

Securities and Exchange Commission Historical Society
Interview with David M. Becker
Conducted on May 21, 2015 by William Thomas

WT: This is an interview with David Becker for the SEC Historical Society's virtual museum and archive of the history of financial regulation. I'm William Thomas. The date is May 21st, 2015, and we're at Och-Ziff Capital Management Group in New York City. Thanks very much for agreeing to speak with us. We have, I think, quite a bit to talk about with your two different stints as general counsel at the SEC. We always like to do a little bit of biographical background first. I understand you're from here, from New York City?

DB: Originally, yes. Basically, I was brought up in the area. Then we moved to Manhattan and I was here in high school, college, and law school, driving a cab a little in between.

WT: And you did an undergraduate degree at Columbia, as well as your law degree?

DB: I did.

WT: What did you study for your undergrad?

DB: Political science; what they call "Government" at Columbia.

WT: Did you have any notion when you were doing your law degree that you'd end up in the corporate and securities area of law?

DB: No, I was generally clueless about most things in law school.

WT: Then after that, I see you clerked first for the U.S. Court of Appeals D.C. Circuit, and then for a retired Supreme Court Justice. Could you tell me a little bit about those experiences?

DB: I clerked for Circuit Judge Harold Leventhal, who was a brilliant man, and the clerkship was a wonderful, extremely intellectually challenging experience for a novice right out of law school. It's an experience with an enormous amount of intellectual growth. The Supreme Court was a different experience. I was Justice Reed's law clerk, but he was retired and quite elderly, and rarely came into the office. What I did is split my time among four active justices. I spent several months with Chief Justice Burger, and then I spent three or four months each with Justices Blackmun, White, and Stewart. The Watergate tapes case was argued in the D.C. Circuit Court while I was clerking there, and then it was argued again at the Supreme Court while I was clerking there. It was a very exciting time to be in Washington.

WT: Did you stay in Washington? I noticed you went to the Department of Health, Education, and Welfare, but you were also at a law firm for a year.

DB: Yes. I stayed in Washington for forty-one years. I just came back to New York a year ago. I had intended to move back when I moved down to Washington to do clerkships,

but one year turned into a second year, and multiple children came along. Washington, in many ways, particularly then, was an easier city to live in than New York, so I stayed.

WT: Could you tell me a little bit about your time at the Department of Health, Education, and Welfare?

DB: I spent a couple of years in private practice and I was bored. Part of the appeal of being in Washington in the first place was always to be involved in issues, public policy and government. I came of age as a teenager in New York City coincident with John Kennedy's election, and then assassination, and public service seemed to me the finest thing that someone could do. After a couple years in the government, or clerking, private practice did not seem quite as compelling. After the Carter election, someone I knew who had also clerked for Judge Leventhal and was going over to HEW as deputy general counsel, asked me to come with him and I jumped at the chance.

WT: Is there anything else that you'd like to talk about the work there?

DB: The interesting thing about the work there is I did special projects that the Secretary, Joe Califano, assigned to our office. It was an interesting primer in how Washington works in certain areas. I wrote, along with others, regulations concerning federal funding for abortions, and later, federal funding of sterilizations. Both of them, in their way, were very highly charged politically—again, quite an education for a young lawyer. We had

certain procurement issues that turned out to be highly political, and it was very interesting to see how the bureaucracy responded.

WT: But then, after a year, you went back into private practice at Wilmer Cutler and Pickering, where you were for twenty years?

DB: Yes, I was at Wilmer Cutler for twenty years. I went back into private practice when my next child was born, thinking that if I wanted to be a partner at one of the zippy law firms, I better get myself back there. That's what I did, and that was ultimately how I got involved in securities law.

WT: Tell me a little bit about the practice.

DB: At Wilmer, it was a time when lawyers are less specialized than they are now and there was a mandatory rotation policy. Young lawyers had to rotate through at least three, or potentially, four different practice areas. After doing other things, I gravitated towards what was a securities enforcement practice area because I liked the people. I liked the people in other areas, too, but this had the greatest opportunity for a young lawyer to take on direct responsibility. It was not because I just inherently thought the federal securities laws were more interesting than other areas of the law. It was just that the practice was a good fit for me.

WT: This is in the 1980s, when a lot of the enforcement cases are really high profile. Did that impinge on your practice at all?

DB: As a young partner, I was involved in a fair number of those cases, including some of the more notorious penny stock cases of the era. My children still tease me, because one day there was a change to the market maker rules with respect to penny stocks. All of the senior people were out of the office, and a camera crew came by and they asked me what difference I thought they would make. And there was a quick run—it was just in the early days of CNBC, and I appeared and spoke for a moment or two with the title under my image of “Penny Stock Lawyer.” My children thought that was quite amusing and haven’t quite gotten over it.

WT: I expect your practice was considerably more broad than that.

DB: It was.

WT: How was it that you wound up at the SEC then, in 1998, as deputy general counsel?

DB: Like most of the important things that happen in one’s life, it was by happenstance. At Columbia Law School I took corporations law with Harvey Goldschmid, and I had kept up through the years. He came down to the SEC as general counsel; he was looking for a deputy and called me up. I went over there and talked to him about it. As I said, I always wanted to be in public service, so after interviewing with him and then interviewing with

Arthur Levitt, they offered me a job. I thought about it for approximately seventeen seconds and accepted.

WT: So as a deputy general counsel, was your job defined in any particular way, or did it range across everything that was going on in the office?

DB: There were two deputies at the time. Mike Eisenberg and I were both deputies and I had, generally, the enforcement, litigation and accounting portfolios, and then all sorts of idiosyncratic things as they came up. But I was not the principal, I would say, regulatory deputy, even though I did get involved in some of these issues.

