SEC Historical Society
Interview with Carlo di Florio
Conducted on July 28, 2022, by Kenneth Durr

Ken Durr:

This is an interview with Carlo di Florio for the SEC Historical Society's Virtual Museum and archive of the History of Financial Regulation. Today is July 28th, 2022. And I'm Kenneth Durr. Carlo good to talk to you today.

Carlo di Florio:

Great to talk with you, Kenneth.

Ken Durr:

Take me back to how you got started in all of this. You went to Tulane, is that right?

Carlo di Florio:

I did. I went to Tulane University down in New Orleans and I studied political economy. I really found myself enjoying the intersection between law, economics, and society, and so pursued that in my political economy major. I then took a year off between college and grad school and had a great opportunity to go live and work in Japan as an instructor for a Time Life educational subsidiary that taught business and conversational English to senior executives who were traveling the world for business . While living and working in Japan, I also had the opportunity to travel and visit other countries and cultures in Asia. I had the opportunity to experience the same intersection of law, economics and society, but more on an international and comparative scale, and really found it fascinating. I decided while I was working in Japan that I would apply to law school, and so I did. I applied to law school from Japan for the following year, finished my year in Japan came back and started law school.

Ken Durr:

At Penn.

Carlo di Florio:

Yes, it's called the Dickinson School of Law, Penn State University.

Ken Durr:

Okay. Yes, Dickinson. Did you start to get into business law, securities, at that point?

Carlo di Florio:

I did. I was really lucky to have an incredibly dynamic dean of the law school, who I got to work with as a research assistant. His name was John Maher, and he passed away in 2015. In addition to being a dynamic dean of the law school, he was also a great professor who taught me corporate and securities law. He had been a well-established partner in New York city law firms and then a general counsel of large public companies, and so he had great securities regulation experience first hand. He was my mentor when I was in law schooland that started me on the interesting path around securities law. There's also a fun fact there, which is: when I then walked into the SEC on my first day of work as the director of the exams program 17 years later, there was a handwritten letter in my inbox sitting at the very top from Dean Maher, congratulating me on my appointment and expressing a lot of enthusiasm. He was a really important influence in my life. He also taught Merri Jo Gillette and encouraged her application to the SEC. John put me and Merri Jo in touch when I joined the SEC. His note said, "Reach out to Merri Jo, she'll be a great partner for you." Indeed, Merri Jo was a great partner and trusted adviser to me during my time at the SEC.

Ken Durr:

He was an important mentor, and he kept track of you at the same time.

Carlo di Florio:

Yes, exactly. Very fortunate to have someone like that at an early age to influence your trajectory.

Ken Durr:

So did you think about going into a firm or doing securities law? How did your route forward get defined?

Carlo di Florio:

Yes, it was interesting. I practiced traditional law for a while, including corporate securities law. Some of it was international in nature, and I really enjoyed that piece of it. I decided to go back to law school and pursue a master's (LL.M) in international law and finance. I did the program at Georgetown at night, and I worked full time during the day to finance it. It was a great experience. I worked with a firm that was comprised primarily of former senior Department of Justice leaders, US Attorney chiefs and former senior regulators. There were also former investigators from those agencies, as well as former FBI and CIA officials. Our work focused on internal investigations for companies, for boards, for investors and for governments. I found the work fascinating, and a lot of it was securities fraud related investigations.

I had the opportunity to learn from people who were really knowledgeable about the securities law industry, and I really liked what they were doing. That was the first time that I thought what I'd like to do is public service, like these folks had done. They were terrific, and I wanted to do that kind of public service and get that kind of experience and background. I thought about going to Justice and doing white collar work there. But around the time I was finishing up a program at Georgetown, this firm got acquired by PricewaterhouseCoopers, which along with the other big four, were investing heavily in forensic investigations, white collar fraud teams. That seemed like a really interesting opportunity and I was invited to join them in building that new practice at PwC. That was my path to the global investigations practice at PwC, where we helped companies, governments and international institutions investigate fraud, corruption, money laundering, and a lot of the critical securities fraud and financial crime issues of the day.

Ken Durr:

What was the driver? Why were the big four looking to beef up this capability?

Carlo di Florio:

It's a great question. It was a very fast-growing business. And I think that was a reflection of the fact that the markets generally were growing very fast, and the industry was very dynamic. The major enforcement agencies and regulatory agencies, like the SEC and Department of Justice and the federal bank regulators were all becoming bigger and more aggressive and more investigative in nature. There was just a lot of work to be done. PwC's global investigations team would be hired by law firms or boards or government agencies to come in and do that independent third-party investigation that all parties could rely on. I think it was the growth of that business that made it very interesting to the big four.

Ken Durr:

And this kind of cloak and dagger stuff must have been interesting to you just starting out. Talk about some of the most intriguing tasks you got.

Carlo di Florio:

Yes, it was fascinating to me. I think it was really easy to recruit, because people found it fascinating and wanted to understand and investigate these issues and stand up for justice and good governance and all that good stuff. I got to work on a lot of very serious security fraud investigations in the private sector, but those cases, of course, are privileged and confidential and the kinds you would expect to be occurring with the SEC. But we also did some really interesting international investigations and those tended to be matters of public record, so I can talk about some of those. These big public cases were more international accountability exercises.

One was with the Volker Commission. The Volker Commission was established in the late nineties. You may recall when there was a lot of scrutiny of Swiss banks and how they had treated assets belonging to victims of Nazi persecution. The Swiss banks themselves had done some internal investigations on their own in the wake of World War II, when these allegations first arose. The international community did not find those investigations credible, so eventually the Swiss banks went deeper again in subsequent decades. But each time they came back with a very small number of findings and had again and again lost credibility in the eyes of the international community. Finally, this international committee was put together under the leadership of Paul Volker, the former Fed chair, very preeminent in the banking industry, to conduct a credible third-party investigation and put the issue to bed and resolve it once and for all. It was Paul Volker and his committee that hired the big four to each take on one of the big Swiss banks and do a comprehensive investigation. I was part of that team, and I was selected to lead the investigation into one of the regions of Switzerland where that bank operated – the Ticino region of Switzerland. I had an amazing opportunity to work with and play a leadership role with a really terrific multinational team of PwC colleagues. Eventually, across all of our investigations across the country for the Volker Commission overall, we found a very large number of accounts belonging to victims of Nazi persecution that had not previously been brought forward, and a large amount of money that was at stake.

We then worked with the Volcker Commission to establish an international database of all records and put in place a process where people could submit claims. We published the names, people could submit claims, and recover their funds. It was a fascinating investigation. It was also one of those wrenching reassessments of the role of what had previously been considered a "neutral" country during World War II andNazi wartime behavior. As you can imagine, it was a very sensitive investigation requiring a great deal of independence and yet diplomacy so we could successfully carry out this important historical investigation from start to finish. For me, it was fascinating, and it was my first big public accountability international investigation at PwC.

Another international investigation that was a matter of public record that I can discuss a bit involved the World Bank and international corruption investigations. In the late nineties, the World Bank had a new president, James Wolfensohn, who had come in from Wall Street and really wanted to bring transparency, integrity and accountability to the World Bank, which had been rumored to have a lot of corruption and fraud in the international development projects and with some of the officials. Before Wofensohn came in, there had been an unspoken policy at the World Bank not to talk about fraud and corruption, and he changed all that.

Wolfensohn knew that before he could focus on fraud and corruption in the international development projects, he needed to clean house and make sure that his team of World Bank officials didn't have allegations against them. To do this, he hired our team at PwC to come in and help him establish an investigative unit to begin to do those early internal investigations. This was a very controversial undertaking, but he got a lot of credit in the media for taking it on. Overall, these investigations and the accompanying accountability helped him get comfortable with the program he had inside the World Bank. That internal governance process and accountability opened the door to the World Bank being able to look at corruption, fraud, money laundering and the like in the international development projects around the world and improve governance, transparency and accountability. I think he made a tremendous impact on really raising the bar of transparency and integrity in the international development world.

The last one I'll mention, because it is closely related, is the Bank Baligate scandal in Indonesia following a multibillion investment by the World Bank and IMF to help Indonesia transition from dictatorship to democracy. In Indonesia there was a dictator, Suharto, who had been in power for a long time and was known to be very corrupt. When his dictatorship finally toppled during the wave of democratic movements in the 90s, the World Bank, the IMF and other international institutions and national governments stepped in to help fund a very significant transition from dictatorship to democracy in Indonesia. There was a $12 billion lending package that the World Bank and the IMF were funding to support this transition to democracy. At a certain point they learned of significant allegations of fraud and corruption in the Indonesian Bank Restructuring Agency that had been set up to help privatize the banks. They stopped their funding until a credible independent third party completed a comprehensive investigation. PwC was hired to perform the high profile independent third-party investigation, and I was part of that team. We worked very intensely for about six to eight weeks. Our activities were tracked daily in the local media and had significant international coverage in publications, such as the *Financial Times* and *The Economist*.

