate. The participant concluded that instead of attempting to make piecemeal changes the Commission should engage in a holistic review of the efficiencies of the operation of the entire agency.

Another participant asked whether, unlike the past, there are now incentives for the investment advisor community to form a self-regulatory organization. There is perhaps more incentive to do so now because investment advisors now understand that they will be inspected and the only question is who will do it. Who will that outside inspector be? Will it be a single group? Will each advisor have to hire an inspector? Another participant replied that this wouldn't be so dissimilar from what is required of issuers under the Sarbanes-Oxley Act. The issuers are required to hire an outside party to audit statements about internal controls, which has turned out to be an audit firm, but could have been a different and more expensive entity. The Commission could easily require investment advisors to hire third-party inspectors that would not be audit firms. The inspectors would do a review and certify that investment advisors meet certain standards. If an inspector found that an investment advisor did not meet those standards, the advisor would be subject to additional oversight and potential enforcement actions. Another participant commented that if investment advisor oversight would be improved and paid for outside of the Congressional appropriations process it is not clear why there is not more push for an investment advisor SRO.

Another participant responded to the need for oversight over any third-party examinations of investment advisors. If the exams are undertaken by accountants, the Commission might have the authority through the Public Company Accounting Oversight Board to provide oversight and mandate how the examinations are done. Other types of oversight such as that provided by credit agencies and proxy advisory firms have been incredibly controversial. Those experiences should be examined before constructing an oversight system.

However another participant argued that the Commission's authority to require oversight over third-party compliance auditors is not really subject to question. The Commission would be establishing an annual compliance audit comparable to what it required for accountants, but it might distinguish such an effort for investment advisors by requiring firms to make an election. For example, firms electing to be under the Commission's oversight would get the advantages of certain exemptions, certain disclosure provisions, and risk factors that would make it commercially unacceptable not to enlist in that option. The concerns about credit rating agencies and proxy advisors are different because they were under no regulatory scheme. They were just allowed to assume power, and the Commission exercised no control and little oversight over them and ultimately wound up with problems as a result. In the case of investment advisors, the Commission could define independence and expertise and assume responsibility for ensuring that the people who do the compliance audits are fully competent to do so and are fully independent of the firms they would audit. Another participant noted that accounting firms undertaking a compliance audit would need to be independent of the investment advisors and could not also audit their financials.

## **SEC RELATIONS WITH OTHER SECURITIES REGULATORS IN THE U.S. AND GLOBALLY**

An increasingly important area of concern for the Commission is its relationship with other U.S. financial industry regulators as well as with financial regulators abroad. How can the SEC interface with those regulators yet preserve its independence?

The Commission faces many challenges in dealing with the cross-border nature of the financial markets. The 2008-2009 financial crisis resulted in a consensus that international financial institutions and markets need to be better regulated and that significant change is required, but international harmonization of regulations and enforcement, while desirable, is likely to be impossible. How then can the national treatment model adapt to the globalization of markets?

## **HOST COUNTRY REGULATION OR SUBSTITUTED COMPLIANCE**

The current host country concept that if you come to my market, you play by my rules, is challenging for cross-border activities and divergent national rules, including primary and secondary market transactions, raising capital, use of derivatives, and many other international activities. An alternative concept of substituted compliance and mutual recognition of home country regulation requires enormous mutual confidence among regulators. So should the SEC rely on the home country of an entity doing business in the U.S. to oversee the entity's activities or should the SEC impose its own requirements on top of home country requirements? The U.S. Federal Reserve Board expressed its skepticism of foreign regulators by requiring major foreign banks doing business in the United States to create a U.S. holding company to oversee its U.S. operations, thereby "ring-fencing" the foreign bank's U.S. operations and providing oversight by the Fed. With regard to issuer disclosures, the SEC adopted a new form of disclosure for foreign issuers, with the right to oversee those foreign issuer disclosures.

There now seems to be movement toward accepting compliance with home country regulations, but questions remain. The European Union has made it clear that the U.S. cannot single out just the UK, France, and Germany for acceptance of home country regulations. The SEC is still concerned about its ability to oversee activities affecting the U.S. markets. It is uncomfortable instituting a mutual recognition system with brokers and exchanges from all 28 European countries.