WT: For example, right after you arrived would have been around the time of the Aircraft Carrier release. Would that have been more in Eisenberg's area?

DB: No, the Aircraft Carrier release was not fully baked then. But, for example, something that I did in the corporate disclosure area was Staff Accounting Bulletin 99, which was at the time, and to some extent still is, the Commission's principle statement on materiality. Harvey delegated responsibility for that to me.

WT: I've read about that in other places, but it's not really been something on my radar. Could you go a little bit more into what the question of materiality was at the time?

DB: Materiality continues to bedevil practitioners and enforcers alike. It's one of these "objective"—I put that in quotes—legal constructs, like "reasonable man," whose meaning can be very much in the eye of the beholder. This came up at this time in the context of a concern by the Chairman with earnings management. Arthur gave his, at the time, very well-known speech on the earnings game, and one of the things that he mentioned—

WT: "The Numbers Game"?

DB: "The Numbers Game" was misuse of materiality, uses of rigid guidelines and saying, "Well, if a number is as much as nine percent off, that's still immaterial," and Arthur wanted to do something about it. So the Chief Accountant's office and our office produced a document that was issued by the Chief Accountant's office and gives materiality guidance, what the terms mean and how to apply them.

WT: So this, of course, as you mentioned, is part of Levitt's much larger initiative to confront the accounting profession.

DB: I don't think this was about confronting the accounting profession. Other pieces of it were, but this was more of a concern with earnings manipulation.

WT: I see. I was reading in Arthur Levitt's book about your negotiations with the auditing profession to develop standards. Could you tell me about that?

DB: This was about auditor independence, which was and remains a preoccupation of the Commission—and probably certainly was, and I think still is, a huge analytical challenge for everybody involved. You start with the questions. Why don't auditors get things right? And among the possible explanations is bias, they're too closely identified with their clients. So, whether consciously or not, they would prefer if things came out in a way that pleased their clients. At a most basic level, auditors are paid by their clients, and if you're an auditor you'd just as soon not have your client go someplace else. So there's that degree of bias built in.

Over the years, the Commission has undertaken to identify additional circumstances that cause an auditor to have an unacceptable level of bias, and it's actually quite difficult.

We don't have the capacity to measure incremental levels of bias, nor is this something that really lends itself to reasoning, simply reasoning from first principles. One can state at a very high level an auditor shouldn't be part of the management of a client, nor should he audit his own work and so on. But when you get down to particular situations, it's very hard to know whether they produce bias.

So there grew up over the years, almost in a haphazard way, a series of situational pronouncements by the SEC that said, "An auditor can't do this, he can't do that"—often inconsistent and not even very well publicized, and some out of date because of technology, and some insufficiencies. Of these, the biggest one was the growth of non-audit services. The audit firms, in the pressure to grow like all businesses have, ended up

doing lots of other things for clients, some of which were much more profitable than the audit. The concern was that perpetuation of these services would subordinate the audit both for relationship partners and firm management, and as a result, auditors would be inclined to pull their punches.

So the Commission decided to codify and modernize the auditor independence rules and to address what became a list of prohibited services by audit firms. This was a gut issue for the Commission, and this was a very serious pocketbook issue for the audit firms.

WT: So, essentially in trying to develop new rules, was it mainly trying to divvy up what kinds of consulting services could and could not be offered in order to avoid, or at least tamp down, the conflicts of interest? My guidance here is mainly Arthur Levitt's book, and he talks about it as being a game of three-dimensional chess, where you have some of the firms, like Arthur Andersen, and then other ones, who are willing to give up IT consulting services, for example, and then he refers to the strong intransigence of the AICPA. What was your perspective in the midst of trying to hash this all out, and what could you do with and without the support of the different firms and organizations?

DB: Like many things, Arthur characterizes this correctly in talking about three-dimensional chess. It is beautifully complex and high-stakes. The easiest part, as always in government, is coming up with an acceptable policy, although, as I mentioned, in this particular area it's extraordinarily complex given the absence of measurement tools for

degree of bias, and people just sit around in a room and say, “Well, I think auditors are biased in this circumstance, and this is just like that.”

We had a joke among some of us in the General Counsel’s office trying to figure some of this out, which was the quote from King Lear, and when we would get off rather bedrock principles and we’d start discussing how they were applied, we referred to King Lear’s wandering on the heath and, “That way madness lies.” It’s really devilishly difficult. But as you say, as in the government, the easy thing is figuring out what the policy should be.

We did have different audit firms with different views, and we also had a political component to this, and the audit firms were not shy. I don’t think they purchased any politicians but they certainly rented a few, and so we had that component as well. And then we had a pure legal component. There was a risk that the audit firms would simply sue us, or appeal or seek review of our rules. And, at the time, the District of Columbia Circuit was—what’s the word—somewhat hostile to the Commission, and so litigation might be uncertain. They certainly threatened litigation several times, so there was that.

The one thing that we did not have to deal with was a falling stock market. I don’t think that Arthur would have been able to sustain public attention on this if at that particular time investors were sustaining huge losses. Those were the things that the subsequent Chairman had to deal with

WT: I was talking to Dick Walker last week and he was talking about building up enforcement cases in this area as well, in an attempt to define a legal framework that way. Did that mesh with what was going on in this area?

DB: It did. There was a rather large case that was brought against PwC that I'm sure Dick mentioned, and Dick was characteristically masterful in bringing that. It was widespread, a disregard of the independence rules at the merged firm and absence of resources to monitor and implement compliance. It was a very serious matter.

