

**SEC Historical Society**  
**Interview with Annette Nazareth**  
**Conducted on November 4, 2005, by Kenneth Durr**

**KD:** This is an interview with Commissioner Annette Nazareth at her office at the Securities and Exchange Commission on November 4, 2005, by Kenneth Durr. I'd like to start with your education and a little bit of background. I understand you went to Columbia Law School.

**AN:** Yes; I did.

**KD:** I want to hear what it was like taking classes from Harvey Goldschmid.

**AN:** That's a very interesting question. Harvey Goldschmid was certainly one of my very favorite professors. Harvey was and is an extremely gifted professor. I actually took anti-trust law from Harvey and corporations. Interestingly, I did not learn securities law from Harvey; that's not the class that he was teaching when I was there. But I got to know Harvey a little bit better than I otherwise may have because I was also a researcher for him when he was updating his anti-trust book.

I have to say that his mastery of those areas was also pretty amazing. Frankly, I enjoyed the anti-trust class enough to have considered being an anti-trust lawyer, although in retrospect I'm very happy I did not pursue that. But again, he was a really wonderful person to know in law school and it was a tremendous honor to be able to come to the Commission and then have the opportunity to work with him again.

**KD:** Sure.

**AN:** And particularly thrilling now having what I consider to be his seat, in a sense, having been appointed to the Commission upon his retirement.

**KD:** So he use to send you out to the library to do research?

**AN:** Yes. It wasn't really a very difficult task because his textbook was widely accepted and it was really a question of ensuring for the next edition that there weren't any additional cases that changed any of the analysis or the footnotes.

**KD:** Did you go right into the financial industry out of law school?

**AN:** I did. I went to Columbia because I was interested in financial services issues. I'm not quite sure how that happened; there was nothing in my background in particular that would have said that that's where I would end up. But when I was at Brown, I was interested in economics and I guess through my study of economics I became interested in capital formation. I was interested—intrigued, I should say, more than interested—intrigued at the possibility of going to Wall Street and learning how public offerings were done, how the capital markets were accessed. And so through that interest I decided to look for law schools that really would emphasize corporate and securities law. Columbia

was at the top of the list of schools that had that emphasis, and certainly given their location in Manhattan, also provided tremendous access to Wall Street.

**KD:** And did you go right into the industry?

**AN:** No. I did not start out in the securities industry. I thought that I would practice law in the securities area and wanted to get what I would consider one of the best post-graduate educations that I could get by going to a Wall Street law firm. So I started my career at Davis, Polk & Wardwell in 1981 and went there to do corporate and securities work. It was a really invaluable experience because they had such a steady diet of interesting corporate and securities work and banking work. I was in the corporate department and they used to rotate people through the three areas into which they at that time divided their corporate practice, which was primarily securities offerings, mergers and acquisitions, and banking—commercial banking, lending type situations. I rotated through all three and spent most of my time at Davis, Polk on mergers and acquisitions work, which was very interesting.

**KD:** Did securities turn out to be your favorite?

**AN:** I actually did less work on public offerings than in the other areas. I did more of the lending work. I worked on the Brazilian debt restructure and I did some other sovereign debt restructuring work. It was very interesting. I did more private placement work than

I did public offering work. I had started to shift into some more public offering work towards my later days there, but for some reason—luck of the draw or just the way I rotated through—I would say that my experience in the public offering area was probably the least of my experience there.

On the other hand, through mergers and acquisitions you do a lot of '34 Act work—and '33 Act as well, so I was certainly familiar with it, but not through straight corporate public offerings.

**KD:** I was really intrigued by the first company you went to.

**AN:** I see.

**KD:** Because I saw that the Yugo was one of your concerns.

**AN:** Yes, yes.

**KD:** And talk about bringing back memories.

**AN:** Yes, painful ones for me. When I left Davis, Polk I had a really—in retrospect—tremendous opportunity, a very unusual opportunity. I was just turning 30 years old and I was offered the chance to go to a regional broker dealer named Mabon Nugent which at

that time was number fifty in the country in terms of equity capital. And I was to be their general counsel. So it was a fantastic opportunity to take a pretty senior position in a somewhat smaller broker dealer but one that was nevertheless well-respected, particularly in the fixed income area, and to advance my career in that way.

I learned a tremendous amount about the securities industry through that job and I think one of the advantages—it wasn't by design—but one of the advantages in retrospect of having gone to a somewhat smaller firm was that I really did do a lot more hands-on work that I might have done. I didn't have to specialize quite as much as I would have had I gone to a much larger firm at that point, and I was very lucky. I worked very closely with the managing partner of the firm and other senior people, who really taught me a tremendous amount about the business. They had me right by their side and with everything they did, and really explained to me how the business worked.

And so it was a really unique experience. But we did have a few problems including the offering of the Yugo, which was obviously very difficult financially for the firm. So we weren't immune from the mistakes that are made by lots of people on Wall Street, but again it was a really good learning experience.

**KD:** And then you made the move to Lehman?

**AN:** And then I made the move to Lehman Brothers. Mabon Nugent had been sold to a foreign entity and so its business started shifting somewhat and I think its commitment to the US markets was also changing over time, and so I was interested in moving at that point to a firm that I thought would have a broader base of business. I didn't pick the ideal time to move; I was five months pregnant with my daughter when I moved. I was hired by Tom Russo, Vice Chairman of Lehman Brothers, who I had worked with a lot when I was at Mabon Nugent. He was chief outside lawyer at Cadwalader and he brought me over. As has always been his way, he was very generous in talking me up with the traders. And when I showed up the first day on the trading floor, clearly very far along in my pregnancy, the traders looked at me as if they could not believe that Tom had sold them such a damaged bill of goods.