Given all the attention and scrutiny, we really had to keep our heads down and do our work as quickly and effectively as we could. We benefited greatly at the time from a very new technology, which allowed us to connect relationships and funds flow between bank and securities accounts and follow the money across transactions. To really help us follow the money in this investigation, we needed to plug that technology into the Central Bank of Indonesia, but the laws prevented us from being able to do that because of bank secrecy regulation. This was the same challenge we encountered in Switzerland with the Volcker Commission investigation, so we applied the same solution that we did in Switzerland - the national legislature passed a special exception to the Bank Secrecy Laws to allow us to conduct this independent third=party investigation for the good of the country. That allowed us to follow the money, identify the public officials and the corporate executives who were involved in the corruption and fraud and present our findings to the Indonesian government, the World Bank and the IMF. This investigation and the accountability that followed ultimately enabled the World Bank and IMF to release the funding back to Indonesia and help with that transition from dictatorship to democracy. It was a fascinating and very rewarding experience, which I will never forget.

Ken Durr:

I noticed that during this period at PwC, you're also doing some writing, speaking of the press and things like that, on governance, risk management and compliance. And I want to figure out how do you get from this reactive investigative work you're talking about, to looking to head things off through proactive governance, risk and compliance strategies? How did you make that transition?

Carlo di Florio:

Something that always struck me when we did investigations, was how acutely they reveal fundamental breakdowns in governance, culture, ethics and risk management. The two pillars of our work were to investigate serious frauds and then also make recommendations on how to make sure those kinds of things never happened again. And it always struck me that we took a very narrow approach - whether it was regulators, enforcement authorities, the companies, the governments or the international institutions -, because the exercise only focused on the specific incident.   I would always walk away with the perception that this narrow focus isn't getting at the broader organizational, cultural, ethical issues in the institution that were the root cause for the incident occurring. So invariably the problems would recur, just in the different part of the organization and in some different form. It was around this time, with these perspectives and experiences, that I started to become more interested in understanding the root cause of failures and how to design more proactive and preventive solutions—good governance, good risk management, good compliance, good ethics—to help companies and organizations avoid those problems.

I started to represent PricewaterhouseCoopers in international standard setting bodies that were establishing standards along these more holistic, comprehensive frameworks. I was involved with developing the COSO Enterprise Risk Management Framework and Application Guidance. I was involved with developing the Open Compliance and Ethics Guidelines. I was involved with developing Transparency International's Business Principles for Countering Corruption and Bribery. They were all taking this broader, more holistic approach to designing and implementing good governance, risk management, and compliance best practices.

Given these thought leadership roles and experiences, it was around this time, that PwC leadership asked me to lead a team to build out our capabilities and business around governance, risk management and compliance, or what we called GRC. That was a really exciting endeavor. To your question there, Ken, one of the first things we did was put together our point of view on what really good governance risk management and compliance looks like across people, processes, technology and data analytics. We published our point of view in a white paper called *Integrity-Driven Performance: A New Strategy for Success Through Integrated Governance, Risk, and Compliance Management*. It was really well received at the time and it helped launch our business. A fun fact here is that now I'm at ACA Group, which is one of the leaders in GRC, and that industry has grown to an over $35 billion market. So again, these GRC themes are kind of a consistent arc throughout my career, which I found really interesting, followed in different ways and through different threads, but always around that GRC endeavor.

Ken Durr:

So you're talking about a discipline of sorts that's developing during this time. Other people were having the experience you were having. What were some of the other things that were leading to the development of this risk compliance, risk management?

Carlo di Florio:

I think the regulators played a really important role. And around this time, sort of the early to mid-aughts, you started to see regulators coming out with enterprise risk, enterprise compliance, regulations and requirements. A great example is the SEC coming out with the Compliance Rule for investment advisors. This rule required investment advisers to have an effective overall compliance program. That was a really big step. It sent a signal to the industry that you can't just have these targeted disconnected exercises around discrete regulatory requirements, but you need to have a coordinated, comprehensive compliance program that has a Chief Compliance Officer who is responsible and accountable and has independent standing and authority to get the job done.

This rule set new expectations. A firm needs to have clear policies and procedures. A firm needs to do training. There needs to be effective monitoring and testing. A firm needs to investigate when there are issues and resolve them and remediate them timely. I think this move away from discrete compliance and toward enterprise compliance and risk programs was an important development and contribution that regulators made at that time. The bank regulators, the Fed, the OCC, had very similar supervisory releases requiring enterprise compliance programs inside of banks and detailing what they should have as part of the overall holistic program. Then you had the whole COSO Enterprise Risk Management Framework, which brought the "Risk" dimension into it. There was a lot of new focus on this new discipline around enterprise risk management. Finally, this was the era of corporate governance. The big frauds revealed at Enron, WorldCom and many others around this time called into question the need for better corporate governance of companies. It was more focused at the board level. But it was about how the board oversees and makes sure that the company is meeting its legal and regulatory requirements, is operating ethically, is managing risk strategically, and is ensuring good governance of that organization.

And so I think it was the confluence of all those forces that really created this more healthy, more holistic, more comprehensive view of integrated governance, risk and compliance (GRC).

Ken Durr:

That's terrific. It explains the forces that were going on at the time. It also sets us up really well for what we need to talk about next. But before that, I want to make sure there's nothing else from your time at PwC that we should talk about.

Carlo di Florio:

Just a fun memory. I was at PwC when the SEC's Compliance Rule was released. I was thinking through how we were going to leverage our GRC framework to help our clients understand these new requirements, advise them on how to implement effective compliance programs, and support them with all the heavy lifting around annual reviews, testing, reporting and remediation. I remember sitting in my office and finishing to read the new rule and release and thinking to myself, "this is a really important moment." It's funny to think that 6 years later I would walk into the SEC as the new Director of The Office of Compliance Inspections And Examinations, which played such a big role in the development of that rule and ensuring firms met the spirit and the letter of the rule.

Ken Durr:

Yes. Well, let's talk about how that happened. Post 2008, you can't ignore Madoff. The SEC, and OCIE in particular, is in a good bit of trouble. How did this come across your screen as being a job, a position you might be interested in taking?

Carlo di Florio:

First of all, I was a student of the SEC and regulatory and legal institutions, and so I held them very dear. I thought they played a critically important role in our markets and broader society. I was focusing my career in the financial services industry and regulation. When the financial crisis hit, when Madoff and Stanford hit, it was like a perfect storm. I think everyone who was involved in this area felt a certain sense of how can I help, in this moment in time, to preserve what's really great and good about our financial system, about our regulatory agencies and bodies, and about the firms that work in the industry and the people who work in this industry? How can we help rebuild and restore public trust and confidence in that?

So, I was very interested. I'd mentioned that earlier in my career I thought I wanted to go to the Department of Justice. Public service was always in the back of my mind, and this felt like a really great moment and opportunity to serve and give back. I was a partner at PwC at the time, I talked to my partners and said, "I'm really interested in going and helping at this moment." And my partners were incredibly supportive. PwC had a long history, like many other institutions, of partners going and serving in senior roles in government. And it's a really healthy back and forth to bring industry best practices, bring back regulatory best practices, breach misunderstanding, facilitate understanding and cooperation.

I went down, interviewed with the new chair, Mary Shapiro, and the senior team, as well as all the commissioners. I was really, really impressed with the caliber and character and integrity of all the people that I met with, the importance of the agency and yet the fragility at that incredible moment in time, where it was being, to your point, criticized by both parties in Congress, the media, everyone, for having missed Madoff and Stanford and the financial crisis. I didn't think that was all fair, but understood where that sentiment was coming from. More importantly, it felt like the people inside the agency were feeling under attack, underappreciated and uncertain about the future for the SEC. There were calls to disband the SEC. There were calls to disband OCIE, and there was just a burning sense of urgency to restore public trust and confidence in the SEC and in the exam program. I found that to be a wonderful mission, something that I would really love to do.

So I joined Mary and her new team of directors leading the various divisions and offices. I think we had an incredible sense of teamwork, collaboration, pride, and mission in what our mandate was and we went about it with a sense of urgency. Mary used to say, "I want everyone running around like their hair's on fire." Let's get at this and let's get at it quick and let's restore the SEC and its programs to the stature they deserve and therefore have the public confidence in them.

Ken Durr:

So you came in early 2010, is that right?

Carlo di Florio:

January 10th, 2010. I came in during the big snowstorm. My first day, there were something like two feet of snow on the ground and it was amazing.

Ken Durr:

You spoke in general terms about what Chair Shapiro and the commissioners were after, but how about some of the specifics? You had the IG's report, which ... I forget, there were something like 52 points, all of which Chair Shapiro agreed with. In that big ball of issues, which ones did you prioritize and how did you do that at the very outset?

Carlo di Florio:

Yes. First, I would just be remiss if I didn't just say that the teams in the SEC were and are incredibly talented and had done a great job already. I joined the SEC in the aftermath of the biggest financial crisis since the Great Depression and the two biggest frauds in the history of the United States. But that was January 10th. There had been a period of time there, six to eight months before I joined, where a very talented team, the very talented teams inside the SEC, had done immediate diligence, and understanding, and lessons learned, and taking proactive steps to take advantage of those lessons learned.

So, when I came in, my mandate from the chair and from my interactions with Congress was do a comprehensive review, understand all the gaps and the issues and the breakdowns that occurred, and put together the critical solutions that are going to make this a great National Exam Program going forward. So, get after that work, do that comprehensive review.

Second, testify before Congress. Testify before other stakeholders, talk with other stakeholders and share what we are learning and what we're doing. So, there was a big communication role there. And then, really important, just behind the scrutiny on Madoff and Stanford was get ready for Dodd-Frank and all the incredible work that's going to be required by the exam program around Dodd-Frank. Those were the three big things. So, I broke it up into Madoff, Stanford, financial crisis, and what's our plan in each of those? What did we learn and what are we going to do to strengthen and improve the program.