What that did—although this was not the intention, but from where I sat—one consequence of that was largely to disable PwC as an active opponent of us in this rulemaking effort. They could not afford to be seen as opposing modernization of the independence rules in light of the public damage to their reputation as a result of their independence case.

WT: Now, in your time there, Enron came along, so obviously that's kind of a game changer, at least it certainly was once WorldCom was added to the mix. Could you talk a little bit about that? Was that a change in strategy, or was that something that kind of put wind behind the sails of what was already going on? I know you weren't there when Sarbanes-Oxley started cooking through.

DB: Enron had an enormous impact in a variety of ways. One that you probably were not focusing on that was probably most profound is this: very rarely does the SEC come to

the attention of politicians. The story I often tell is that on September 11, 2001, on that dreadful day, among the impacts were to the financial system of the United States. Wall Street was shut down, and we did not hear anything from the executive branch until very late in the day: what's happening to the markets?

Arthur Levitt, during all of the audit independence struggle, was very eager to get the White House involved and they could not have been less interested, because, just from their perspective and from their political perspective in particular, there are no votes here, and there's not much political consequence here.

So that was as of September 11th. Fast forward a couple of months to the Enron implosion, and then all of a sudden the SEC becomes a center of political attention. "What happened?" "How could the SEC have let this happen?" "Why aren't they doing more?" And that precipitated what I've referred to in other context as the outrage limits. The press and the politicians were very much outraged, certainly at the conduct of Enron, but at the fact that the government let this happen, the SEC in particular. They're outraged that it happened, they're outraged that you're not outraged enough, and they want to express their outrage by asking for all sorts of documents and holding hearings.

Fast forward a few years to the 2008 presidential campaign, and a Republican Presidential nominee talks about one of the first things he would do—this was in the aftermath of Lehman—is get rid of the Republican Chairman of the SEC. It was an extraordinary moment in the history of the agency, building on what had happened in

Enron, and it became much more of a political public focus, and this had a profound effect, and continues to have a profound effect, on how the Commission operates.

WT: That was 2008?

DB: 2008, yes.

WT: Coming back to the 1999-2000 period, one area that did have pretty focused attention from the White House, and certainly its advisors, was the Gramm-Leach-Bliley and Commodity Futures Modernization Acts. Could you tell me a little bit about the political process and the SEC's involvement in the build up to the implementation of those acts?

DB: Context here for Gramm-Leach-Bliley: the one thing that I was completely unprepared for when I showed up at the SEC in 1998 was the existence of this political death struggle between the banking regulators and the SEC that persists to this day. There was a speech by an SEC Commissioner yesterday that said the banking regulators don't know anything about the Capitol workings. Forget about auditor independence; forget about most other fights. Nothing that I experienced at the SEC came close to this for rancor and viciousness. At the SEC, we thought ourselves to be the recipients of the viciousness. I wouldn't be surprised if the banking regulators had a similar view, although we certainly felt that we never did anything untoward.

Gramm-Leach-Bliley was, from our perspective, about a quarrel between the bank regulators and the SEC, among the other things, for a diminishing piece of regulatory territory as banks got more and more involved in areas that were traditional securities areas. The legislative struggle was pretty intense, and was perpetuated over six, seven years by folks in Congress as an excellent way to raise campaign contributions from banks and securities firms with lots of money.

Harvey Goldschmid and Arthur negotiated with Congress—and here, Senator Gramm more than anybody else—the best deal that they could, which was fundamentally pretty much a standstill. The banks have far more in the way of political resources than the SEC ever had. There is not a strong political constituency for the SEC, and there's a community banker, or used to be, in every district of Congress. It's a tough political fight, and Arthur and Harvey did quite well.

The Commodities Modernization Act was a watershed that we didn't realize at the time. Senator Gramm wanted to keep the government out of the regulation of the emerging financial technologies, what we now describe as derivatives. The tenor of the times was that really there was very little opposition from the government, period, other than Brooksley Born. The SEC was concerned about two things: keeping anti-fraud jurisdiction, which it kept, and preventing the sale of single stock features to retail investors, the theory that they're subject to enormous abuse. The anti-fraud jurisdiction was principally a vehicle to keep control over the latter.

I don't know that anybody, at least not on the SEC side, foresaw the systemic issues that arose through the absence of regulations for credit bond swaps and other derivatives.

From the SEC's side, there was a contentious issue here over regulation. The issue was about protecting retail investors and not about protecting the broader economy.

WT: As far as the Clinton administration is concerned, it seems to have been mainly influenced by broader economic arguments from people like Larry Summers, as far as encouraging capital formation through innovative financing means. Is that fair? Wasn't that congruent with the bankers' position?

DB: That's what I read. We didn't chat then about it, but again, it was about not retarding the growth of socially beneficial financial technologies.

WT: Coming back to some of Levitt's priorities, in 1999 he started to focus on mutual fund governance, encouraging, for example, the creation of the Mutual Fund Directors Education Council, now Forum. Was that something that you were involved with?

DB: Not much. In 1999 I was not general counsel; that was in Mike Eisenberg's purview. I was aware of it, but I don't think I was a central player in that.

WT: Let's move on to Reg FD. Again, this is something that Levitt writes about a bit in his book. He puts it in the context of developing insider trading cases, and I guess the misappropriation theory. He doesn't mention the influence of the O'Hagan case in '97,

so I'm wondering if you can lend a little more detail to what led up to the push for Reg FD and the kinds of cases the SEC was trying to make.