So I was very lucky. We ignored, literally, the elephant in the room and just moved on. But that was a wonderful segue into working for larger broker dealers. There I was in charge of the fixed income legal section which was really a great opportunity for me because Mabon, although we were full-service, was really known as a bond house. So my area of expertise was in fixed income. Lehman's businesses were just tremendous; many of them were number one in their areas, including structured products and things like that. And so it was a great opportunity and worked out really well.

**KD:** So you came in specializing in bonds?

**AN:** Yes. I was the senior lawyer for the whole fixed income area, and at that time Lehman was number one in fixed income, so it was a great chance. Again, I was a somewhat smaller fish in a much larger pond, so it was a move well worth making.

**KD:** And then the next jump?

**AN:** And then the next jump was to Smith Barney. That was likewise a good opportunity because there I was brought in to be the General Counsel of the whole capital markets division. So again, trying to broaden myself back out and not just being limited to fixed income, I was made a managing director, which at the time seemed important. I would then be the senior lawyer over all of the sales and trading of securities and the derivative products and the futures.

**KD:** So this gave you a very broad overview?

**AN:** It was a broader overview, exactly. It was also a very dynamic time on Wall Street because shortly thereafter, as you know, Smith Barney merged with Salomon and then shortly after that they announced that they were merging with Citigroup. So it was a very dynamic time where the job shifted—there were several permutations.

**KD:** Things were moving underneath your feet.

**AN:** Things were moving underneath frequently which is a truism on Wall Street. If it doesn't happen you're probably in a very unusual place.

**KD:** Did you deal with the Commission at this point? What was your impression of the Securities and Exchange Commission?

**AN:** Well I always had a very high regard for the SEC. It never in a million years occurred to me that I would work at the SEC or go there. But I certainly had a deep respect for the Commission. I had participated in industry activities that enabled me to meet with the Commission staff primarily; I was active in both the Securities Industry Association and the Bond Market Association. And so through those efforts I would work with other industry participants to comment on rule-makings and the like.

I don't think I ever met a Commissioner. I did have some interaction with the Enforcement Division—not too much fortunately. It's funny. Just the other day I ran into Colleen Mahoney who she said that she felt like she had known me before but she couldn't recall the context. It was an enforcement action that, very late in the game, I got involved in with Lehman Brothers. We had not spoken in person, which is one reason why she didn't remember in particular, but I spoke to her over the phone several times about how the order should be fashioned, so that there was no question that Lehman was consenting and agreeing to what had been done, but that the characterization of some of the activity I thought was problematic. And she said “well I hope I was helpful.” I said



you certainly were. I recall that we agreed on the changes. So that was my somewhat limited experience with the Enforcement Division.

**KD:** You never got a Wells Notice on your desk or anything like that?

**AN:** Well we certainly had a lot of Blue Sheet requests and we did have issues, but fortunately I don't recall personally being inundated with enforcement matters. I also wasn't in charge of litigation or the regulatory side per se at some of these larger firms.

**KD:** How did you come to the attention of Arthur Levitt?

**AN:** Well that's a good question—totally by accident, I think. When I was at Salomon Smith Barney, I had the pleasure of working with someone who had been chief of staff to Arthur Levitt named Michael Schlein, and at some point in my tenure at Smith Barney, my husband started working in Washington. He was a member of the Federal Reserve Board and so he was commuting back and forth to New York, but working in Washington most of the week—or actually all of the week. The senior folks at Smith Barney were aware of that and seemed to be looking for opportunities occasionally, just to be nice, to send me on little jaunts to Washington.

So they very kindly asked me to represent the firm along with Michael Schlein at a charity event in Washington. I didn't have the heart to tell them that my husband was

actually out of town that day; it did not serve any particularly useful purpose for me. But it was such a nice gesture—and I thought that in the future there could be other opportunities—that I accepted and I came to Washington with Michael. We had not had the opportunity, I realized as we were talking on the plane, to really get to know each other and what our situations were. That was the first that he realized that my husband was commuting.

And so apparently after our event, I went back to New York and Michael made a stop at the SEC to visit his old boss, Arthur Levitt and anybody who knows Arthur will understand this story. Arthur was very happy to see Michael and then said “well, what have you done for me, what have you done for your country?” You know, “I sent you to Wall Street—I sent you back into the world, but you were supposed to send others from Wall Street down here to help me and to assist the Commission and you haven’t sent me a single name.” And so Michael, being pressed, said “well I actually know of someone who is not looking to work in Washington at all but she should be because she’s making her poor husband commute.”

And so Arthur made him give up the name and the phone number immediately and the next day I was stunned, because I think Arthur called before Michael had a chance to warn me; I had a message on my desk from my secretary that said Arthur Levitt called. And the first thought I had was there’s no advice in the recent past that I’ve given that was either so important or so wrong that Arthur Levitt would be calling me personally.

But it turned out it really was Arthur Levitt and it was a cold call from Arthur Levitt. It was sort of “hi, this is Arthur Levitt; I’m Chairman of the SEC. Would you like to have lunch?” And so I did and the rest is history. It was very interesting.

**KD:** Was it easy to make that decision to come to Washington?

**AN:** It should have been easier. I really was a Wall Street junkie. I loved what I did; I loved working in the brokerage firms, being on trading floors; I loved crises. It was the kind of thing, I’d go in the morning and the first time I looked at my watch it would be five in the afternoon. I couldn’t believe how much fun it was, and so I actually debated it quite a bit.

When I told my husband he was so obviously thrilled that it became clear to me that this commuting business wasn’t quite as easy for him perhaps as he had let on. He was extremely interested in my moving to Washington but also made very compelling arguments about the value of public service, which obviously he was a bit ahead of me on. In retrospect it’s sort of silly that I wasn’t more wildly enthusiastic immediately because it is a tremendous opportunity. I did though frankly have some doubts, because of my own love of the dynamics of trading and the active pace on Wall Street, that perhaps policy-making would not suit me—that the tempo of it would not be something

that I enjoyed. And that does take a little getting used to. It's a different style, but once you're hooked, you're really hooked.