With Madoff, that was $65 billion Ponzi scheme, the largest in history. It had gone on for 16 years, during which time the SEC had received a half a dozen tips, complaints, referrals from different parties. They had conducted three exams. They had conducted a couple investigations, but the fraud hadn't been identified and uncovered. So, what were the critical lessons learned and what did we have to do to address those lessons?

The first that was probably the most important, was we need to have one central place in the SEC, where all tips, complaints, referrals, concerns that we get about a firm or around individuals, where that's centralized, so that when we decide what we're going to do about a firm or an individual, we have all the facts in front of us. We know how potentially big it is. We know where the concerns are. We can draw threads and connections between different aspects of the tips or complaints or referrals, and we're not going in blind with one eye covered. We have the benefit of all the information about this firm or this individual going in. That just wasn't the case.

Over 16 years, different tips, complaints, referrals had come in. Different teams had looked at different aspects of those, not knowing that there were other teams looking at things, that there were other referrals, concerns to consider. So, that was a really big problem and a really big solution, build that integrated TCR database.

The second critical gap in need of a solution was asset verification. We need to verify assets. And that became a critical exam exercise in the wake of Madoff and Stanford. First thing you do is check to make sure that customer assets are there, and they're as represented by the firm. Don't take the firm's word for it. That was a really big thing and so we launched asset verification broadly. We automated that process. We had data analytics around it, and that became a fundamental response.

The third critical gap in need of a solution was custody. With Madoff in particular, there were other really important things. You recall a custody rule in the SEC was really born out of Madoff. The notion that custody really needs to be well regulated. There needs to be really good governance, risk management, and compliance around it. And in those circumstances where a firm maintains custody, doesn't use a credible, independent third party. In those instances, there need to be surprise audits. So, the custody rule, the focus on audits became intense. And if you think about Madoff, you had a really big market maker that also had an investment advisory business with unusually smooth, 12 percent returns, with a very tiny little auditor in some strip mall in New York.

And so this gave birth to the PCAOB, the need for standards around audits, for auditors to be qualified by the PCAOB, and then for them to be regulated by the PCAOB. And that really was another critical lesson learned, a critical area of focus for us. These all became red flags and risk indicators in our risk analysis on which firms should we examine, what area should we focus on at those firms?

A fourth critical gap in need of a solution was aberrational performance. I mentioned that Madoff told regulators, told investors, told everybody that he made these incredibly smooth 12 percent returns because of his options split strike strategy. Anytime regulators see aberrational performance now that's smooth, that's a huge red flag. We're going to want to go in and look at that. So, the team did a great job building that capability right off the bat.

A fifth critical gap in need of a solution was breaking down silos. I mentioned that we did three exams of Madoff over the 16 years leading up to the fraud being disclosed. Those were on the broker-dealer side of the business, but it was the investment advisor side of the business where the fraud took place and Madoff's investment advisor business had been registered, but we had not gone in and examined it in the four or five years that it had been registered, despite the tips, complaints, referrals, and the like. So, a couple big lessons learned and new protocols there. One is, let's think about firms holistically. Again, bring all that TCR data together around tips, complaints, referrals. Think about the broker-dealer, the IA, other parts of the business. Think about the team and the talents that we need to go in and do an effective review and let's make sure we do that.

So, we brought together integrated broker-dealer, investment advisor exam teams. We cross trained. We made sure that we had more holistic understanding of the firm and its risks before we went in to do our exams. That was really important.

A sixth critical gap in need of a solution was around governance and escalation. Madoff was known to be an overbearing CEO who would micromanage exams and regulators during the times they did go in, and that's a red flag. And so now, in the exam program, we have specific risk indicators around that. We look for that. We respond to that. That's really important, but in all of this around Madoff, and we'll talk about Stanford in a second, there was not the escalation to the home office in DC and the more comprehensive review and independent perspective on the issue, the fraud, that there should have been.

Our response to this was to implement really good governance on national programs and escalation protocols to resolve issues, make critical decisions, provide some independent challenge and make sure that we were approaching tips, complaints, referrals, or concerns we had about a firm or individuals, in the most strategic and impactful way to protect investors. These were some of the critical lessons learned and responses to Madoff that I had to testify before Congress about.

Stanford was a different story. Stanford was a story where really talented examiners identified and escalated a Ponzi scheme concerns. (I would like to note that there were very talented examiners on Madoff as well, they were narrowly focused and didn't have all the data and information, but they were very talented.). With Stanford, our examiners went in, conducted four exams of Stanford and on all occasions referred and recommended to the Fort Worth enforcement program and leadership that this looks like a Ponzi scheme, and that they – Ft. Worth Enforcement team - should institute an investigation and bring an enforcement action. And in all four instances, the enforcement program in Fort Worth chose not to do that. You had this big disconnect there, but it was never escalated to Washington, so 14 years passed before the fraud was revealed and escalated.   So during all that time, the SEC lost the opportunity to act upon what the examiners had identified.

The critical governance breakdown in Stanford is that the exam concerns and Ft. Worth Enforcement's decision not to take action was never escalated to the Director of OCIE or the Director of Enforcement for them to be able to look at it, examine it and say, "Wait, this is something we need to dig into and not give up until we get to the bottom of it." So big lesson learned around governance and escalation again. And we put in place protocols and programs to fix that between exams and enforcement, to make sure we're making decisions together, to escalate and review where regional teams disagree on whether or not to take an enforcement action based on a referral and to periodically review referrals not acted upon by Enforcement. That was a really important part of Stanford.

Another really important part of Stanford was understanding why local enforcement leadership never acted on the concerns about a Ponzi scheme that the exam team kept on escalating. One of the key discoveries was that there was an incentive system in place in enforcement that really credited the regional offices for the number of enforcement actions they brought, which had the perverse effect of incentivizing quick, easy, slam dunk cases and avoiding very complex, sophisticated, international cases, which is what Stanford was. So, enforcement got after that problem and quickly changed the incentive structure, improved that process.

And then last, in Stanford, as in Madoff, there was more information, more broadly about the firm—the practices, the tips, complaints, referrals—that one local regional team didn't have, but what a central office would've had bringing all that tapestry of information together. So again, the need to be comprehensive, complete, and centralized in these critical issues.

Ken Durr:

Yes. One of the questions I was going to ask was when the name National Exam Program came up, where the origins of that were. I'm hearing clearly that what was driving it was just this idea that everything had to be in one place.

Carlo di Florio:

That's exactly right. So, that was just a term of art that I had brought to bear to really get at the essence of the Madoff and Stanford findings, that how do you explain what we had, what we didn't have, what we needed. And it was clear that we had really good regional teams running programs in very disparate ways. And what we didn't have was a national, unified exam program that was governed from the top down, that could address and see all of the critical information, could coordinate with other SEC offices and divisions as well as other regulators, nationally and internationally, to investigate critical cases, that could make the tradeoff decisions around allocation of resources. We needed a program that could ask what other resources could we bring in from other regions, different programs, to investigate something? We needed that National Exam Program to move away from this notion of a confederation of regions that really operate somewhat autonomously. We needed to break down silos and improve governance, decision-making, information flow, escalation and accountability. The National Exam Program solved for all of this and became the umbrella framework under which all of our improvement initiatives were implemented.

The National Exam Program concept, strategy and plan was well embraced because the regions themselves felt very vulnerable based on the findings of Madoff and Stanford. They understood that no one region has all the data, the tips, the complaints, referrals, resources, etc. They understood that if one region acts on their own, there's a lot of liability at stake. And that the better solution is to operate this as a national program. So, there was a lot of support around that. We created a shared vision, mission and strategy around it. We executed on that strategic plan with great discipline, implementing over 150 improvement initiatives. I had a very inclusive governance process to undertake the comprehensive review that brought all the regional directors and all the regional associate directors into a shared leadership team, so that we together as the national leadership team could define our vision for the program, our mission for the program, and how we were going to review and improve the program.

I think the inclusivity, the fact that we had the cases of Stanford and Madoff, the sense of urgency to restore trust and confidence, and the regions seeing the benefit of working together, the "why" this is beneficial for investor protection and what's in it for each of the regions if we've become this more comprehensive National Exam Program. I think there was a lot of quick support in that direction, even though we had to overcome some old regional silos legacy and behaviors.

Ken Durr:

In this group that you put together, what were the kinds of insights that the regions provided? Was there something about that perspective that was particularly valuable to you in DC?

Carlo di Florio:

The regions provided a lot of great insights to help us identify the root cause problems and develop effective and efficient solutions. When you think about it, you bring together a team to undertake a comprehensive review. We had the insights of the inspector general. We had a number of independent reports that had been done identifying flaws. So, we had all of those insights. We had my insights coming in from the outside, as well as the external insights from the team I'd assembled from the outside to bring an independent perspective. Fundamentally the team inside the SEC, the existing exam program team, which was comprised of incredibly talented people across the regions, had just an enormous amount of insight. One of the things I thought was really important was to implement a process as we embarked on this comprehensive review, that would have both a confidential channel for centralizing suggestions for improvement, so you didn't have to identify yourself, AND a transparent channel that you could identify yourself, where anyone, any examiner on the front lines, could say, "You know what? I've been working in this program for two or ten years. I've always thought, 'Why don't we do this?' or 'I've been working in the program for two or three years, and I don't understand why we do this procedure because it's not effective." And those ideas could be escalated, centralized, analyzed and inform both our root cause analysis for Madoff, Stanford and the Financial Crisis, as well as innovative solutions to better protect investors and markets. So, this bottoms-up effort to gather ideas as a critical component of our comprehensive review.