DB: This is really Harvey Goldschmid. I think more than anything else it's probably—I don't know about more than anything else—but it certainly is a contribution he made to the law, not so much O'Hagan, but Dirks. There were circumstances where it was clear to the enforcement division on investigation that issuers of securities had leaked non-public information to analysts, and that was lawful. It was lawful because the use of the information was being done for corporate purposes by appropriate representatives of the corporation, and not for the personal benefit of any particular individual.

From the SEC standpoint, though, what this did was confer special informational advantages to the clients of particular analysts. The thinking was that it was just unfair. Arthur described it in a speech, famously, as a stain on our markets. That was the genesis of FD.

WT: Then the last thing that I have to ask you about as far as policies are concerned, is the development of the rules and the enforcement cases around the broker analyst conflicts. This is something that Levitt had also been working on before Eliot Spitzer started in with his prosecutions, so maybe you could tell me about what this looked like from the SEC end.

DB: I think there was a sense that analysts were not to be trusted in many circumstances, and because of their ties to other parts of their firms, getting an analyst to tell you what he or she really thought was like getting a parent to tell you that their baby is ugly. And there was a concern about bias. I don't think there was very good information about it, and this was something that Arthur would mention from time to time in speeches. There was some regulatory work done on, fundamentally, attribution in corporations. In effect, right analyst reports would contribute excessively to analysts' reports.

But in truth, nothing had a galvanic effect until Spitzer brought his case against Merrill. I remember that very well. I got a call—and this is after Arthur had left and Harvey Pitt was there—one morning from the general counsel at Merrill Lynch, whom I had known in other contexts, a nice man, back then saying, “Eliot Spitzer is about to file a complaint against us. It's going to take all sorts of recordings out of context. It's going to have a terrible impact on us, and, as a result, on the financial markets. Can you do something about that?” That started that particular circus.

WT: As far as putting together rules around this, I gather that the focus was mainly on the SROs. What would dictate whether one would look to implement an SEC rule, or that one would look for the SROs to develop their own rules around something like that?

DB: Resources, ease of enforcement, ease of inspection. I think that the genesis of having the SROs involved—this started with an effort on best practices, not necessarily to make it a rule-making matter, and that got the SROs involved. Once Spitzer had brought this case

very publicly, and the Commission was deeply involved in enforcement cases, I think the thinking was that the SROs were the most efficient way to get from here to there.

WT: As far as the SEC working with Spitzer and his office—of course there’s different strategies and different styles involved there. Sometimes these are played up. I’m wondering to what extent that represents the reality of it. You weren’t there for the global settlement, but you saw the first part of this.

DB: I saw this first part extremely vividly. Spitzer, in my view, was a man who was extraordinarily ambitious, bright, ruthless, and not completely honest. He started right off the bat—and I think this was because at that time we had a Republican Chairman—of fostering, “I’m only doing this because the SEC is dropping the ball.”

I had personal experience with that shortly after this started. In the aftermath of George Schieren’s call—he was the general counsel of Merrill Lynch—we were quite certain that we weren’t going to do anything to intervene if this was a matter of fraud, as Spitzer suggested. The last thing the bureau would do is try and get any law enforcement agency to stay its hand. We had no interest in that. What we did have interest in was making sure that this very public, vigorous effort did not contribute in any way to the balkanization of the securities markets. These are national markets and they’re national resources.

Annette Nazareth and I—at the time she was head of the Division of Market Regulation— at some point while the Merrill Lynch case was going on, I believe pretty early on, we went up to New York to visit Mr. Spitzer. We went up with a very simple message, which was, “We want to help you in any way possible with your prosecutions. We think they’re a fine thing to do.” I remember telling him, “You ever call up Steve Cutler? You would like Steve Cutler.” I didn’t say anything to him about whether Steve would like him.

But our only concern was that, when it came time to resolve these cases—and he wanted non-punitive relief, he wanted some sort of undertakings about how they would do this, or how to do this and that—that we wanted to be at the table with him on that. We certainly felt that we could reach consensus on that, that we wouldn’t have much in the way of disagreement. He was interested and had questions about, “Well, why shouldn’t we have a rule, a complete wall between underwriting and analysis? Why shouldn’t we make these firms get rid of their analysis groups?” It was a policy-based discussion on that, all very cordial, and it was, “Well, we’ll talk some more,” and we left.

While we were travelling back to Washington, Spitzer gave a press conference in which he said Annette and I had been dispatched by Harvey Pitt to come up to New York to persuade him from bringing the cases, but that he would not be afraid, would not be deterred. He would pursue wrongdoings wherever he found them. This is of no real importance, but it was vivid to me because it was a complete lie. Over the years Spitzer

has had a profound impact on securities enforcement, probably more than any other person, some of it good, some of it dreadful.

WT: Harvey Pitt does come in 2001, a very well known well respected securities lawyer. Stylistically, how is he different from Arthur Levitt, and did he have a particular agenda before things like Enron started to dominate the Commission's attention at this period?

DB: Harvey was and is a friend of mine, so my recollections and perceptions are certainly colored by that friendship. Harvey is much more substantive than Arthur ever was. And I don't mean that as a criticism of Arthur; Arthur is a genius in the things that he did. I learned so much from him, and I don't know that anyone other than Arthur could have pulled off these auditor independence rules, for example. Harvey, over many years, is an extraordinarily knowledgeable and talented lawyer. Harvey is also a very principled guy. Harvey, while his approach to things in many ways is analytical, Harvey's a very emotionally engaged man. He's not detached about anything, and so the styles are very different. I personally was closer to Harvey than Arthur, who I had a very good relationship with, but I just spent a lot more time with Harvey.