**KD:** I take it you had your moments of panic in the process?

**AN:** Yes; but not quite the same way. There's really more time to reflect in this kind of job.

**KD:** As there should be I suppose.

**AN:** Yes, I hope so.

**KD:** At first you were assistant, is that right?

**AN:** I was Senior Counsel to Arthur Levitt.

**KD:** You were senior counsel?

**AN:** Yes. Senior just meaning that I was one of the counsels in the Chairman's office.

**KD:** What was your portfolio? What were you supposed to do?

**AN:** I was covering primarily the market regulation issues that came through the Chairman's office. Arthur had counsel who would independently advise him on the matters that came to him so that he would not only get a briefing from the Division but also to some extent a second look by someone who had expertise in his own office, who could give him independent evaluation of what he was looking at.

**KD:** So you were helping him triangulate?

**AN:** Yes.

**KD:** Did you find yourself generally in agreement with what Market Reg was saying?

**AN:** I did. And frankly if there were times that I didn't or if there were times when I thought that I had issues or questions I would go directly to the division and they were very generous—either making changes or working through the issues or explaining how they got to where they were. There was at least one occasion where Arthur thought that, well, how rigorous are you being because you always seem to have consensus. And I, in my own way, made it very clear to him that it wasn't that there was always consensus to start but that my view was that it was far more productive to work with the division and get to where we all needed to be rather than to tell Arthur that they were wrong and then be the big shot and try to fix it.

I think at first he had some question as to whether that's what was really going on, but I think it became clear later that is what was going on. And frankly, again in retrospect—I'm very glad that it was my style to do it that way anyway—I'm very glad I did it that way because once I had the opportunity to do the job that I really wanted, which was be the Director of Market Regulation, I was viewed as more of a team player rather than somebody who had been foisted on them and who had gotten there by making them all look bad for my own benefit, which was not the purpose at all. The purpose is to ultimately come out of the Commission with a product that we're all proud of.

**KD:** So that worked well even if there wasn't a strategy; you were in a good position to move into Market Reg.

**AN:** Yes, well, it was my desire to do that. When I came to the Commission it was not my desire to be Counsel to the Chairman. I really thought that given my experience I wanted to have the opportunity to be Director of the division. That job was not available at the time I came, although there was a lot of speculation that Rich Lindsey would be leaving soon and I think he had given some indication to Arthur Levitt that he would be retiring in the next several months. So Arthur did not promise me the job, but he said that I would certainly be in an excellent position to apply for it. So again, my view was that if I was going to get there, I was going to get there by getting along with everybody one way or the other.

**KD:** At this point, there had been a funding freeze on the SEC for quite a while and I'm wondering if you saw the effects of that.

**AN:** I was at the very tail end of Arthur's years. I didn't have particular experience with what it was like before.

**KD:** I just wondered if that was in the air at that point and whether people talked about the situation.

**AN:** I don't recall.

**KD:** About the time that you went into Market Reg there was some talk about you going into the CFTC.

**AN:** That's right.

**KD:** Was that serious?

**AN:** That was very, very serious.

**KD:** Would you have liked that decision?

**AN:** I'm really glad that I stayed and that things worked out the way they did. Frankly, it was an honor to be considered, and I was very seriously considered for that position. I think it really came down to Bill Rainer or me for that position. But the securities area is one that I knew well and was comfortable with. I had done work in derivatives, but I really was not as proficient in the commodity futures area. I think I could have gotten up to speed reasonably quickly.

But to some extent, the CFTC is a small agency—and this was certainly Arthur's argument as well—the opportunities in the Division of Market Regulation were pretty vast. Again, obviously being a Presidential appointee and the head of an agency, albeit a smaller one, would still be a tremendous honor, but the issues that Market Reg got to grapple with and address during my tenure were really tremendous. And I think that turned out to be in retrospect the better opportunity for me.

**KD:** So Levitt was selling you on this?

**AN:** I have to admit, I think on the one hand he really wanted me to stay. I think it's fair to say that whenever you're in play like that it sort of increases people's interest in you. I suspect that it didn't hurt in terms of my getting the Market Reg position that the backup was Chairman of another agency. So I think that certainly made people stand up and think she must really have something to offer if we're fighting over her.



**KD:** Right. And it didn't happen too much later.

**AN:** Oh no. It was all being considered at exactly the same time. It was sort of a high wire. Again I came down here having no idea what was going to happen with my career other than Arthur Levitt had convinced me to come down, and then suddenly I could potentially have two fantastic positions. I could potentially have neither position, as well. I was not used to this. I like watching other people play high stakes games on Wall Street, but I personally—you probably have noticed: I'm a lawyer. I am not a trader. So that was a little more risk than I was used to.

**KD:** So things were still moving under your feet even in Washington?

**AN:** Yes, they have.

**KD:** When you took over Market Reg, what did you find and what were your priorities? What did you want to do?

**AN:** What I found was a committed group of professionals who were expert at what they did. I was delighted to see that at the senior levels the people were again very committed to what they were doing and very, very knowledgeable about the markets. I think I was actually surprised at how much they understood about the markets and I think a lot of that came from the fact that they were in the final stages when I came here of Reg ATS. And

I think there was a group of people in the division who had spent a huge amount of time studying the markets and the equity markets in particular. So they were at least as far along and probably some of them knew a lot more than I did about the equity markets, having spent as much time as I had on the fixed income side.

And I think that was my reputation, too. “She’s okay but does she know anything about the equity markets?” I did but they really had developed an expertise for that regulation. So I found that—and I guess my own priorities again having coming from the street, I think Rich Lindsey had a similar priority—everybody over the years had come saying we really have to do some sort of net capital reform, that the net capital rule needed updating.