Then you had all the middle managers who really saw what was working and not working across the program, both up and down across their teams, and they brought terrific insights and perspective. And then you had this incredibly talented team of senior leaders from across the regions, with 15, 20, 30 years of experience, who had tremendous insights and this was their opportunity to share them and see them actioned in our overall improvement plans. Remember, this was a fortunate moment from a resource perspective, because both sides of the aisle wanted to fix the regulatory framework and maximize the likelihood that Madoff, Stanford and the Financial Crisis scenarios would be mitigated in the future and improvements would protect investors and markets. So, we had budget and resources that my predecessor Lori didn't have, and other pre-Madoff and pre Financial Crisis SEC directors and other divisions didn't have to their benefit. Congress doubled the resources for the SEC after this. So we had resources with which to do more and I think that was a great benefit to be able the strengthen the SEC overall and fund these improvement ideas so they could come to life.

At the highest level the way we structured the comprehensive review was to break it down into critical elements of the program we wanted to review, analyze and improve, including our **mission**, our **vision**, our **strategy**, our **structure**, our **talent**, our **processes**, our **technology**, and our **data analytics.** Those were the critical elements of our review. "What do we have in place today? What's working? What's not? What could be more effective and more efficient and help us better protect investors?" And then our leadership team broke up into sub-teams and these teams made over 150 critical recommendations on how to improve the exam program. The regions and their teams played an absolutely critical role in every aspect of our comprehensive review and the great solutions that flowed out of that. So, it was a very teamwork and collaboration-oriented exercise, and one of really the most remarkable ones I've ever seen, in my own experience.

Ken Durr:

How long did this process take?

Carlo di Florio:

Really interesting question. My goal was to get most of the comprehensive review done in the first six months. The reasons were: One, it just takes a little bit of time to get in, to get to know everybody, to organize the exercise.   Second, you want to build a sense of shared goals, teamwork, collaboration, vision, and that takes a little bit of preliminary work so that everybody's rowing in the same direction. Then we organized the substantive work in a way that, I think, let us do the crux of the work in just a few months, which was really at lightning speed given the context and the complexity of issues we were looking into.

The time pressure for me was that Congress was finalizing the Dodd-Frank Act, and that was going to be coming into play for OCIE fin the summertime frame. My hope was that we would get the bulk of the comprehensive review done before then, land our vision for the improvements that were necessary, get the support and funding from the chair and the commission and Congress, and have that launched as we then had to turn to the next big challenge for us, which was implementing this enormous new legislation, the biggest since the Great Depression.

Ken Durr:

Did you make it?

Carlo di Florio:

We did. We had such an impressive team and such a great sense of collaboration and such a sense of urgency.

I had given everybody on the leadership team, which was about 30 of us from across all the regions and the home office, a book called *A Sense of Urgency* by John Kotter. It is a short but very impactful book on how to undertake a comprehensive review with a sense of urgency, and then implement all the improvements in a way that makes them successful so that you manage change through the exercise. I asked everybody to read it at the very beginning of the exercise so we would have a common frame of reference. It was really helpful. We followed that methodology, and we were able to get it done in time.

I invited Chair Schapiro and some of her leadership team to a meeting with the whole group that had done the comprehensive review for us to present our findings and our recommendations. It was great. She came down, all the regional directors, and associate directors, and our DC team were all sitting together as a team in a U, and she sat down at the head.   We went through a comprehensive explanation of the review, how we structured it, how we did it, all the sub-workstreams, what the key findings and recommendations were, and she was blown away. She said, "This is fantastic. That you guys were able to come together and get this done so comprehensively in such a short period of time and have agreement on it is tremendous. You have my full support to move forward." And so we did, and everybody was really fired up to turn to implementation and actually implementing all these great improvements.

As I was walking Mary out, she pulled me aside and said, "Carlo, I don't know how you did it, but you herded the cats, and this is a great plan." I said, "This is them. This is the team working together." And I never had that sense of everybody bickering and the regions won't cooperate, won't work together. I never felt that. There were just some traditional things, but if there was a team that was terrific at coming together, working together, collaborating, and driving outcomes, this team did it. They deserve just a huge amount of credit.

Ken Durr:

That's really interesting. Some of the regions had old enmities from a long time ago, between themselves, but also with the home office.

Carlo di Florio:

Yes. Just to that point, Ken, we did have an "airing it all out" session right off the bat, so everyone could get issues off their chests and we could move on. I said, "let's just get the issues out on the table." It was a really healthy session. In that session, some of the things we were talking about came up, like regions saying, "I never understood why OCIE dropped this policy on us. We didn't agree with it. We didn't think it was the right way to go. And yet, there it was. We were told, 'Implement this policy.'" Or a region saying, "You guys do it this way in home office. We do it a lot better this way, using a cool tool or technology that somebody on our team developed." That went both ways. Home office had issues and frustrations with the regions on similar issues.

So it was important to get all that stuff on the table and get it out there, but it would be the tail wagging the dog to make that the primary focus. It was something that kind of needed to be aired so everybody understood what the tensions were. But then there was really cohesive focus forward.

Ken Durr:

But there was still lots of discussion about the need to break down silos. Those are different from the people, because they'd been there, formed out of organizational imperatives and that kind of thing. Talk to me about breaking down those silos, how you did that, how the group did that.

Carlo di Florio:

First, I think, Madoff and Stanford helped. They revealed how destructive silos were and how much they can expose regional silos to liability and mistakes. Nobody wanted to be the next silo. I found that the group was very receptive to my mantra of, "We've got to break down silos and have a comprehensive, coordinated governance model and team."

So what were some of those silos? One is the regions. The regions had fierce independence. They liked operating as regions. They had a sense of pride in being from this regional office or that regional office, and they took their orders from the region. So that was a challenging silo.

Did that silo serve New York well during Madoff? No. It served New York horribly during Madoff, because they weren't able to find the issues and the root cause, because they didn't bring the broader team in. So that regional silo was exhibit A.

Did the regional silos serve Fort Worth well with Stanford? No, it was a disaster. Information never got out of the silo, so nobody else was able to come in and help. Investors were harmed in a major way in both cases because of silos.

Those cases helped demonstrate the risks of operating in silos and not having a National Exam Program. Also, if you're in a region and you're operating in the data in the region, you're going to miss all the other insights and information and data in the tapestry that helps bring the picture into focus. It was pretty clear that that silo needed to come down in order for us to be able to better protect investors and market integrity.

The exercise here was very simply not how do we make region A or region B better, it was, "How are we, as the SEC, generally and the Exam Program specifically, best able to protect investors in market integrity?" We would analyze problems and solutions through that lens. And never did a silo come out as the right answer to achieve that important mission objective.

So regions was one silo that we needed to break down. Programs was another. Broker-dealer folks really thought of themselves as a certain really strong cohesive crew. Investment advisor examiners thought of themselves as a really strong cohesive crew. They both thought differently of each other's industries and markets and firms. And of course, in the meantime, the industry was rapidly growing beyond mono-firms, and you had many dual registrants, investment advisors, broker-dealers operating together. Madoff was a great example. It was a Broker-dealer and an investment advisor.

And we needed to break through that notion that I'm either/or, and into the notion that I'm and/and. So we started cross-training to get examiners both competent to examine investment advisors or broker-dealers, or both together. That was a really important silo to break down.

Again, Madoff and Stanford helped us, right? Because we saw what the cost was of maintaining those silos. That was really big.

The third thing that really helped was competency silos. So the SEC was designed to hire primarily lawyers and accountants. That's a silo of perspective and discipline.

Meanwhile, the industry had dramatically moved on and was very sophisticated, very complex. Lawyers and accountants played a role, but technologists played a role, data scientists played a role, product experts played a role, trading experts, risk managers and so on. This diversity of talent didn't exist in the Exam Program because of the siloed perspective on, "Let's hire examiners—let's hire accountants and let's make them generalist examiners" didn't reflect the reality of where the industry was. And in part, it's very hard for an examiner to sit down and talk to Madoff about his split-strike option strategy if you don't really understand what that is, right?

So bringing in experts was one of the critical strategies that we had to improve the program. And we got to hire a few hundred people while I was there, which was a tremendous opportunity, and we would generally lean in the direction of bringing in experts to make our team more diverse, more sophisticated, more comprehensive, and more able to solve problems with a diversity of perspectives.

A fourth silo was people, right? The SEC was very focused on people. People can solve problems, people can investigate, people can do examinations. And again, the industry had moved on and broken through that silo and was rapidly using technology, and data analytics, and comprehensive algorithms, and patterns. That required a whole different set of capabilities. So we had to break through the silo of people being the answer, into this broader framework of designing a National Exam Program strategy leveraging people, process, technology, data analytics, and the like.

So those were some of the silos we had to break through to identify the root causes of problems that led to the challenges in the financial crisis, the challenges in Madoff, the challenges in Stanford, and then open the door for us to identify really good creative solutions to strengthen the program going forward.

Ken Durr:

You talked about the timeline before for doing the self-assessment. How about standing this thing up, the implementation of the National Exam Program? Did that roll out pretty well, or was that a long process that had to be done in increments?