In truly international markets, the identification of the decision-maker is very difficult. To take the example of derivatives, whose rules would apply to the registration of central clearing organizations or of intermediaries doing business in the international derivatives market? Who decides, for example, what the margin requirements should be? Who determines registration requirements for swap dealers, major swap participants, and central clearing parties? Ideally, the systems and requirements would converge, but they do not now. Europe takes more time to create common regulations and does not now have the ability to engage in the ground work for substituted compliance. One possibility would be to require foreign institutions to register in the U.S., but then defer to their home countries with respect to requirements of capital and oversight. Another is to accept their doing business in the U.S. without registering here. Europe is prepared to rely on U.S. registration and defer to it while doing business in Europe, but it is frustrated by the many U.S. regulators: the CFTC, the SEC, The Federal Reserve, the FDIC, and the fifty state insurance regulators. Asia is even more complicated and has different approaches to regulation. The Chinese, for example, are prepared to

allow registration with the SEC, but not SEC inspection. So the possibility of substituted compliance has substantial limits today. The regulators need much more dialogue between them to try to build mutual confidence. And in those dialogues, the SEC may not have as much influence as we might hope, in part because of the political situation in the United States.

Another participant addressed the subject of foreign markets and foreign clearinghouses. The U.S. regulators are insisting that if the clearinghouse clears for a single U.S. customer, that entity must register in the United States, which is an incredible exaggeration of their jurisdiction. The U.S. regulators do not seem to believe in substituted compliance. For example, the Commodity Futures Trading Commission has decided that even if a foreign market has some U.S. participants and wishes to register in the U.S., all transactions, even between totally non-U.S. entities, must be effected in a way identical to the way they are effected in the U.S. Basically the U.S. regulators are saying that the U.S. has the perfect model which must be exported to any offshore market.

A reply was that with sophisticated markets and disclosures you should permit differences, but that approach does not seem likely. The issue with central clearing parties is systemic risk. For example, the derivatives market would be most efficient if all derivatives were standardized and cleared through one clearing agency, but that would pose unacceptable risks of concentration. Dodd-Frank gave the Financial Stability Oversight Council the power to indicate that financial utilities pose systemic risk and it has already done so with some. Europe has not taken that approach. Clearing members have to register, but funding the obligations of their clearing parties is still at issue. Since that market is mostly institutional and sophisticated, one would have thought that regulators would be willing to come up with comparable approaches and allow choice based on full disclosure. But the chances of that system being employed seem to be zero because there is a lack of confidence between the regulators. Following the financial crisis, there is concern among the U.S. regulators that if something goes wrong, an American investor will claim that the U.S. SEC permitted reliance on a foreign regulator who failed its duties. So the U.S. regulators feel a need to retain jurisdiction as the Federal Reserve Board did with respect to independent holding companies in the banking sector. Foreign banks, with operations in the U.S. were borrowing in the U.S. and sending assets abroad. The Fed had no confidence that the home country would allow the U.S. operations of the foreign banks to repay their debts or that the home country regulator would help deal with a debt incurred in the United States. So the Fed chose to ‘ring-fence’ pure and simple.

The arrangements between regulators of different countries are normally informal and governed by memoranda of understanding. The question is whether, particularly among banking and perhaps capital market regulators, a treaty-based arrangement could be established that would provide a bit more power. The treaty could lay the basis for a relationship like the International Monetary Fund. In Europe, the blend of banking and capital markets regulation has resulted in the banking regulators being the dominant of the two. In the U.S., the SEC is handicapped because the SEC and the CFTC are not merged. The divergence between the two frustrates the Europeans. We can explain all we like about the competing Congressional oversight committees but that makes no sense to the Europeans. In fact, it jeopardizes the efficient regulation of the most important, deepest market in the world. We often assume that others will copy the U.S. market, but no other market has copied the U.S. model.



# CONCLUDING REMARKS: WHERE DO WE GO FROM HERE?

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## TOPICS DISCUSSED IN THE CONCLUDING SESSION

The last session covered some new topics and some agenda topics not fully discussed.

### THE GOVERNMENT AND THE PRIVATE SECTOR

One participant commented that, in many areas of regulation, the government is assuming more and more power over the private sector. For example in regulating central clearing houses and in self-regulation, it seems to dictate how things are done. Similarly in the National Market System regulation there are very specific rules about how trades are made and how many quotes are needed. There is now a fundamental issue about the degree of governmental power and the way that power is exercised in the rule-making process. One area of concern is the way government entities interact with one another or with non-U.S. regulators, but another is the way government interacts with the private sector.

Another participant responded that the interaction between agencies is an important issue in a number of respects, certainly in enforcement, where there is so much overlap and duplication and therefore there is a crucial need for government agencies to synchronize and coordinate more with each other. For instance there is a need to avoid multiple agencies “piling on” when someone is thought to be in violation. Cooperation is crucial. In the 1960s, the SEC was antagonistic to the banks and, to some extent, the banking regulators were antagonistic to the SEC. The relationship between the SEC and banking regulators seems to have improved. Today there seems to be constant communication among the relevant financial agencies. Of course there are sometimes disagreements among agencies, and the SEC has an obligation to resist another agency’s pressures if it disagrees.