**KD:** Explain that a little.

**AN:** We had a rule in place that, given modern risk management techniques, was considered somewhat rudimentary or antiquated. We imposed high capital charges for securities positions that did not take into account things like portfolio margining and value at-risk analysis and the like, and there were a lot of people on Wall Street who believed that the Commission should be moving more in that direction as the banks had done the Basel Accord. There was a lot of pressure to do that. It’s a very, very complicated issue and we did ultimately make some significant changes, but something that I thought would be easy was not easy and I can say it took us nearly seven years to do it. I think if I hadn’t been here so long it wouldn’t have gotten done.

**KD:** One of the things you did early on surprisingly involved deregulation derivatives.

**AN:** Yes.

**KD:** I notice that there was some concern about the derivatives market and—I think working with the CFTC—the sense was that holding back regulation was necessary.

**AN:** If you're referring to the Commodities Futures Modernization Act, our piece of it was rather small because the legislation involved mostly deregulating large parts of the CFTC's mandate. But there was also an interest given some things that had happened before in insuring legal certainty for derivatives, which we strongly supported and we worked on that. And we also wanted to make sure that it was clear that securities-based swaps were subject to the anti-fraud provisions. So while the whole package was quite deregulatory, there was some additional certainty that we were able to achieve with respect to derivatives that were securities-based swaps—securities-based swaps were subject to anti-fraud provisions. We thought it was clear but it was awfully good to get it in the legislation.

And then, as you know, the Commission spent a good deal of its time on that legislation on the provisions relating to single stock futures. But much of what was in the CFMA was consistent with what the Commission's position had been in the President's Working

Group on Financial Markets. So coming out of the Long-Term Capital Management issues and the like there was a feeling that yes, there had been problems and the counter-parties needed to have a better understanding about the risks that those that they were doing transactions with were undertaking. But it was unanimous on the Working Group that there was not support for regulating derivatives.

**KD:** Was it the idea that widows and orphans aren't investing?

**AN:** Partly the understanding was that it's largely an institutional market. We didn't really have the concern with retail investors. Certainly, occasionally you'll get some hiccups in the system—and obviously we should have some concerns about systemic risks, but to the extent that most or virtually all derivative transactions are done with counter-parties that are regulated entities, such as broker dealer affiliates or banks, then through the entities that we regulate, we could raise the standards to insure that they understood the transactions, the exposures, and what the exposures were with their counter-parties. And I think we've seen through our focus in that area that there have been substantial improvements in the area of counter-party risk management.

**KD:** Single stock futures went in with this and you were saying that the SEC had a little slice of something...

**AN:** Right.

**KD:** ... was it the other way around for some of those stock futures? Who was leading on putting that in place?

**AN:** Well it was essentially the CFTC bill. It was part of the Commodity Futures Modernization Act. That was the part that the Commission took I believe a most active role in; the reason being that we felt pretty strongly and continued to—and the legislation reflects this—that single stock futures are both a future and a security because a future on a single stock is a substitute for the underlying security and therefore if it's not deemed a security and it doesn't come within the securities laws then you have this gaping loophole for all sorts of market protections like insider trading and manipulation concerns. So we took a very active role in drafting that part of the legislation.

**KD:** You can still sell the futures short on a declining market—right?

**AN:** Right.

**KD:** But you couldn't do it with the securities.

**AN:** The short-sales issues were a bit less of a concern. As you probably know, since then we've done all sorts of short-sale reform as well, but that's not what drove our work on

single stock futures. It was really more of the market integrity, insider trading and market manipulation issues. I don't think short-sales would have driven the process.

**KD:** The interesting part was the agreement to split regulatory authority between the SEC and the CFTC.

**AN:** We shared regulatory authority.

**KD:** How does that work? It would seem very difficult from an outsider's perspective.

**AN:** It depends on who you talk to. I don't think it's actually been that difficult. The futures markets may disagree. But for the most part, for whatever reason, the product hasn't taken off that much, so I can't say we have vast amounts of experience. But all the rules that were necessary to put the product into effect were ultimately completed and put in effect. The regulatory framework is there. It may have been a little duplicative in the sense that the markets have to file it two places—I think that some of the rules wouldn't be effective on filing here as they would with the CFTC. I think we have to approve them, but in general I don't think that has been the problem.

The product hasn't taken off as much as people would like. Some people say it's because the margin is at options levels, not at futures levels. We're trying to address those issues

and are now reviewing option levels on all products through portfolio margining analysis and the like. But I don't think it's been a major problem.

**KD:** Something that it seems you spent a good deal of time with in one way or another is the idea of a national market system. The '75 Act introduced the idea that there would be this national market system. How much progress had been made when you came in 1998? I know you weren't there in '75, but what had been accomplished in the way of bringing markets together?

**AN:** Oh, I think a huge amount had been accomplished. I think we had certainly achieved the early mandates of a national market system. We had multiple competing linked markets. We had order handling; we had lots of things that had been put in effect over time—all of which were consistent with the goals of the national market system.

What happened was that many of those rules that had been put in effect no longer made sense given advances in technology, so that the rules that were well-reasoned thirty years before now were actually having a distorting effect. They were keeping some new entrants out of, certainly the listed market. You had an ITS system that all the listed trades went through for purposes of insuring that you weren't trading through a better price in another market, for instance. But given the protocols of that system and the slowness of the system, if you were an automated market you'd have to wait what would

be viewed as an eternity to get a message back to hear whether or not your trade had been executed.

So that was a major problem. Mismatches in business models meant that the regulations were basically making it impossible for some to even enter the market. So we had to make changes; we were at a point where we were no longer in a steady state. The status quo wasn't acceptable. We had to make some major changes and whenever you make changes of that type that are significant you're going to have people who are disproportionately impacted given where they're starting from, whatever their current business model is, so it was a real challenge to do it. And you can understand why it takes about 30 years to address because some parts of it aren't fun all the time.

But I hope that as a result of that effort we're now at the new plateau, the new place on which we're all going to operate and again be able to continue to further the goals of the national market system and have multiple competing markets with lots of different models and let the best model win.