Carlo di Florio:

Yes. You said it well there at the end. Any kind of comprehensive transformation like we were implementing here is going to happen over a period of time. Some things can be done relatively quickly, like establishing policies and procedures to do asset verification or establish effective reporting and escalation protocols to home office.

Other improvements take a longer period of time because of the nature of the improvement. For example, we established over a dozen new units in the Exam Program to achieve very specialized objectives. You've got to recruit experts. You've got to find the right leader. They've got to come together and develop their program. That's more of an intermediate time frame exercise. .

And then you have things that are going to take a longer timeline, like technology investments. We had to define our business requirements, identify the technology you need, put together a business case, get budget approval for it, do vendor selection and integration, then get that whole technology system wrapped into the SEC. That's going to take yet a little bit longer time. Identifying and buying all the data sources that will make you more informed, better, faster, smarter, that's going to take a little bit more time.

So I looked at it as, "Let's come up with the right vision. Let's make sure we've understood the root cause of the problems. Let's come up with the right solutions and recommendations. And then let's sequence those on a big implementation plan that shows exactly when we're going to implement each of these improvements over what time period, and that becomes what we measure ourselves against, and that becomes how we determine whether we're successful or not." This transformation plan enabled us to design and implement over 150 improvements to the program during the time that I was there. I felt really, really proud of the team for, again, maintaining that sense of urgency, running each of their pieces and that overall implementation plan down. It was like turning on capabilities switches like, "check, now we have quants. Check, now we have trading specialists. Check, now we have private fund experts. Check, now we have technology. Check, now we have data analytics," and just turning those capabilities on one by one and seeing the whole program significantly improve in a different light. That was really rewarding.

Ken Durr:

One last thing that I thought was interesting, and this must have come toward the end of that process, or maybe somewhere in the middle. You did what you called an inward-looking review, where you tried to make sure that there was a compliance culture within OCIE itself.

Carlo di Florio:

That's right. There were a couple things that I thought were really important that we provide to the industry so that it would rebuild their trust and confidence and it would also empower CCOs in the industry, firms in the industry, other key players in the industry, to improve their programs. In a way, sort of be our deputies, because we were only a thousand examiners relative to a huge industry, right?

Three things in particular I thought were really important. One is that we have the discipline that we expect firms to implement. We expect them to have compliance programs. We should have a compliance program. We should hold ourselves accountable to the same standard of training, monitoring, testing our program, just like we expect firms to do that. So we implemented that. And for the first time, we created one unified National Exam Program manual that laid out all the policies and procedures that every examiner anywhere in the country would follow consistently, just like you would expect a firm to have one consistent compliance manual that they hold their firm to. That was tremendously helpful. It allowed us to then automate that exam process end to end, which also helped drive training and consistency.

The second was to publish our annual exam priorities, so that the Exam Program was proactive, not a gotcha program. Let's make our exam priorities transparent. Every year, these are the priority areas that we're going to focus on. So if we come to your firm, you better have your house in order and not be surprised, because we've shared with you what we see as the critical risks to investors and markets, and so what we're going to spend our time on. That was really new and different, and the industry really appreciated that.

On average, we were only able to get to 15 percent of firms. By publishing our priorities, we deputized CCOs all across the industry to take that as their checklist and to get that work done over the course of the year. So it was also just an ability to have a bigger impact.

The third area of focus was to publish the key findings from our exams in the form of Risk Alerts on key toipcs. We shared the results of our exam findings, both in terms of the deficiencies that we saw in priority areas and effective practices that we saw. So that, again, CCOs could take that in and fix their own programs to align with the effective practices and do a health check to see whether they had any of those deficiencies and needed to fix them to raise the overall level of compliance in their organization. These Risk Alerts were also very well received by the industry. All three of these improvements continue to this day.

Ken Durr:

Okay. You talk about reaching out to CCOs. And OCIE had previously done that. There was CCOutreach. There were also the sweep examinations, which were widely publicized. Did you continue that with the sweep examinations as a way of providing information?

Carlo di Florio:

We absolutely did, Ken. What we started with was all the great work that Lori and the exam team had done from the time OCIE was established to the time we came in. That was just a great body of work to build an excellent program with really talented people. When I came in, I wanted to embrace all that was working really well with the program and then build upon that to improve it further.

We didn't want to stop doing anything that was really helpful and useful there. We focused our energy on, given the way the markets are developing and given what we learned from the financial crisis and Madoff and Stanford, "What additionally can we implement to strengthen the program?" That was our focus. So we had a wonderfully strong foundation to work from and a wonderful opportunity to further strengthen the program.

So we kept the CCO outreaches, we kept the sweeps. We kept a whole lot. I mean, so much of the program is what Lori and the team built that we inherited. The way I think about these things is that we're all one team running one very long relay race. We sort of get the baton that our predecessor poured a lot of heart and soul and energy into to make it really strong. The next person brings the same energy and sense of urgency to improving the program further, and so on and so forth. That's not just in OCIE, but also across the SEC.

So I picked up from the great work that Lori had done. Drew picked up from the good work that our team had done, that he was part of. When he left, Mark picked up from the good work that Drew had done to improve the program further. And Mark and his team took it to the next level. And then Pete Driscoll came in and took it to the next level. And now Richard Best is coming in with Joy Thompson, and they're taking it to the next level. That's just kind of the virtuous relay race that occurs.

Ken Durr:

A lot of runners in that race.

Carlo di Florio:

Yes. A long arc.

Ken Durr:

Let's talk about that landslide that you were thinking was going to come down on your shoulders, which was Dodd-Frank. A number of people have shared with me OCIE being the eyes and ears of the SEC. In this case, there's a lot of rules to implement, right? A lot of rules to be worked out, to start with. What was OCIE's role in that process?

Carlo di Florio:

One of the things we did as part of the comprehensive review was to take a fresh look at our mission, vision and strategy, just as we were taking a fresh look at our people, process, technology, data analytics. In looking at our mission, we landed on a mission that had four pillars - first is to prevent fraud, second is to promote compliance, third is to monitor risk, and fourth is to inform policy. Again, the spirit of building on all the good work of our predecessors, prevent fraud and promote compliance were kind of the heart of the existing Exam Program mission. And we decided to add inform policy and monitor risk.

The reason we did is because, one, monitoring risk was such an important lesson learned coming out of Madoff and Stanford and the financial crisis. And we had implemented several new quantitative analytics programs and risk analysis and surveillance programs and the like to help us do that better, be able to look around the bend, identify emerging risks, trends, and issues.

To inform policy was also a new aspect of the mission. The thinking there was that the largest piece of securities legislation in history since the Great Depression is about to land on our desks, and examiners are going to have a whole lot of great insights to help inform the rules and regulations that need to flow out of that Dodd-Frank Act. So we put together a function and a process whereby we identified all the parts of Dodd-Frank that really impacted the Exam Program, and then we identified an Exam Program expert and liaison who would serve with the policy divisions and others in the rule-writing exercise. We did that comprehensively.

It was a huge effort and it was a really well-done effort. I remember my fellow directors really thanking us for putting in the time and effort to make sure that the rule-writing teams understood from the examiners, who were the eyes and ears of the SEC in the field, what are some of the practical challenges, what are firms struggling with in this area? What are things you're going to want to get out of this rule, in terms of data, policies, procedures, practices, that we're going to want to incorporate into the rules so you guys can do the exams and risk monitoring that you want to do. So that was a really comprehensive exercise, and it turned out really well. It still goes on today. It's a process, because now that's one of our formal four pillars of our mission. There's a continuous process for the exam teams to inform policy and rulemaking.

Ken Durr:

There were particular parts that were urgent, which is you've landed some new entities that you need to examine. Talk about that. Talk about how you prioritized that and worked out the next steps in hedge funds and the like.

Carlo di Florio:

Yes. So, if you think about Dodd-Frank you're exactly rights. We had whole new responsibilities. We had private funds, hedge funds, private equity firms, which were coming under registration and needed to have a whole exam program designed around them. We had credit rating agencies, which were a big part of the financial crisis and were coming under a whole new regulatory regime. We had clearing agencies, which were the fundamental plumbing of the financial system that Dodd-Frank had taken to a new level of Fed, SEC, and State oversight that we had to develop a program around and coordinate. A whole bunch of new rules and regs around security-based swaps and broker dealer requirements, municipal agents. So a whole lot of new regulations. And what we did to address those was take them one by one, and think through what do we need to put in place to be able to effectively examine this industry and monitor risk?

Private funds was probably the biggest. It was really significant effort. First, we needed experts in these areas. Expertise is one of the critical improvements that we made. We found and recruited great experts. We brought two industry experts in to lead the effort, Marc Wyatt, who ultimately became OCIE director, and Igor Rozenblit, both of whom had come from the private fund industry. We hired a number of other folks with great private fund experience, including general counsels, CCOs, and the like. My deputy director, Norm Champ, had been the former general counsel and CCO of a private fund, and he was incredibly helpful in building this capability and training the broader team. Experts, they know where the bodies are. They know what the games are that are played. They can focus immediately on the critical issues, and they'll have credibility when they go into do exams. So we hired the experts. We built specialized units so that they could really have an impact and program to focus on.

We did a presence sweep to get out quickly to the private funds and say, "we're here, here are the kind of things we're going to look at, here are our expectations," so they could feel the presence of the SEC and begin to understand what it meant to now be a regulated entity. And we worked really closely with our colleagues in the division of enforcement, which had a specialized asset management unit, and the division of investment management, which had all the responsibility for the rule writing around these new areas. We worked in very close coordination and partnership with them. And that's effectively the play that we ran for each of these new areas. We did that for private funds. We did it for the credit rating agencies.