Substantively, he had a huge agenda, really reaching most pieces of the Commission's operations, much of which was preempted by Enron and Sarbanes-Oxley and implementing those rules, and soon September 11th, which of course was an enormous preoccupation.

WT: Could you tell me just a little bit about September 11th, and getting things back on track after everything that happened.

DB: I remember September 11th very vividly. I had a TV in my office and I remember someone saying, “Oh, a plane just struck the World Trade Center,” and it was this extraordinary something, a plane wandered off course or something. I turned the TV on and then saw the second plane hit. I went to Harvey’s office and spent the rest of the day in Harvey’s office, to the evening.

We were in touch with the markets right away; it was very clear that they were going to shut down. We were concerned about the safety of our own people in 7 World Trade, where our New York regional office was located. It collapsed and we were concerned about the people in our building. Once it was clear that the Pentagon had become a target, there was concern whether the Capitol might become a target and we were close by the Capitol. I don't think that anybody thought that Al-Qaeda was particularly interested in targeting the SEC, but downtown Washington was a scary place to be.

We got our people out of the building, and we stayed there until late in the day because we couldn't go anywhere else—gridlock downtown. We were all in touch with our families, who were worried. Late in the day, Harvey determined he was going to go up to New York the next day, and we did that and went down to the New York Stock Exchange. I don't think I'll ever forget the smell in the area. People were walking

around with masks. We met with various people, talked out what they were going to do, Harvey went on TV—anyhow, enough anecdotes.

But let me tell you what Harvey did. Harvey's internal response was to canvass the agency and to collect suggestions of what we can do to be helpful, and we got some having to do with liberalizing the issuer buybacks. I don't even remember what all of them were, but we were certainly in touch on a regular basis with the exchanges and the broker-dealer community. The most extraordinary thing that Harvey did—and this was not only extraordinary but this was extraordinary for Harvey; Harvey's a man who obeys some impulses, particularly this one, always to get deeply involved and embedded in everything—is that he sized up the situation quickly and said, "The people who are best equipped to handle this are Dick Grasso and the broker-dealer community, the financial community," and he got the hell out of the way. If you know Harvey, he doesn't get the hell out of the way very easily, and it was one of the finest things he ever did. He really managed an agency response that was extraordinarily constructive and useful.

WT: Is there anything we should talk about before your departure and then return to the SEC?

DB: I'm sure I could regale you with boring anecdotes endlessly. Why don't we just move on?

WT: Tell me then about leaving the SEC, were you on a schedule to be there as long as you were and then leave?

DB: No, I was tired. I was there for close to three and a half years. I think the wonderful thing about the government is that it engages your entire mind, spirit, and body. The dreadful thing about the government is it engages your entire mind, spirit, and body. And I was tired. I had had enough of it.

During the auditor independence battles, at one point I didn't sleep much. At one point I developed facial twitches, something I've never had before or since, and I had had enough. I wasn't getting any younger, and I wanted to make some money so I could ultimately retire. So I went back into private practice. I assume you want to skip over what happened in the private practice.

WT: I assume you were in securities law?

DB: I was on an internal schedule to retire when I was about sixty-two, sixty-three. After the 2008 elections, I got a call, first from the SEC transition committee, part of the President's committee: who do I think ought to be chairman of the SEC? I said, "Well, I think there's only one candidate, and that's Mary Schapiro."

WT: Had you known her a while?

DB: I think it's safe to say we were professional friends, and we maintained the friendship after I left the SEC. I was very impressed with her. Shortly after Mary got nominated I

got a call from Elisse Walter, whom I'd known for many years, and Elisse asked me whether I'd be interested in coming back to the SEC, and I said no. I was a couple years from retirement. If I went to the SEC I would have to push that back, and I really didn't want to do that. I had done that once.

The next day, Mary calls me. I pick up the phone and she says, "David, your country needs you." I knew she was flattering me, but as I said to her, "I'm a sucker for flattery, and particularly that kind of flattery." This goes back to what I said about my high school days: I thought public service was the finest thing one could do. So we talked and, unlike the previous situation where it took seventeen seconds, this may have taken, at least in my head, thirty seconds, of which thirteen was playing the speech to my wife.

I've worked out certain things with Mary, including an absolute, firm deadline that I would stay only two years, because I knew I needed a couple more years' private practice before I would feel comfortable, financially, to retire. So that's what I did.

WT: The background to all of this is that the financial crisis has just erupted, so that's the primary thing on the agenda. Where should we begin?

DB: There are several things that coalesce, and their common cause was the financial crisis. There is Madoff, and there is regulatory reform, what became Dodd-Frank. All of those were interrelated, so you tell me where you'd like to start, and I'll be glad to work through it.

WT: Let's start at the political level. Mary Schapiro is under a lot of pressure to undertake reforms, to step up enforcement. What does that look like on the inside? It's what you were getting at a little bit earlier with the aftermath of Enron, is that you have a lot of people beating on the SEC for not seeing things like Madoff and the financial crisis, whether this is deserved or not, and so what does a response like that look like?

DB: The SEC at this time is operating from a position with negative, if any, political strength. In the best of circumstances, there is not a constituency out there that supports the SEC to the extent that the SEC identifies itself as protecting investors, retail investors in particular; they're not organized in any way politically. If you read Arthur's book, he refers to that and one of the things he had hoped to do was perhaps set up a vehicle for that. That didn't happen for the same reasons that all sorts of individual, grassroots, broadly-based financial things don't happen.

And politicians, doing what they do in the aftermath of the crisis, blame others for the crisis, and so that's a dynamic that hurts that SEC. Then there's Madoff, which is a punch to the solar plexus. To some extent, it still is. Then there's another dynamic which is, well, various politicians take advantage of this dynamic in a variety of ways.