**KD:** Well you've jumped through the whole process but I want to talk about the process a little bit.

**AN:** Okay.



**KD:** Obviously you had to tackle this in pieces.

**AN:** Yes.

**KD:** Do you recall what kinds of steps you took during your time in market regulation to address this? Regulation ATS for example, was that already in when you came in?

**AN:** Yes. I was in the Chairman's office when that was approved so I really came at the tail-end of ATS. Obviously ATS was very important. It's hard for me to think back on all that we did, but when I started with Arthur one of the things that we did was push the New York Stock Exchange to eliminate its rule—now I forget the number of the rule—this is funny. They had a rule that required that all trades in listed securities be done on the Exchange.

**KD:** 390?

**AN:** 390—how could I forget that? So Rule 390, through a tremendous amount of cajoling by the Commission, was repealed and that was absolutely the right thing to do in terms of basically saying that you couldn't force all listed securities to be done on an Exchange. But the issue now is, what happens next? There was a benefit to insuring that people were having order interaction in some venue and that we weren't encouraging internalization by repealing Rule 390.

So we decided to go out with the concept release on market fragmentation, which was the beginning of dialogue on what does this all mean as we change these rules? What is the impact going to be on the market? Is fragmentation a problem at all? Is this something we should be worried about or not? And what we did was we said, if it's a problem, there are a variety of alternatives that the Commission could consider and we had six different ways if fragmentation was indeed a problem. We said, what about these ideas, and we threw out lots of ideas. They weren't all novel. If you look back at the legislative history going back to the '70s, some of these ideas had been considered then, but sometimes, you know old ideas in a new context make sense.

We threw them all out and started with what we saw as the most benign thought which was, how about if we just have better transparency about the execution quality? The final idea was, what if we make all orders come together in some sort of virtual limit order book? And there were some who read that concept release with great trepidation because they viewed it as the Commission's first move towards a CLOB, a central limit order book, which certainly wasn't the staff's intention at all. It was just to put all the ideas on the table. But merely raising the dialogue had some people absolutely crazed with concern.

Where we ended up ultimately was implementing the first of the thought pieces. We implemented execution quality disclosure statistics, which I think has been an amazingly

powerful tool in having brokers assess the quality of executions that they were receiving at different market centers. So that was a very good result. Then some in the markets said that they thought more centralization of orders would be a good thing and others who were terribly concerned about it, so there were lots of permutations in terms of how we were going to go about addressing these things.

But ultimately we ended up with Reg NMS because, as we continued to have roundtables and hearings and outreach with the industry, there were some primary areas of focus that kept emerging: that sub-pennies were a problem and that basically in today's world, you should be able to access other markets without going through a central pipe. You should be able to do it on a point-to-point basis through various Internet type technologies and therefore if you had access standards as opposed to a central point of access with a single point of failure that would be a modernization step that we needed to take.

Obviously, the trade through rule had caused problems, again because of this notion that it didn't work in the world in which you had some people executing transactions at lightning speed and others who were waiting to get back to you in a minute and a half at that point.

**KD:** That's slow, I take it?

**AN:** Yes, some were doing it in sub-seconds. And then we had complaints about the market data system, not all of which have been resolved, but a small subset of which was addressed in Reg NMS. So it was a very iterative process, but as it should have been, since these were very, very complicated issues. We really needed to get consensus on, of all the things that people are complaining about, what are the most critical things to address? How can they be packaged in one document that will achieve the goals that we're trying to achieve? We put the proposal out a few times to really vet it as much as possible to try to avoid any unintended consequences and now that the Commission approved it, we're in the implementation stage. So it's very exciting.

**KD:** Right. Where was the resistance coming from? Was it coming from the markets that didn't want to lose their sort of exclusive turf? I'm just wondering because there was some substantial concern about trade through, things like that.

**AN:** Right. Well I don't want to characterize exactly where the camp was, because people were all over the lot. I think there were some people who didn't want an order protection rule merely because they thought it wasn't necessary, and that the markets would migrate that way in any case. With them, it seemed more like religion. They simply didn't want regulation. Some who were opposed to it, in fact, had their systems already programmed to do precisely what the rule would require.

So it wasn't an issue of breaking their model or inconveniencing them; it was more that they would have done it anyway, but now that it was a rule they would be audited and they'd have to defend their actions and that kind of thing. It's true that there will be some compliance surveillance, so that it is more of a burden. But we didn't believe that everyone would achieve best price uniformly. Given all the improvements in technology, the fact that you could program systems now to say if a quote is immediately accessible, in less than a second, why shouldn't you use all that computer technology to go get one? So we obviously on balance thought that and the release speaks for itself in that regard—thought that there were public policy benefits and benefits to investors of requiring it.

But I think the irony is that, now that it's been adopted, although we still haven't implemented it, people are somewhat calmer. I think as with many things, people argue up to the last minute that they want a different result, but I don't hear very many people saying today that it isn't going to work. They're saying, "I would have been happier if I didn't have to do it," but we're obviously hoping to make the implementation as seamless as possible.

**KD:** And that sort of thing has happened a lot of times with the SEC.

**AN:** Yes.

**KD:** Right back to the beginning.

**AN:** As you know, I've given speeches on that. It's rather ironic that sometimes I would gain strength by—you'll appreciate this—going back in the history and looking at what people said about similar circumstances. I gave a speech last year before Reg NMS was approved by the Commission that spoke exactly to that issue. We had gone back and looked at other situations, such as when we banned fixed commissions and we got letters saying that grass would grow on Wall Street. We looked back at some of the comment letters on the order handling rules and other instances where people who are now the biggest advocates of those rules were those who literally said you have no idea what you're doing, you're going to bring the capital markets to a grinding halt.