For the Credit Rating Agency exam program, we looked for people who had been leaders inside of credit rating agencies, many of whom had risen the red flag and said there's conflicts of interest. We had an excellent team that we brought in there. Robert Cook and I were asked by Mary Schapiro to identify, recruit, and select the new head of the credit rating agency program, which was required to be a new office under Dodd Frank. In the meantime, they were housed in the exam program. Ultimately we hired Tom Butler to lead that new office, and he did a fantastic job.

Until Tom joined us, I was going out with these new leaders to meet with the boards of directors and the senior management teams to explain the expectations, talk about strategy and critical risks. I had rolled out a Large Firm Monitoring program that allowed us to do this more broadly across the top ten financial institutions. We did the same with the Credit Rating Agencies.

For Clearing agencies, the flavor there was that we had to coordinate with the Fed and with the states and really put together a collaborative program. I recruited Dawn Patterson in with terrific industry experience to lead that program. Again, people with expertise were brought into the program.

Ken Durr:

He was leading within the SEC?

Carlo di Florio:

I'm sorry?

Ken Durr:

Patterson was leading within the SEC?

Carlo di Florio:

Within the exam program. So these are all people who ran the exam program components of it. So Mark Wyatt and Igor Rozenblit ran the private funds team. Tom Butler ran the credit rating agencies team. Jim Giles ran the large firm monitoring team. Dawn Patterson led the clearing agency team. Drew Bowden led the investment advisor investment company exam team. Julius Leiman-Carbia led the broker dealer exam team. So we really had terrific talent coming together to lead each of these critical elements of existing exam programs and new expectations coming out of Dodd-Frank.

Ken Durr:

The large firm monitoring unit is interesting because you're working with the Fed, with the OCC. Was that a smooth process? Was it difficult?

Carlo di Florio:

It was a lot smoother than I expected. Again, I had heard coming into the role that agencies are always bickering and they don't coordinate. On my first hundred-day plan, I had noted who I was going to call, the senior heads of supervision at the Federal Reserve, at the Office of the Comptroller of the Currency, the bank regulatory agencies, with whom I knew we had to coordinate. The criticism of the financial crisis was where were the regulators? And they were all focused on their little alphabet soup piece of the firm. Nobody fully understood the risk profile of the whole firm was the criticism levied at regulators.

So we had to come together and maybe, again, because of that criticism and that transparency, there was a lot of receptivity and great partnership that I experienced with leaders at the bank regulatory agencies. Sarah Dahlgren, my partner at the New York Fed, had worked very closely with Tim Geithner. She was an excellent partner, and we got our teams together right away. Same at the OCC, same at Treasury. So we got together, we formed teams, we shared concerns, risk perspectives we were seeing across our areas of the firm. We met together with senior management, with boards of directors, had very strategic conversations, and all of that modeled effectively and reflected what was happening at the Financial Stability Oversight Council, which had been established by Dodd-Frank to make sure that there was a comprehensive regulatory approach to thinking about the industry, the risks in the industry, the responses in the industry. I had selected Jim Giles to lead and build out the Large Firm Monitoring program, and he did a terrific job.

Ken Durr:

We talked about Dodd-Frank, which was one of the big externals that you had to deal. Another one, which was less expected, would have been the flash crash. Tell me about OCIE's role and your role in following that up and figuring out how to try to keep it from happening again.

Carlo di Florio:

Yes. This was another one of the "biggest" things that we experienced – in this case one of the biggest days of intraday volatility and plunge in history. And immediately, Chair Schapiro called a group of us around to respond to it. OCIE, as the eyes and ears of the SEC immediately deployed teams to each of the exchanges and the trading venues to begin to understand what happened, gather data, gather information, flow it back to the SEC. My fellow director, Robert Cook, was running point in Trading and Markets. And then there was also the Office of Risk, Strategy and Financial Innovation that had been established by Mary Schapiro to give a broader perspective on risk. Gregg Berman from that Office was the point person there. The exercise was to understand what happened. From my perspective, the biggest lesson learned was that we couldn't fully understand what happened, without an enormous amount of time and detailed analysis and still, big gaps in the picture. There was no consolidated audit trail that would help us recreate a detailed picture and understand the root causes and potential solutions.

The best thing to come out of the flash crash was that it became the business case and rationale for the need for a consolidated audit trail. We could not track all trades and orders across all markets and be able to recreate events like the flash crash, understand the root causes, and respond in a timely manner. So the teams in Trading and Markets, in Risk, Strategy and Financial Innovation and in OCIE, I think, did a great job, to the best they could with the information and tools they had, to get an understanding of what happened.

But again, I think the better takeaway was we learned that we didn't have the regulatory tools. Our tools were very fragmented. The markets themselves were tremendously fragmented and really making it difficult to recreate events and analyze them for root cause issues. We had new developments like high frequency trading happening, and we had, of course, macroeconomic conditions that had already made the markets very jittery, particularly what was happening in Europe with sovereign default risk. And all of that led to, again, a perfect storm. Ultimately, the SEC and CFTC completed their report, I think it took five or six months, and reported out on it. It was a valiant effort, But to me, the biggest takeaway was we need better tools, and the consolidated audit trail became that tool. It is great to see it come to life today, since the idea for it was really started back then. The SEC and FINRA and the industry have done a commendable job.

Ken Durr:

One last external on my agenda is MF Global. What was the effect of that one?

Carlo di Florio:

MF Global was scary because it reminded us about big financial institutions collapsing. We had just been through the Financial Crisis and big banks collapsing, and yet here we were, with another institution that seemed like it was teetering on collapse. It's CEO, Jon Corzine, had been the co-president of Goldman Sachs that then had gone on to be a U.S. Senator and a Governor of New Jersey, and then was coming back for act two to Wall Street. They had taken really big bets on the European credit crisis and the outcomes around that, and it started to show weakness. It was under a lot of scrutiny. We, of course, as regulators, were very concerned about protecting customer assets. When firms are under stress, sometimes they need resources and they reach for resources that the law prohibits them from using, which are customer resources.

And sure enough, ultimately, it was found that there was a deficiency in customer assets, and that led to the collapse and liquidation of MF Global. That was one of those moments where Mary called a number of us into her office. Gary Gensler was on the phone from the CFTC, Jon Corzine and his team were on the phone from MF Global, and it was, "here we are, here's our concern, what are you doing?" What's the plan? We deployed immediately teams onsite from OCIE and from Trading and Markets. And those teams did a tremendous job, found the issues, escalated the concerns. And ultimately, it was an unfortunate outcome for customers who were left holding the bag, leading into the collapse.

Ken Durr:

So this is an instance in which OCIE is working closely with enforcement, I guess.

Carlo di Florio:

Working closely with the Division of Trading and Markets. One of Mary's mantras was to always work very collaboratively. So we were working nonstop all the time with the policy divisions, TM and IM, and Enforcement, as well as Risk, Strategy, and Financial Innovation.

Ken Durr:

Okay. Anything that we haven't spoken about regarding your time at the SEC that we should touch on?

Carlo di Florio:

No. I think this has been a great conversation. I really appreciate it. I think the message I would leave is I loved working at the SEC. It was a tremendous honor and privilege. I got to serve under three amazing chairs, Mary Schapiro, Elisse Walter, and Mary Jo White. I got to serve an incredible team of colleagues, both my fellow directors and my team in OCIE and other teams across the SEC, and I consider it just one of the real highlights of my life. And while I'm sitting here talking about it, because you're asking me about the oral history, hopefully I'm representing that this was a tremendous teamwork and collaboration effort across the entire exam division.

Ken Durr:

Terrific. Well, if you have time, I want to just wrap up a little bit with where you went from there. And it's interesting, because it looks like you moved on to FINRA and kind of did more of the same, right? Is that how things worked out?

Carlo di Florio:

Yes, so I had a wonderful opportunity to go to FINRA. I was invited by the CEO, Rick Ketchum, and the Chairman of the Board, Jack Brennan, to join. It was a new role. They were creating the Chief Risk and Strategy Officer role to bring a lot of what we had done at the SEC and blend it with a lot of really good work that was happening at FINRA. Mary Shapiro and Elisse Walter had both worked at FINRA. So that made it even more interesting to me and a wonderful opportunity. They were very encouraging.

Rick Ketchum, who had been at the SEC as the Director of Trading and Markets, a wonderful regulator, was the CEO of FINRA, and I was looking forward to the opportunity to work with and learn from him. I was also excited about the opportunity to contribute to helping to strengthen another really important regulator. I spent ten years as a senior regulator at the SEC and FINRA, which is a big chunk, maybe a bit more than I had expected, but I thoroughly, thoroughly enjoyed it. And I feel the same about the wonderful people I worked with at the FINRA as I do about the wonderful people I worked with at the SEC.

Ken Durr:

And now you're at ACA Group, and this finally gets you back to your global interests, I guess.

Carlo di Florio:

Yes, ACA brings it all together. This is my biggest, most exciting and most entrepreneurial role yet. I get to be both a significant investor in the business and a global leader of a fast-growing Private Equity backed dynamic company - one of the "unicorns" in the market – a private company valued at over $1 billion. We are the largest employer of former SEC regulators and FINRA regulators, so it brings a lot of my former colleagues into our core business. We also are the largest employer of former in-house risk and compliance officers, so just a tremendously talented team.