WT: So, is it fair to say that there's changes in enforcement strategies at this time? You'll talk to an Enforcement director from any period and they'll tell you that they'll bring the

cases that they think they can bring, so I'm kind of curious as to what can be done to tweak or augment that process.

DB: Mary started and she took what really was a tweak, which was to delegate to Enforcement the authority to issue formal orders of investigation. Issuing formal orders of investigation is essentially a formality. It was devised as a means of keeping the enforcement authority in check.

It became routine at some point when Harvey Pitt was Chairman, in which he used it as a management tool to reinforce a very simple message, which was: faster. "Why have you waited so long to come to me for enforcement authority?" "Why aren't we moving more quickly?" "Why aren't we bringing the case tomorrow?" "Have we subpoenaed this guy?" "Have we done this?"

Harvey—who is not someone that people typically think of as a manager—did a masterful job of managing a very enthusiastic Division of Enforcement to move more quickly, more aggressively in a variety of ways. Notwithstanding his Republican orthodoxy of limited government, when it came to enforcement, Harvey was probably the most vigorous enforcement-minded Chairman, at least in my adult lifetime.

Mary tweaked the formal order system, and then it became clear—because again, this was a political perception thing, that because of Madoff it was necessary—to bring in a new Director of Enforcement. I don't think anyone had any particular criticisms of Linda

Thomsen, and I think there was a widely held view that, to the extent the Enforcement program had been less vigorous than it might have been, it was at the Commission level, not at the staff level. There were a variety of stratagems apparently employed by members of the Commission to slow down enforcement.

WT: You think otherwise Linda Thomsen would have stayed?

DB: If it were not for Madoff? Yes, I don't think there's any doubt about it. But the White House, among others, said, "All right, well, you've got to bring in a new director of Enforcement." So we cast about for names, Robert Khuzami's name came up; many of us had bumped into him over the years. I went up to New York and had dinner with him, and he came down. I may have the sequence wrong, but he came down and met with the Commission, with Mary, and decided to come.

WT: He was at Deutsche Bank with Dick Walker?

DB: He was recommended by a lot of people. He was recommended by Dick, he was recommended by me. There were at least ten people. His name was on everybody's list. Rob comes to the Division of Enforcement and experiences the number of levels of supervisory review that any case has to go through, and basically says, in more elegant language than this, "This is nuts." Rob sets about to reorganize the division, in bringing management tools to the division, including identifying the most significant cases at the time.

Enforcement is inherently reactive to a large extent. You go to the banks, you try to figure out who's robbed the banks as opposed to standing outside every bank. And remember, in the scheme of things the Commission is a tiny agency, and its Enforcement staff is smaller than the compliance staff of major financial institutions. So the case mix of the division is dictated, in the first instance, by the financial crisis. How did this stuff happen, did anybody defraud anyone else. Then through the staples, there's plenty of stuff always to go after. Bill McLucas once told me, "When you're director of Enforcement, you just feel like you have your finger in the dike all the time, overwhelmed by the oceans out there."

WT: It's often said that the Commission, in this time, was more divided than it was in earlier periods. You, having been there in two different periods, was that your perception?

DB: Yes. I think that's part of the process that started with Enron, and the process that started with Eliot Spitzer making all this stuff visible and moving extremely quickly. And they are broader social trends. The country's more divided, politics are more divided. The agency is significantly more political than it was decades ago, and I don't mean principally in a partisan sense.

WT: More ideologically, in terms of economically and philosophically?

DB: More ideologically and more stylistically. Whatever one thinks of Chris Cox's tenure, he plainly had the reflexes of a career politician. There's nothing inherently bad about that, but it's a different way of running an agency than other Chairmen have. We had members of the Commission of different parties who would play to the public much more than traditionally Commissioners did. And then we had some of those same Commissioners who were less collegial in the sense of arriving at compromises. Obviously those two things are related.

WT: So let's talk about Dodd-Frank and the process through which that was formulated. Obviously it's an incredibly complex topic, so let's see if we can try and get at the highlights and the Commission's role in that legislative process. What were some of the key concerns that were the focus? Is it on the systematic risk element of it and defining what the SEC can do in that respect?

DB: Survival, I'd say, is the principle concern. And I don't mean survival for its own sake. I mean survival of a particular voice that the SEC has traditionally had of both from the standpoint of protection of retail investors, and from the standpoint of vigorous enforcement as part of the regulatory arsenal. The SEC has not traditionally been focused on systemic risk. I think the financial crisis and concerns for run on money market funds focused the SEC on systemic risk in ways that we hadn't been previously.

WT: Just reinterpreting what you're saying, was there a danger at that moment that the mission of the SEC would be completely reoriented?

DB: I think the traditional view of the SEC is that the banking regulators coveted the SEC's regulatory role in the same way that Vladimir Putin covets the Ukraine, and I have to say I don't think that's unfounded. I don't think it's mere bureaucratic infighting there. There are differences of views. Certain elements in the Treasury Department and banking regulators felt that the SEC was essentially representative of the left-wing of the Democratic Party, which is a little ironic given the view of the left-wing Democratic Party that the SEC is a patsy for large financial institutions. So we wanted to maintain our capacity to be the investor's advocates, simple as that.

WT: So let's talk about the substance and the difficulties of formulating legislative provisions, and then after that, rules. There are questions like how do you divvy up different institutions? I've run into the issue of whether or not mid-size hedge funds might pose a systemic risk, or whether or not separate entities have to be cleaved off in order to undertake certain kinds of transactions.