Maybe we've had a pretty good run of it and I hope we'll be laughing about some of the comments in this case as well. It does go to show that we truly have to be dispassionate. We have to take all of these comments very, very seriously and we have to—and we do—ultimately use our own expert judgment because what we bring that others don't is hopefully some objectivity. We are not trying to protect our own models or our own profitability. We do have this overlay of investor protection, keeping in mind a responsibility to insure that the benefits of what we're proposing exceed the costs. But sometimes we come out in a different way than people would like.

But ultimately I think those who are the real visionaries in the business, and I think there are fortunately a lot of them, say for some reason whenever we oppose these things and then they go into effect, often what results is a better marketplace, with more business for everybody. We somehow have benefited, spreads have come down but volumes have gone up—that kind of thing. So I'd like to think that will continue to be the case.

**KD:** And once the rules are in place, the people in the industry learn how to...?

**AN:** They learn how—exactly. And I do think that there were some elements of NMS and clearly with the order protection rule that there will be some—trading will adapt to that rule. It will change a bit. The way block orders are done and the like will change a bit, and so I think people are saying “well I don't want to change.” But they also knew that they'd have to change and really didn't like it with decimals as well—much harder to find liquidity and the like. But they have adapted. It was painful; they didn't like it. Some people still don't like it but the fact of the matter is they learned to adapt to a trading environment where there was a lot less liquidity at every price point and they figured out how to do that.

**KD:** Is decimals better for the investor? Why make that switch?

**AN:** I think decimals are logical in a world of trading where every other jurisdiction in the world trades in decimals and not fractions. To a large extent it simply makes sense.

Obviously it narrows spreads because it's a lot easier to trade in pennies and you don't have an artificial eighth or sixteenth spread. That having been said, I think it was good for retail investors. I think it has made it a bit harder for institutional investors and part of what you saw in NMS was a response to that concern. It definitely was harder to find liquidity in size and that's part of what people were complaining about. This notion of how do we get more people to show what they're willing to trade at, to put up more limit orders in hopefully somewhat greater size—came out of that decimal experience and you see it reflected in NMS.

**KD:** I want to back up just a little bit and talk in broader terms about the Commission. When Harvey Pitt came in, did the tenor around the Commission change?

**AN:** Well I think it changes with every Chairman; of course I was a staffer.

**KD:** How much does it change?

**AN:** Well there's always a lot of consternation. It's funny. It may be partly because I came from Wall Street where there's always quicksand under your feet. I was more used to change, but I think longer term staff at the Commission don't like that disruption as much for the most part. There is some uncertainty over, not what is our mission, but what's the tenor of our mission because the staff really does want to serve the wishes of the Commission and particularly the Chairman. So you get some Chairmen who are more



activist than others or more enforcement oriented than others. They have certain priorities and the staff eagerly awaits the message from on high in terms of what's the tone that is being set at the top?

With Harvey it was interesting because he had been a defense lawyer. I think the initial impression that people had was that he came in being more critical of what the staff had done in the past or its enforcement efforts. But it was interesting to watch and now that I've been there through several Chairmen, I've seen it more than once. I think once you get to sit in that important chair and you look at the facts as the staff is looking at the facts, it changes your tone because you realize where they're coming from, all the things that they can't say publicly as to why they've done what they've done. I definitely felt that was the case with Harvey.

I think he was a very, very bright man and when he looked at the same information that others on the staff did, I was amused that sometimes he would be more passionate on an issue than we were. He saw things very much the same way. Again, it was very different from what I think people had as the first impressions of where he'd come out on things. I think he was very balanced and he was very thoughtful. It's been interesting to observe each person who comes into that job. Now they come in with tremendous speculation by the press as to what their views will be and how everything they've said in the past is an indicator for the future. Maybe it's the importance of the position and maybe it's like

being on the Supreme Court, but my sense is that people grow in the position and step up in ways that may not be apparent from their past statements.

It is similar to when people say you can't predict where how a new Supreme Court justice will vote. I can understand why it is difficult to predict, because it's when you are actually in that spot and you feel the responsibility of the position and you see the facts really laid out—all sides—that you seriously weigh them. I think it changes what would have been your knee-jerk cocktail party reaction before the issue had to be decided by you and on your watch.

**KD:** But did Harvey Pitt in fact take another look at enforcement when he was the Chairman?

**AN:** I think he was very interested in enforcement matters. I recall a few times—and I know people have said this publicly—that he was very hands-on. He was a very good writer and he liked to edit, and so I don't think the staff was used to having such a hands-on Chairman with his own marginal notations. Indeed, there was one order that he wrote himself. He sent Steve Cutler a first draft and Steve's reaction was, oh my God, who's reporting to who here? It's not like getting a draft from another staffer.

**KD:** Right.

**AN:** May I comment on this? May I go back? I think he was particularly good at giving the staff a clear idea of where he wanted to do procedurally; the kinds of messages that he wanted to send; when he wanted to do 21-A reports; when he wanted us to issue a formal order even when we didn't necessarily need it. I recall some instances with the NRSROs; if you ask for information, they willingly give it, but just in case there was any problem he wanted to have the formal order in place so if he needed to use that subpoena power he could.

So he had definite ideas about process and things like that. He was excellent at conveying what he wanted people to know. He didn't like a lot of footnotes. There were certain ways he wanted things expressed. He wanted plain English, accessible language, and it was amazing how good he was at letting that be known. It really affected how we as a staff operated.

**KD:** When Donaldson comes in—is there yet another change of focus?

**AN:** There is always some change. From from my own experience—and I see everything through my Market Reg lens—what was great was that he was well-equipped to consider the market structure issues. He had probably the best market experience of almost anybody with whom I had worked and he really wanted to carefully consider the issues before he did anything.

It wasn't really delayed, but it was done toward the end of his tenure. That was partly because earlier on he was really considering the issues himself, studying them and getting comfortable with what the staff was proposing. He knew it was extremely important and he would ask incremental questions along the way and then we would try to discuss the issues with him and make sure he was comfortable. He'd really want to understand in a very granular way how we got to where we were, which I thought was fantastic. And once he got comfortable—and that took really several months of work on his part—then he was ready to go. He was convinced that this was the way to go.