Another participant responded that the Assembly discussion has focused on the interaction between government agencies, with little discussion about the interaction between the government and the private sector. The session on the Role of the SEC at Home and Abroad raised difficulties the government faces in hiring from the private sector and the advantage of getting private sector expertise in the government. But even improvements in that area would represent a fairly limited and constrained way of hearing from the private sector. Yet it is the private sector that is being regulated and that drives the economy.

A reply was that the private sector too would need to take additional initiatives. The business community sometimes takes a kind of “laissez-faire” approach, waiting for the government to tell it when it is doing something wrong and how to fix it, and then it doesn’t like the government’s answers and solutions. No doubt there should be more interaction, but the private sector should reach out more, not just to oppose government initiatives, but to raise major issues, to educate the government, and to collaborate more in fashioning ideas for solving problems. Another participant responded that in the enforcement area the government provides disincentives to cooperation, so when a company initiates

a conversation about a problem it is having, it does so in an environment in which the government seems to conclude that the company is a felon. The government's prosecutors reply "Thank you for your cooperation. We are now going to charge you \$2 billion not \$1 billion."

## **PRIVATE SECTOR AND PUBLIC POLICY**

Another participant commented that some believe that over the past five or six decades the private sector has become less engaged on public policy and thinking about the public interest. Has the private sector changed? Has it become less civically focused, less public spirited, less engaged on larger public issues? One participant replied that in the financial crisis of 2007-2008, although there was plenty of blame to be allocated to the government and its policies, there was also blame for the private sector. Some in the private sector saw the problems building well before the catastrophe hit. Yet there was no organized effort by the business community, before or after, to tender solutions to the government because doing so was thought not to be in their interest. Some believe individual companies are well-advised not to engage in that sort of effort individually, but to find an organizational umbrella in order to avoid being identified as the company causing the problem. Still the business community as a whole did not propose solutions, let alone recognize some of its own mistakes. Instead, while we needed financial service reform, we got the Dodd-Frank legislation that really left a lot of the problems unaddressed and did not greatly improve the chances of the next crisis being detected earlier and perhaps avoided.

We need enlightened business leaders, as we have had at times in history, who speak out on issues. But when problems arise, it seems that both the government and the business community have adopted an "us against them" mentality. The government has attacked business and businesses have attacked the government. None of that is constructive. When we see a problem, we should be asking how we can we fix it and prevent it in the future. Later we can assign blame if that's important. There surely must be better efforts by the private sector to think about public interests, for example the ways in which regulations can have a terrible impact on employment, economic growth, and other public goods. The more regulations that are piled on, the more they are just increasing the cost of business and putting businesses out of operation. One participant suggested that perhaps, in addition to investor education, the SEC should consider some corporate education to encourage the corporate community to analyze its own problems.

## **ACCOUNTING AND AUDITING**

A number of unsettled issues were discussed regarding the SEC's responsibilities concerning accounting and auditing. One question is whether the Commission will allow U.S. issuers to use International Financial Reporting Standards promulgated by the International Accounting Standards Board. If it does so, will there be continued efforts toward harmonization and convergence of U.S. Generally Accepted Accounting Principles and IFRS? One participant noted that to be effective, the accounting standards need to be identical or convergent and they also need to be consistently interpreted and applied.

## **CORPORATE GOVERNANCE**

One participant commented on corporate governance matters, noting the corporate governance implications of auditor rotation. The participant observed that Europe requires the rotation of audit firms and that other countries like Singapore, Canada, and Australia are debating the rules govern-

ing auditors and audit committees. There is a global philosophical debate about corporate governance measures related to company audits. The corporate governance rules in the U.S. have taken a long time to institutionalize and the rotation issue is now being debated. It is easy to flip a switch and mandate audit firm rotation, but a lot of time and effort is required to make a new system work. The U.S. has chosen not to mandate auditor rotation, but many jurisdictions are up for grabs on that policy. It is important that the Commission be active in international efforts and discussions of that nature. Mandatory auditor rotation has been considered about five or six times over the last 15-20 years but has not been adopted by the SEC or the PCAOB. However, some proxy advisory firms are supporting the ouster of directors if their audit committees do not change auditors with some regularity and, in effect, adopt mandatory rotation. Those proxy advisory firms are not subject to any oversight or regulation. That is precisely why the Commission should not take a laissez-faire attitude, or it will risk an unwanted result.