We help firms comply with laws and regulations, just like I did at FINRA and the SEC, and at PwC before joining the SEC. We also help firms manage cyber security and technology risk, just like we focused on at the SEC and FINRA. We also help firms implement environmental, social, and governance (ESG) programs, and comply with the global investment performance standards (GIPS), again really important elements at both the SEC and FINRA. But it also lets me bring the tools of technology and data analytics, and a lot of the things we brought into the SEC and FINRA that were experiences I'd gathered at PwC. So

I have the pleasure of bringing all of that together into this role. It's fast growing. It's dynamic. We've doubled in size since I've joined, nearly tripled in value, and we have a really exciting trajectory forward. It's the culmination of all those experiences. Also, as you note in your question, it provides me an opportunity to build a global business, which is a very rewarding experience that leverages my international work with PwC and with IOSCO.

Ken Durr:

Some would argue that this is a great example of the revolving door with all those former SEC people.

Carlo di Florio:

Yes, I am a big fan of the revolving door because it brings critical experience and skills sets to regulatory agencies and great regulatory ambassadors back out to the industry. I think it's a wonderful, wonderful tool. Some people are worried about potential conflicts of interest, but there are robust programs at the SEC and FINRA to manage that risk. If you just think about the oral history that I just shared about all the significant improvements we made to strengthen the National Exam Program, that could have never happened without the benefits of the revolvling door and all the talent we were able to recruit into the agency. We also deployed significant technology and data analytics. That wouldn't have been able to happen without the experienced experts we brought in from the outside on how those can be used. And then with experts we hired from the outside we built a national exam program with all sorts of process improvements. A lot of that came in as industry best practice. And then we developed the exam priorities and the risk alerts, again, sharing back out with industry critical lessons. So really, a wonderful benefit has been the revolving door. You got to manage the conflicts, but it's a great benefit.

Ken Durr:

Well, that's a great place to leave things. Thank you so much for the lessons and the insight. It's been a great talk.

Carlo di Florio:

Thank you so much, Ken. I really appreciate it, and really appreciate all the work you're doing with the Historical Society. Thank you.

Establishing The National Examination Program, 2010-2013 (Supporting Detail)

Press Release announcing departure of Carlo di Florio -
https://www.sec.gov/news/press-release/2013-2013-80htm

Regional and Home Office leadership come together to conduct a comprehensive review to assess lessons learned from the Madoff, Stanford ponzi schemes and the Financial Crisis, and to implement improvements to strengthen the Exam program, including:

1. Establishing a National Exam Program with key centralized support functions
2. Recruiting quants and other industry experts and establishing Specialized Working Groups
3. Investing in new technology and data analytics to improve risk assessment and outcomes
4. Promoting compliance and transparency through Annual Priorities, Risk Alerts and engagement with firm leadership on emerging risks, industry trends and strategic developments; and

5. Establishing new risk assessment and examination protocols for new Dodd-Frank responsibilities.

1. **Establishing the National Exam Program:**
   - Breaking down regional and programmatic silos to establish one integrated National Exam Program, supported by centralized support functions, e.g.:
     - National governance model with clear roles, responsibilities, reporting lines and escalation protocols at the individual and committee levels
     - Centralized coordination model between Exams and Enforcement to break down Madoff/Stanford related silos and establish clear escalation protocols
     - National Investment Adviser/Investment Company Exam Program (lead: Drew Bowden, who then went on to serve as Deputy Director and the Director)
     - National Broker-Dealer Exam Program (lead: Julius Leiman-Carbia)
     - National Clearance and Settlement Program (lead: Dawn Patterson)
     - National Market Oversight Program (lead: John Polise)
     - Establishment of one consistent National Exam Program Manual and Compliance Program to drive consistency nationally (lead: Paula Drake, Chief Counsel)
     - Centralized Operations function (lead: Robert Fishman and Pete Driscoll, Managing Executives. Pete then went on to serve as Chief Risk and Strategy Officer and then Director)
     - Centralized Risk Analysis and Surveillance Unit (lead: Jim Reese)

       - Implementing a risk-focused exam strategy supported by a newly formed Risk Analysis and Surveillance Unit to aggregate, analyze and prioritize data from within and outside the SEC to help allocate resources to mission critical efforts.

     - Centralized Large Firm Monitoring Unit (lead: Jim Giles)

       - Monitoring systemic and large firm risk through the establishment of a Large Firm Monitoring Unit that works with other SEC divisions and other regulators nationally and internationally to collaborate on risk assessment and monitoring without duplication of effort.

       As we increase our focus in these areas, we will generally want to understand how risk management is embedded in key business processes and decision-making at five levels:

       - How do the business units of an entity ensure they are taking and managing risk effectively at the product and asset class level in accordance with the risk appetite and tolerances set by the board and senior management of the whole organization?

       - How are key risk management, control and compliance functions structured and resourced to ensure they are effectively embedded in the business process, while having the necessary independence, standing and authority to be effective in helping the organization identify, manage and mitigate risk?

- How is senior management ensuring effective oversight of enterprise risk management and embedding risk management in key business processes, including strategic planning, capital allocation, performance management and compensation incentives?

- How does the internal audit process independently verify and provide the board and senior management with assurance regarding the operating effectiveness of risk management, compliance and control functions?

- How is the board of directors (if one exists in the organization) staffed and structured to ensure it can effectively set risk parameters, foster an effective risk management culture, oversee risk-based compensation systems and effectively oversee the risk profile of the firm?

- Centralized Private Fund Unit (leads: Marc Wyatt and Igor Rozenblit. Mark then went on to serve as Deputy Director and then Director)
- Centralized Quantitative Analytics Unit (lead : Erozan Kurtash)
  - establishment of a Quantitative Analytics Unit comprised of quants to examine complex data sets and identify new and emerging risks in algorithmic/high-frequency trading and other investment and trading practices.
- Centralized function to inform Dodd Frank Rule-making (lead : Norm Champ)
- Centralized Technology function (lead: Ed ?)
- Centralized Communications and Change Management function (lead: Carolyn Grillo)
- Centralized Examiner Training Program with SEC University
  - Ensuring quality, consistency, and ongoing professional excellence through the establishing a Certified Examiner Training program to enhance skills, expertise and ongoing technical and leadership training for the SEC's more than 900 examiners.
- Centralized Exam Priorities and Risk Alert Publication function (lead: George Kramer)
  - Improving transparency and promoting compliance by sharing and publishing Risk Alerts and Exam Priorities to provide guidance to industry on key priorities, risk focus areas, and exam observations so firms can incorporate such guidance into their own risk assessments and program improvement efforts, thereby enhancing investor protection and market integrity.
- Centralized process to coordinate with other regulators, including bank regulators, nationally and internationally to address Financial Crisis lessons learned:
  - CFTC
  - Fed
  - OCC

- International

2. **Recruiting industry experts and establishing Specialized Working Groups**
    - Expertise included quants, technologists, data scientists, risk managers and industry experts in derivatives, hedge funds, private equity, credit rating agencies, trading, complex products and many other valuable technical skill sets.
    - Specialized Working Groups included…
        - Derivatives
        - Private Funds
        - New and structured products
        - Valuation
        - Market structure and trading practices
        - Fixed income securities
        - Microcap fraud
        - Marketing and sales practices.

3. **Investing in new technology and data analytics**

Technology — Automating the Exam Process to Keep Pace with New Developments

We have focused our technology improvement initiatives on automating our exam process end-to-end, including risk assessment and surveillance; exam preparation; all key activities associated with exam execution, such as trade analysis; work paper management and data analytics and reporting. Here are some of our technology initiatives:

- We've set up our first Technology Committee to oversee our technology resources and strategy.
- We hired a dedicated Senior Technology Officer to develop a comprehensive technology strategy, technology architecture and implementation plan to automate and strengthen our exam program.
- We've added new risk assessment and surveillance technologies
- We're automating our Exam Workbook
- We've developed automated tools to enhance trade analysis
- We've developed management information systems that support key performance indicator monitoring and reporting.

4. **Annual Exam Priorities Letter, Risk Alerts and firm engagement on risk governance and compliance culture.**
    - Initiated an annual Exam Priorities publication to promote better governance, risk management and compliance – see link below
    - Initiated routine publication of Risk Alerts to share exam findings on deficiencies and observations on effective practices.

- Initiated Large Firm Monitoring to engage senior management, boards of directors and risk, compliance and audit leadership on emerging risks, strategies and industry practices.
  - Strengthening firm governance, risk, and compliance by institutionalizing risk governance reviews of registrants that engage senior management, the boards of directors, business unit leadership, risk and control function leadership, and internal audit to evaluate the tone at the top, the culture, and the effectiveness of governance, risk management, and compliance enterprise-wide

5. **Establishing new risk assessment and examination programs for new Dodd-Frank responsibilities, including:**
   - **Private Funds** – Private Equity and Hedge Funds, Form PF introduction and Form ADV enhancements
     - We recruited private fund experts from industry, former GC, CCOs and COOs to build our expertise, training and capability in this area.
     - We established a Private Funds Unit with great leadership by two PF experts (Mark Wyatt and Igor Rozenblitz, both with extensive PF industry experience)
     - We launched presence exam sweep to better understand new registrants, assess potential deficiencies and risk areas and share findings and perspectives back with the industry.
     - We worked very closely with the Asset Management Unit in Enforcement to ensure strong teamwork, collaboration and coordination on exams, investigations and enforcement actions.
     - We worked very closely with the Division of IM to participate in and inform rule-making and disclosure requirements related to Form PF and Form ADV
     - We engaged in extensive outreach to the PF industry to educate firms on what it meant to be registered with the SEC and what they could expect from the Exams program.