But it was interesting; I mean he literally started off going back to square one. I think he started off with several conversations with me on what was my philosophy of regulation, what were we trying to achieve, what were the different ways that people could go about it? I don't think people fully appreciate the level of his interest and involvement, because he really did understand how important it was. And that was wonderful. What was unfortunate when Harvey was here was that I think he would have liked to have done that. He didn't have the time. It was such an overwhelming period with Enron and World Com and the like that on several occasions he said to me, "I really don't want to move ahead with this until I can feel that I really understand the underpinnings of it. And I just need to have the time to do that." And the time was just very precious given all the other problems.

So it was really thrilling when Bill Donaldson was able to finally turn to it and focus on it and I felt very good about having somebody like him who had the experience that he had and had his good sense of the markets. And the other thing that made me comfortable was that I knew that he always had lots of people that he grew up with on the Street who I had no doubt he would bounce things off of.

**KD:** And they were still there?

**AN:** I don't know exactly who he talked to, but I'm sure that there was some bouncing of ideas here and there and so I think it was a good test.

**KD:** Perhaps he wasn't bouncing to the extent that Harvey Pitt was, though.

**AN:** No.

**KD:** Something I want to touch on before we start to wrap up is the NRSROs. That's another thing that you were involved in this period that we're talking about.

**AN:** Right.

**KD:** Where did that come from? That issue has been up and down at various times and I wonder what spurred it in early 2000?

**AN:** The issue was a complicated one because NRSROs or Nationally Recognized Statistical Rating Organizations is really a term that's original purpose was only to be used for the net capital rule. It was really very narrow usage; it was intended to identify those rating agencies whose ratings were so recognized by the marketplace as having integrity and were so widely used that an investment grade rating of one of those entities on a debt security would mean that you could get a better capital treatment than you would have had did it not have that rating. So for instance, if you had a bond with AAA rating from S&P, the capital charge that you took on the position would be less than if it didn't have that rating. It's very simple.

But it turned out to have captured the attention of others because it turned out to be sort of a proxy for a reliable rating. And so it ended up being used in other Commission rules including: when you could use an S-3; if you had debt securities out there that were rated by an NRSRO; it ended up being used in foreign statutes and in state statutes, but it never had an infrastructure internally. For the little purpose that we had it for—I guess originally in Market Reg many years ago it wasn't that hard to apply and we didn't worry about it quite as much. But then when you went further and it ended up taking on this great meaning, there were people who wanted the designation because they thought it was an entrée into the business and all sorts of things.

So it got a lot of attention, but where it particularly got attention by Congress was because as we had some of these problems—World Com and the like. You had folks in Congress and others saying “why were these rating agencies late in downgrading the securities and the like?” So they were conflating this NRSRO issue with a separate issue of whether the Commission should be regulating credit rating agencies. And they thought because we had this term, NRSRO, that we did regulate them. All we were doing was using that as a proxy for the fact that this is a widely accepted rating.

But having done that some would say that, because of the wide usage of the term, it started to take on almost a seal of approval type connotation, which is why we are now trying to be more transparent about what it means to be NRSRO, what it takes to be one, those kinds of things in the rule. What the proposed rule on NRSROs does not address directly—it does a little indirectly—is the broader question of what are the limits of the Commission’s authority with respect to these entities. After a lot of legal analysis and debate, we determined - and I testified before Congress - that we really think that our direct authority over credit rating agencies is quite limited.

And the kinds of things that Congress seems to be most concerned about, such as our being able to take enforcement action against rating agencies or holding them to particular standards and the like, really substantive regulation, we don’t have direct authority for. It’s a topic of great debate, but if Congress really wants us to take a much

more active role with credit rating agencies I think we would need more legal authority.

So that's what that whole debate is about.

**KD:** Is that dropping off the map now?

**AN:** Not clear. I think it remains of some concern. I don't know where Congress is on it, but I feel better knowing that we laid the groundwork both in addressing the technical issues of NRSROs by having this proposed release out there and also being on record as saying that we are at the limits of our authority and if Congress would like us to do more, we need that authority. Unfortunately, by not having been as clear on it before, we would often hear the frustrations of Congress, as if we hadn't done something that we should have done. So I think it's more important to be clear on that.

**KD:** Regulation NMS and SHO, two big things came out about at the same time earlier this year.

**AN:** Yes.

**KD:** I'm wondering was there some reason that these threads came together at that point?

**AN:** No; usually it's just where you are in the queue frankly. I think it depends on what the Commission has time to consider. Bill Donaldson had a very aggressive agenda and the



Commission has a limited number of these major initiatives that it can carefully consider at one time, so I think that's just sort of where we fell into line. Certainly even with Reg SHO, that was something that we had been working on for quite a long time, and so I suspect that the staff might have been ready earlier.

But that was where they were able to slot us in because of all the other securities act reform and Reg ABS and there are lots of other divisions. You may have noticed that there were a few mutual fund issues that got addressed in this period, which was really remarkable, because after the mutual fund area being so quiet for so long, the thought that we were getting bumped in terms of Commission attention because of the mutual fund area was just hard for me to believe. But that was the luck of the draw. But then fortunately it all got done, but I didn't always have that confidence that it would all get done.

**KD:** How involved were you in the mutual fund issue?

**AN:** Oh very little. I was aware of it. There were a few things that sort of touched on Market Reg, but I like to tell people that I feel like I'm going back and revisiting the history now as a Commissioner because although I was here, I was a little diverted on some of my own issues. And to the extent that some of the mutual fund rule-makings were also areas of some controversy, I felt, well I have my own battles to fight. The last thing they need

is me opining on what they're doing. But now unfortunately I'm supposed to have an opinion on everything.