### **THE SEC AND THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD**

There has been some concern that the SEC is not pushing hard enough on the PCAOB. In contrast, some believe that the PCAOB is adroitly dealing with difficult problems and that the SEC's oversight is good. Another view is that the SEC's oversight of the PCAOB is too rigorous. One participant thought that SEC has set the cost/benefit justification bar for standard-setting by the PCAOB so high that the PCAOB's standard setting has almost come to a halt, asserting that the PCAOB has retreated from its core function of setting auditing standards because it doesn't think it can get the standards through the SEC process. A more cooperative attitude by the SEC would help the PCAOB to move forward on standard-setting and would be very desirable.



# A TRIBUTE TO RODERICK M. HILLS

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I was fortunate to be able to call Rod a friend for almost 20 years. Some of you may have had the privilege of knowing Rod longer than that. I first met Rod when he had just been named chair of the audit committee of a Fortune 100 company where the management had abruptly left and the outside accountants could not find any solid support for the company's financials. What I learned quickly is that kind of situation was not that unusual in Rod's life.

He was fearless in taking on difficult and complex situations. If the goal or cause were worthy enough, Rod was ready to take up the challenge with an endless supply of enthusiasm, a lightning fast intellect, and a deep compassion for others. Rod was a dreamer but with his feet firmly grounded in reality. He was fully aware that at times he may be putting himself in harm's way, but that was a price he was readily willing to pay, if required, to achieve a greater good.

And, much good he was able to achieve during his life. For example, with vision and fortitude, he championed what is today one of the pillars of current day corporate governance—the independent audit committee—and he is rightfully known as the father of the Audit Committee. And, although he was able to accomplish much, he never stopped searching for ways to make things better.

There was a grace about Rod that came from his refreshing perspective. From simple things, such as believing that it was more important that meetings actually have a purpose rather than simply having an agenda; to his unique way of tackling difficult problems: by breaking them down into small components, throwing those pieces into orbit and then plucking them from the sky to put them in an order that made sense. The real secret to Rod's accomplishments is that he worked tirelessly behind the scenes without regard as to who would get credit for the results.

Three things I know Rod loved:

1. First and foremost, his family, and also
2. The SEC, and
3. American Assembly programs just like this one.

Although I could talk for a considerable amount of time about Rod and his accomplishments, he would prefer that we focus on the substantive issues in the program rather than on him, so I will not go on. However, will you please raise your glass with me and toast a dear and cherished friend who is very much missed and a good friend to the SEC, the American Assembly, and worthy causes far and wide, to Roderick M. Hills.

— Charles D. Niemeier

May 1, 2015



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The Hills Program on Governance is situated in the Center for Strategic and International Studies (CSIS), one of the leading think tanks in the United States. Founded in 2004 by Rod and Carla Hills, its purpose is to identify serious failures of governance, both global and local, to better understand the factors that cause such failures, and to organize efforts to mitigate or reduce those factors. The Program does its own research and regularly hosts delegations, diplomats and statesmen from across the world and hosts forums for exchange of views on areas such as combating corruption and supporting rule of law and good governance. Apart from its private research, the Program has co-sponsored public programs over the past few years on the Governance of Financial Institutions, the Future of the Accounting Profession, and Drug Violence in Mexico. Since its inception, the Program has helped establish similar centers at Yonsei University in Seoul, at the Asian Institute of Management in Manila, at Tsinghua University in Beijing, at IPADE Business School in Mexico City, and at Strathmore University in Nairobi. All of these centers conduct and sponsor research, produce reports, create forums for the exchange of views, and brief others interested in similar problems. Most of the staff at the centers also teach courses at their respective institutions and share curricula among one another. The Washington center participates with the other centers on some of their programs, acts as a nodal hub for the network, and helps raise funds for all seven centers.

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The Zicklin Center was established in 1997 to study and support private sector responsibility and public accountability; promote thinking and scholarship on business and normative ethics; and provide research assistance to the Center's many stakeholders. The Center serves as a focal point for the normative inquiry in business at the Wharton School and the University of Pennsylvania. Center-sponsored research, however, embraces a wide range of scholarly approaches, methods, and disciplines.

### **THE AMERICAN ASSEMBLY**

The American Assembly is a public policy institute founded by Dwight D. Eisenhower at Columbia University. For over 60 years, The Assembly has fostered non-partisan public-policy discussions through convening, research, and publication. Over 100 'American Assemblies' have been held on topics ranging from prison reform to health care to nuclear disarmament. In recent years, Assembly projects have made a wide range of contributions to economic, urban, and cultural policy, including projects on workforce development, financial regulation, and the role of the arts in American universities. Today, The Assembly has two major program areas—Cities and Knowledge Economie—which focus on building the resources and networks needed to develop effective public policy in these areas.

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