   - **Credit Rating Agencies**
     - We recruited Credit rating agencies experts from industry, former credit rating experts and analysts to build our expertise, training and capability in this area.
     - We established a dedicated team, recruited a new Office of Credit Rating Agencies Head (Tom Butler).
     - We worked very closely with the Division of TM around the new rule set
     - We engaged in extensive outreach to the Credit rating agencies Boards of Directors and Senior Management to explain new expectations and how the exam program would work.
     - Worked with Enforcement Structured Products specialized unit.

   - **Large firm risk governance and coordination between the SEC and the banking regulators**

        - One key lesson learned from the Financial Crisis was that the **lack of coordination across the alphabet soup of regulators** in the U.S. contributed to no single regulator or governing body could see the big picture of emerging and systemic risks across the big firms and therefore the entire industry.
        - The **Financial Industry Oversight Council**, created by Dodd-Frank provided one mechanism for bringing together the leaders from all the federal financial services regulators do exactly that and ensuring open communication, collaboration and information sharing.
        - As part of that effort, and to ensure OCIE could provide the Chair and SEC Commission with important insights on emerging risks across the industry and within the largest most systemically risk relevant financial institutions, I established a **Large Firm Monitoring program** within OCIE to focus on these large firms, coordinate with other regulatory partners and report to the SEC Chair and Commission on key trends, emerging risks and important developments.
        - To facilitate this process, I personally **reached out to the heads of Supervision at the bank regulatory agencies** in my first 100 days to meet and agree a framework for periodically bringing together our leadership teams to share key insights, concerns and developments across the industry and within large firms.
        - I also implemented a practice of **regularly scheduled meetings with the Boards of Directors and senior management teams at the largest financial institutions** to focus on strategic governance, risk management and regulatory compliance issues of the day.
        - I attended all those meetings and invited our regulatory partners to join us to facilitate teamwork, collaboration and coordination.
        - That process continues to this day, and I continued to attend these meetings when I went to FINRA, so basically a decade of strategic risk dialogues and engagement.

    - **Clearing Agencies**
        - Critical **systemically important plumbing of the financial system**, so new requirements to …
        - Hiring **Dawn Patterson**
        - Coordination with the **Fed and NY State** Financial Services Regulator
        - My participation in **risk governance meetings**

    - **Volker Rule**
        - Prohibited banks from prop trading and having private funds
        - **Our expertise in trading and new jurisdiction and expertise with regard to private funds was valuable to monitor compliance.**
        - Monitored large firm compliance in through the process noted above

- **Securities based swaps/ derivatives**
  - Hiring **experts**
  - Providing **training**
  - Serving on drafting teams with policy divisions
  - **Specialized working group**

- **Municipal securities advisers/ pay to play**
  - Hiring **experts** to help establish the office
  - Coordinating closely with **MSRB** and developing exam program
  - Same play as Credit Rating Agencies – heavy lift on front end and then transition

- **Whistleblower and TCR process and system**

Di Florio Congressional testimony

Sep. 22, 2010	Oversight of the SEC Inspector General's Report on the "Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme" and Improving SEC Performance, Before the United States Senate Committee on Banking, Housing, and Urban Affairs	Robert Khuzami, Director, Division of Enforcement, and Carlo di Florio, Director, Office of Compliance Inspections and Examinations
May 13, 2011	"The Stanford Ponzi Scheme: Lessons for Protecting Investors from the Next Securities Fraud", Before the Subcommittee on Oversight and Investigations, Committee on Financial Services, U.S. House of Representatives	Robert Khuzami, Director, Division of Enforcement and Carlo di Florio, Director, Office of Compliance Inspections and Examinations
Mar. 10, 2011	Testimony on Budget and Management of the U.S. Securities and Exchange Commission , Before the United States House of Representatives Committee on Financial Services, United States House of Representatives Committee on Financial Services [PDF version]	Robert Khuzami, Director, Division of Enforcement Meredith Cross, Director, Division of Corporation Finance Robert Cook, Director, Division of Trading and Markets Carlo di Florio, Director, Office of Compliance Inspections and Examinations Eileen Rominger, Director, Division of

		Investment Management
Nov. 16, 2011	Testimony on "Management and Structural Reforms at the SEC: A Progress Report" , Before the Subcommittee on Securities, Insurance, and Investment, United States Senate Committee on Banking, Housing and Urban Affairs	Robert Khuzami, Director, Division of Enforcement Meredith B. Cross, Director, Division of Corporation Finance Robert Cook, Director, Division of Trading and Markets Carlo di Florio, Director, Office of Compliance Inspections and Examinations Eileen Rominger, Director, Division of Investment Management Craig Lewis, Chief Economist and Director, Division of Risk, Strategy, and Financial Innovation

Di Florio Speeches

2010

Speech by SEC Staff:
Remarks at the *CCOutreach* National Seminar

by

Carlo V. di Florio[1]

Director, Office of Compliance Inspections and Examinations
U.S. Securities and Exchange Commission
SEC Headquarters
Washington, D.C.
January 26, 2010

From <https://www.sec.gov/news/speech/2010/spch012610cvd.htm>

Speech by SEC Staff:
Remarks at the 2010 NSCP National Meeting

by

Carlo V. di Florio[1]
Director, Office of Compliance Inspections and Examinations
U.S. Securities and Exchange Commission
Ronald Reagan International Trade Center
Washington, D.C.
November 1, 2010

From <https://www.sec.gov/news/speech/2010/spch110110cvd.htm>

Speech by SEC Staff:
Remarks at SIFMA Compliance and Legal Society December Monthly Luncheon, December 2010

by
Carlo V. di Florio[1]
Director, Office of Compliance Inspections and Examinations
U.S. Securities and Exchange Commission
Washington, D.C.
December 21, 2010

From <https://www.sec.gov/news/speech/2010/spch122110cvd.htm>

2011

Speech by SEC Staff:
Remarks at the *CCOutreach* National Seminar

by
Carlo V. di Florio[1]
Director, Office of Compliance Inspections and Examinations
U.S. Securities and Exchange Commission
SEC Headquarters
Washington, D.C.
February 8, 2011

From <https://www.sec.gov/news/speech/2011/spch020811cvd.htm>

Speech by SEC Staff:
Keynote address at the SIFMA Anti-Money Laundering Seminar

by
Carlo V. di Florio[1]
Director, Office of Compliance Inspections and Examinations
U.S. Securities and Exchange Commission
New York, NY
March 3, 2011

From <https://www.sec.gov/news/speech/2011/spch030311cvd.htm>

Speech by SEC Staff:
Remarks at the IA Watch Annual IA Compliance Best Practices Seminar

by

Carlo V. di Florio[1]

Director, Office of Compliance Inspections and Examinations
U.S. Securities and Exchange Commission
Omni Shoreham Hotel
Washington, D.C.
March 21, 2011

From <https://www.sec.gov/news/speech/2011/spch032111cvd.htm>

Speech by SEC Staff:
Private Equity International's Private Fund Compliance

by

Carlo V. di Florio[1]

Director, Office of Compliance Inspections and Examinations
U.S. Securities and Exchange Commission
New York, New York
May 3, 2011

From <https://www.sec.gov/news/speech/2011/spch050311cvd.htm>

Speech by SEC Staff:
The Role of Compliance and Ethics in Risk Management

by

Carlo V. di Florio
Director, Office of Compliance Inspections and Examinations[1]
NSCP National Meeting
October 17, 2011

From <https://www.sec.gov/news/speech/2011/spch101711cvd.htm>

2012

Date	Title	Speaker	Type
OCTOBER 2012			

Oct. 22, 2012	Conflicts of Interest and Risk Governance	**Carlo V. di Florio**	Speech
MAY 2012			
May 2, 2012	Speech by SEC Staff: Address at the Private Equity International Private Fund Compliance Forum	**Carlo V. di Florio**	Speech
JANUARY 2012			
Jan. 31, 2012	Speech by SEC Staff: Remarks at the Compliance Outreach Program	**Carlo V. di Florio**	Speech

Exam Priorities

- 2013 Examination Priorities
  February 21, 2013

Risk Alerts

- SEC Examinations of Business Continuity Plans of Certain Advisers Following Operational Disruptions Caused by Weather-Related Events Last Year
  August 27, 2013
- Strengthening Practices for Preventing and Detecting Illegal Options Trading Used to Reset Reg SHO Close-out Obligations
  August 9, 2013
- Significant Deficiencies Involving Adviser Custody and Safety of Client Assets
  March 4, 2013
- "Pay-to-Play" Prohibitions for Brokers, Dealers and Municipal Securities Dealers under MSRB Rules
  August 31, 2012
- Strengthening Practices for the Underwriting of Municipal Securities
  March 19, 2012
- Strengthening Practices for Preventing and Detecting Unauthorized Trading and Similar Activities
  February 27, 2012
- Investment Adviser Use of Social Media
  January 4, 2012
- Broker-Dealer Branch Inspections
  November 30, 2011
- Master/Sub-accounts
  September 29, 2011

From <https://www.sec.gov/exams>