DB: Again, we're a small player in an administration. We get opportunity to voice our views to the Treasury Department, and some meetings with other financial regulators, but ultimately the decisions of what's in Dodd-Frank are made by the White House, advised principally by the Secretary of the Treasury. We had positions on viable stuff, we would send them over to the groups who were melding together the positions of various agencies, and had opportunities to speak to some of the decision makers.

Basically what came out of that was an administration bill, and then what came out of that, the action moved to committees. We, sometimes separately, sometimes with other parts of the administration, speak to committee staff about that and all sorts of issues. As I say, finding the right answer, the answer that we prefer is the easiest part, always is with government.

WT: What were the signals coming from the administration? What were their key concerns that they were preoccupied or most focused on? Were you worried that the bankers' view was going to overwhelm?

DB: Not worried, convinced. I've talked about the death struggle between the banks and the SEC, the bank regulators and the SEC—by the way, much more the bank regulators than the banks; interesting phenomenon.

WT: Are we referring mainly to the Fed in this instance, or is it really the whole array?

DB: No, the Fed, all the banking regulators, but principally the Fed. But that struggle, in many ways, ended the day the Fed wrote a check to J. P. Morgan Chase to acquire Bear Stearns, because the SEC can't write a check to anybody. So, to the extent that there had been something of a standoff for decades, with guerilla warfare going back and forth between agencies, fundamentally, at this time the bank regulators held all the cards. They had a Treasury secretary who was himself a former bank regulator, and we had Madoff. So basically, we cajoled and advocated and got the best we could.

WT: Over-the-counter derivatives come back into the fold at this time. What are some of the principal issues there from the SEC's perspective? It's a huge market. How do you undertake a regulatory regime for something at the center of the financial crisis?

DB: Well, legislatively, the sensible thing to do would have been to combine the CFTC and the SEC, but in a world in which a September 11th report recommended combining eleven congressional committees with oversight over intelligence operations—and that has yet to happen—it was quite clear that combining, not so much two agencies, but two congressional committees was an impossibility.

We had concerns that there would be definitions of what became securities-based swaps that would take away from us our regulatory authority. CFTC, which whom our relations were quite cordial, had similar concerns, and so we were concerned about that. We were also concerned about building up our regulatory capacity.

When I left the SEC in 2002, as of that time I had never heard the phrase credit default swap. Fast forward nine years later: there were some people who through their extraordinary intelligence and efforts had gotten themselves fully educated on these issues, but not enough. So I'd say our concerns were both external, in terms of policy and limitation, and also internal, in building up and maintaining our capability.

WT: Is the Division of Risk Strategy and Financial Innovation the key element of that, or is it more of an addendum? I guess it's referred to as the think tank.

DB: I'll tell you the story of that division, and I'm going to be a little immodest: that was my idea. I had long felt that the Commission did a very good job in responding to short-term issues, but did not have enough capacity to think about five years from now and needed, in effect, a pure research capability. At the same time, there was a need—and I tend to think of these things somewhat less abstractly, perhaps, than most—but there was a need to enhance our capabilities for economic analysis and convincing courts that we were taking economic analysis seriously.

WT: Did this have to do with the challenges on a cost-benefit basis to some of the rules?

DB: Yes. In addition to that, the risk profession, if you will, had developed—or at least so we thought. Now, the SEC had some of this, but in my view didn't have enough, and didn't have it integrated. I did an outline that I showed to Mary, Elisse, and all the Commissioners, proposing an office of smart people. Everybody was enthusiastic about it, although when you get into details, everyone has different views as to who's smart and what smart people ought to be doing. But that was basically how the office developed.

WT: Then, as part of the Dodd-Frank legislation, I'm looking more into the aftermath of it now than in the development, there were a lot of issues that the SEC had addressed in the past that were controversial, they go through shareholder access, hedge fund registration

had been overturned and that is now part of that legislation. Can you tell me how much of a fight that seemed to be brewing up to be in the rule-making process?

DB: Proxy access was at least a ten-year struggle, and it was a struggle even congressionally. Republicans were generally opposed to it. It was the Congress with a Democratic majority, but it's not easy to get members of Congress interested in this particular issue. What we ultimately got out of this at the last moment, I think, was something authorizing us to promulgate rules on proxy access, so at least to take off the table the issue as to whether or not we had the authority to promulgate rules. We did, and ultimately the D.C. Circuit didn't like them and invalidated them anyway. But, like in many things, we were smarter than we look. We wrote the rules in a way so that in the event the D.C. Circuit did invalidate mandatory proxy access, permissive proxy access, in effect, was what the rules defaulted to. And that was something that just a few years earlier the corporate community described as Armageddon, so it didn't end up all that bad.

WT: And disclosure of executive compensation is a part of this whole thing as well? That, I know, had been very bitterly fought on and off for many, many years.

DB: It's still being fought. People have different views about what came out of Dodd-Frank, and how useful it will be. There are many senior corporate people who would kill to keep their information out of the public eye, and the other side of it is this is something that the public is interested in, as opposed to proxy access.

WT: You gave a very interesting, I thought, speech on the whistle blower provisions of Dodd-Frank, and of course, that was a major issue after Madoff. I'm wondering if you can discuss the context of what the SEC's position was with respect to that. The number was something like 700,000 tips per year, so what exactly it was able to do in that area, and what the dangers were of offering high compensation for whistle blower information?

DB: The rules came out pretty much the right way in the sense that tips, by themselves, are not necessarily all that useful. It is an enormous chore to sort through hundreds of thousands of tips. And there's a huge risk for the agency with tips—particularly in the aftermath of Enron and the Harry Markopolos tip—is that if you don't follow up on a tip, or if you don't bring a case based on it, there are lots of people out there, both in the media and among politicians, who are quite ready to hammer you for not having done that.