**KD:** Let's talk about the nomination. When did you find out? Do you remember where you were and what you thought?

**AN:** I was called by Senator Schumer's staff to have lunch and the purpose of the lunch was to discuss possible candidates for Commissioner. I was very flattered that they wanted my opinion. I didn't know quite why, but I said that was fine. And we got together and they ran some names past me and all of them sounded quite good and I threw in a few more and I thought that was that. And then about two or three days later I got a call back from one of the staffers saying something to the effect of "well thank you for your help, but the Senator thinks that there was an omission on your list. He thinks that you should be considered." I was a little incredulous for a variety of reasons. Frankly I was considering, after being here for over six years and having, as I like to say pejoratively, trained three or four good Chairmen, that maybe I was ready to move onto something else. And so this was really a shock. It just wasn't what I was thinking about. I was thinking that maybe it was time—even though I said earlier I like change, there's a point where you say "well if I'm going to change maybe I should really change and not just switch gears in terms of..."

**KD:** Were you going to go back to Wall Street?

**AN:** Well I wasn't thinking of moving. I decided that this was a great place to live. And I really hadn't looked, but I was just thinking that maybe I should be thinking more expansively than just staying at the Commission. I wasn't opposed, it was not something that I had considered. And so that was a surprise to say the least.

And then I thought, frankly having just come off a rather controversial time—I didn't think it was devastatingly controversial, but I had worked on some initiatives that had gotten some attention—that it was unlikely that the person who was put on the Commission would be somebody with a history. I also frankly feared that to the extent that there was controversy on any of these Commission mandates that my nomination would be an opportunity to reopen all of those debates. And that's what I said to Senator Schumer.

And he was completely unfazed by it; he didn't think that would be an issue at all. And I said maybe not, but I thought it was a good enough chance that he should really consider it and consider going with somebody who wouldn't generate the same attention. I said I was a complete open book. You can look at the speeches I've given, you can look at the rules I've done; so I said it's possible that anybody who didn't like where we ended up was going to say we don't want her.

But I think frankly what happened was when Chairman Donaldson decided to leave and there was a Republican Chairman slot available, it became very easy to package. And it was very gratifying that regardless of where people had come out—everybody may not have gotten everything that they wanted in prior rule-makings—that the general consensus of what I was hearing was that at least they knew where I had stood and they respected the process and they thought I understood the process. I guess they agreed with what some of the folks on the Hill were saying, which was that this was a very important time for the markets and that it would be helpful to have somebody on the Commission who had an understanding of the markets and was not someone who - and I don't want to say that pejoratively - just came out of a law firm or didn't have Wall Street experience. And so I think it worked out pretty well—surprising to me.

**KD:** I did see the phrase “lightning rod” attached to your name.

**AN:** You know that was attached, although I have to tell you that was not my experience. That's what was so funny about it. I learned through this process, although I had certainly been covered by the press before, that the press was actually looking, I thought, to create controversy. I felt like I was reading about somebody else's life because in actual fact what I felt was happening was much less controversial and more seamless than what was being described. It was almost as if the press was hoping for a story and they were trying to create one.

In fact, the day that one of the most negative stories ran was the day that the White House said they were absolutely moving ahead. The stories were making it sound as it was as much as dead. Everybody had it on good authority. So you realized that there may have been one or two people who thought if they said it, it would be so. But I would say, given how these things go and not that I have a lot of experience with it, but it seemed to me to be pretty straightforward, surprisingly.

**KD:** Yes; clearly given how it went through Congress.

**AN:** But again, I think a lot of it was the fact that there was now something to move. That there was a new Chairman, I'm sure made a difference. I think if it had just been one slot it may have been a little slower.

**KD:** Well you've got a new Chairman, a new Commissioner; how many meetings have you been in now?

**AN:** Several. We have one closed Commission meeting a week and then we've only had one open meeting so far. We've had an appeal from an ALJ decision which was open.

**KD:** How's it going?

**AN:** I think quite well. I think Chairman Cox is really making a very good effort to have all the voices heard well in advance so that we can work towards consensus to the extent possible. I think the dialogue has been very constructive. So far, so good. It's funny, there are people who just really try to read Commission tea leaves. I literally have people commenting on body language and all this stuff that I just find amazing. I think there were some people who commented on how we were all chatting before the first open meeting—that was news. In general, people just don't understand how we all get along and that if there are policy differences it's not personal—certainly not intended to be personal - but so far it's worked out quite well.

**KD:** Given recent history, that would explain why those discussions are still under scrutiny and people are reading the tea leaves.

**AN:** Right.

**KD:** What's on the agenda? Where do you think you're going to be going—you have two more years, right?

**AN:** Right. I don't have my own agenda. If I have a personal agenda, it's to insure that what the Commission ultimately goes out with makes sense and is good from a public policy perspective and is good for investors and the marketplace. Certainly the agenda will be set by the Chairman; my own personal interest obviously is seeing that NMS gets

rationaly implemented, but I also have a lot of experience at the Commission. I know how it operates, so fortunately I don't have a learning curve on how things get done.

So my own view is that to the extent that I can be helpful in helping the staff communicate with the Commission in all divisions, in bringing thoughts back to the staff that are my own or that come from thoughtful people in the street—whatever—I want to do that. I just am hoping to have a positive impact in general on the operations of the place and to the extent that I can do that, I think that would be a really major contribution in a large organization like this, particularly one that's grown so rapidly in such a short period of time.

As you'd expect we have some growing pains. To the extent that you have a Commissioner who was on the staff, who understands the frustrations of getting things done, I always say it's a minor miracle that anything gets out of a building with this many lawyers in it, which I truly believe is the case. To the extent that I can move things along, particularly with my sense that time is money—I think would be a very important contribution.

**KD:** Well great. Thank you for contributing to this project.

**AN:** Thank you.

**KD:** Is there anything else that you'd like to cover?

**AN:** No, this has been great fun. Thank you.