On the other hand, the SEC is a small agency. Evidence that enables you to bring cases is enormously useful and leverages the SEC's capabilities. So I think our thought was, as much as was possible, to encourage information that enabled the Commission to bring cases, and not merely to just encourage tips.

WT: Are there any other aspects of the Dodd-Frank legislation that you'd like to highlight?

DB: Page 830 was terrible (laughter). I would say many of the criticisms were valid. It's badly written. Like much legislation, it is ultimately a formulation decided on late. It has

a Christmas tree aspect to it, and it has tied up the agency for years. I'd say that the worst aspect of it, from an SEC standpoint, is that much of it is an empty promise. Despite the talk about the interest in reform and the interest in a performing SEC, this remains a tiny, underfunded agency. Unless and until the Congress and President are serious about changing that, you can write the longest legislation that you want and it's not going to have much impact.

WT: I'd like to discuss the question of addressing technological change in the markets. I know you were there for the flash crash, but how much did that enter the General Counsel's office?

DB: I don't know that it entered the General Counsel's office particularly, except in the sense that we wanted our piece of the resources available for technology, like other parts of the country, but for my ambient advising role, it played a great role. We were very focused on getting people who were technologically savvy, who had trained and were comfortable with the use of data in their analytics, and in getting and in enhancing technology. And that's a multi-year effort that's still going. But that was a very serious focus of the agency.

WT: Now, of course, in the midst of all of this, the SEC has a very zealous inspector general, and I know that that gaze fell upon you and that nothing came of it. You've mentioned how disruptive that was, I think, in another interview, so I was wondering if you could

offer any further insight. Is it part of this whole atmosphere of looking for incrimination after the financial crisis?

DB: Well, it's a long story. Inspector generals are essentially a projection of congressional power to executive agencies, and Senator Grassley in particular, who has been the most vituperative about this, have been interested in that. Before I came to the SEC, it was clear that David Kotz was simultaneously just a poor lawyer and difficult guy, and at the same time invulnerable, in part because of the experiences the Commission had had over a series of complaints brought by Gary Aguirre in complaining that the Division of Enforcement had stopped him from bringing a serious case involving Morgan Stanley.

WT: Aguirre?

DB: We could talk about that for hours. I understood when I got to the agency how dangerous David was, but I determined that the best way to deal with him was to shoot straight at all times. My first conversation with David took place in the Chairman's office shortly after I got there, and he was explaining that in connection with his Madoff investigation he would be interviewing Commission members and former Commission members. But he said, "Don't worry. I'm doing this just for show. Just so that I can show Congress that I am on this." Because I'd been an enforcement lawyer and been around the track, I felt compelled to jump in at that time and say, "Well, wait a minute, David. Just so it's clear, you investigate this how you want. No one is telling you what you should do or what you should not do." "Oh, I know, I know," he says. That was my introduction to David Kotz.

Over the next couple years, there were times when I felt that I had to say similar things. We were concerned that he was using experts. David churned out a ton of reports, and the way he did it was by hiring third parties to write drafts and he would review them. I remember feeling that I had to have a meeting with him, and like every meeting with him you had to have witnesses there, to tell him that we thought he wasn't complying with the procurement rules. He was dismissive, not terribly pleasant about it.

I had another occasion with him where he started using the New York Stock Exchange image on his reports, and we got calls from the New York Stock Exchange saying, "This is our intellectual property. You can't do this." We had to tell David not to do this, and he was very unpleasant about it. "Why can't I do this?" I explained if they had spoken to the Justice Department about it, we could get sued. "Well, if I had a real lawyer here advocating for me, I wouldn't be in this position."

At the same time that this is going on, I'm hearing from people, "David's doing this; David wants to tap into all our emails on a real-time basis." I explained to him why he couldn't do that. As I said when I left, I had people come into my office and a couple of occasions weep because they had been subjected to essentially ambushing by David.

"Oh, could you come to my office? I want to talk to you about a few things." They walk in and there's somebody with a court reporter there and explaining to them, "You have a right not to talk to us, but if you don't, I'll put that in my report."

On top of all of that, just as a lawyer, he wasn't very interested in law. I remember with a couple of the reports, we – the Office of the General Counsel - had to determine what could be provided to Congress consistent with the Privacy Act. David would say, "Oh, you've got to give these people much more. I know how to handle Congress. Just give them what they want and they'll be all right." "David, but there's the law in effect," and he had no interest, and no knowledge of that.

At the same time, the members of the Commission were afraid of him because he had Congressional protectors, principally Senator Grassley and his staff, and he had the capacity to embarrass all sorts of people, and had an interest in doing it as well. So he was, in my sense, the classic abuse of power by someone who was pretty adept at it.

WT: I've come to the end of all the questions that I have, and I appreciate your taking all the time that you have from your day. Do you have final thoughts on your time at the Commission?

DB: Two thoughts. The first is, everybody you talk to who's worked at the Commission, virtually everybody, describes it as a highlight of their professional career. I certainly felt extraordinarily fortunate to have two highlights in my professional career.

The other thing is—it's something that I said to Alan Beller when we were recruiting him to be director of the Division of Corporation Finance and Harvey Pitt was recruiting him, and then I repeated it to Rob Khuzami when Mary was recruiting him—and that is,

“When you’re at the Commission, you have lots of hard days, but you don’t have a single bad day.” And that’s what it was like.

WT: Well, thank you very much. Once again, I appreciate it.

DB: My pleasure.

[End of interview]