SEC Historical Society
Interview with Laura Unger, November 7, 2005
Conducted by Kenneth Durr

KD: This is an interview with Laura Unger on November 7, 2005, at JP Morgan, Washington, D.C. by Kenneth Durr. I want to start with some background. Something interesting in your resume is a B.A. in rhetoric.

LU: Yes, everybody thinks that's interesting.

KD: Do you think it's not interesting?

LU: No, I do. It was very interesting.

KD: What did you get out of that degree that affected the way you did things?

LU: Well, rhetoric is both a study and a discipline. In terms of study, it basically consists of dissecting how people present arguments, and how you would present yourself, and make your point in arguments. So, you break it down to ethos, pathos, and logos. Ethos is how you appear to people; pathos is emotional appeal; and logos is logic. You can use those three components both as a means of communicating and as a way of understanding communications.

We applied those concepts in the study of rhetoric, in a variety of different ways, including the rhetoric of Plato, the rhetoric of Evil, the rhetoric of religion, the rhetoric of

fiction. It was very interesting to study, not only of the ancient philosophers and how they used rhetoric, but also how it impacted our society. Rhetoric teaches you a way to think and approach problem-solving, and to convey thoughts and ideas in everyday life. The logic component of rhetoric made it a natural segue to law school. A lot of rhetoric majors were what people would consider "pre-law."

Rather than majoring in humanities, literature, or English, or something similar, rhetoric was a very natural fit for someone who was interested in pursuing the law—which I knew at the time I went to college.

KD: So you were pre-law.

LU: Yes.

KD: Securities law?

LU: Well, no. Not right off the bat. But when I graduated from college, I came back to New York, which is where I'm from, and I worked for my Dad's business for a year, because he was hoping that I would take over the business. It was a brokerage business, but it was real estate brokerage in Manhattan.

KD: What business was it?

LU: It was real estate brokerage. It was called Pogue Simone. There were three offices, and they had a very high-level clientele, so it was a lot of fun and very interesting. But I also knew that I wanted to continue what my original passion was, the law, so I applied to law school. I went to New York Law School. I should back up, because before I actually made that final decision about law school, I considered a joint MBA/JD program to combine my love for business with law.

I figured it could work to be a business person with a law degree but not a lawyer with a business degree. I really wasn't all that interested in getting an MBA and JD, so I went on to pursue my JD at New York Law School. Within my first semester, I took a Corporations course, which I found very fascinating. Because I was at a law school in New York, there were securities practitioners teaching as adjunct professors. I remember having professors from Wachtell, Lipton. Of course that was the premiere M&A takeover firm in the late '80s, when I was in law school. These courses seemed like the perfect blend of business and law.

KD: Takeovers in particular?

LU: At that time, M&A was fascinating and hot when I was starting law school. By the time I left, it had already diminished in interest somewhat. I quickly found out that securities lawyers were not in hot demand right out of law school. In fact, most firms were looking

for seasoned securities lawyers. Instead - after collecting an entire file cabinet full of rejection letters, I wish I had saved—I decided to pursue opportunities with the government. At that time I was living in New York, so I interviewed at the New York office of the SEC. And I got a job there within three days of my interview. Fortunately, the interview went very well.

KD: Who interviewed you?

LU: Carmen Lawrence, Regina Mysliwiec, Robert Blackburn, and Jason Gettinger, and I think there was one other sort of lower-level assistant director, but I can't remember who it was at this point. But I remembered all of them, in part because Regina had gone to law school with my uncle, so she recused herself from any final decision-making, but we caught up a little bit on my uncle.

Because I had done so well in the corporate and securities law classes at law school—my grades were really, really high in those areas - it was a perfect, natural fit. After about maybe six months there, I took over some old cases, as most junior lawyers do, at the SEC. And then, as most junior lawyers also do, I looked in the paper for something new and exciting, and found the *Business Week* insider trading case, which ended up involving the printers McGraw Hill. Theat case probably catapulted my so-called fame in the Enforcement division. I took on that case, and spent a good six months or so really

focused on that case, the California part of it; one of my colleagues, Andrew Geist, took over the Connecticut part of it.

KD: Did you end up going to California?

LU: I spent a lot of time in California, yes.

KD: Tell me a little bit about that case. You found this on your own?

LU: Yes. It was that classic tug. I was in one of the regional offices in New York, and Washington also wanted the case. Richard Breeden was the Chairman at the time and I remember there being a discussion and a debate, and Washington agreed to let New York have the case. So the pressure was on to perform well, both for myself professionally, and for the New York office, to show headquarters—which is what we called Washington—that the regions could do just as well, if not better.

I remember we got the formal order, I'd say, within twenty-four hours. I wrote up the memo quickly; it was hand-delivered among the Commission, and we got subpoena authority. I got on the train with Ira Spindler, one of the investigators, and the witnesses presented documents during the testimony. One witness in particular, Brian Callahan, a Prudential broker, was the tipper, basically. He was paying the printer a hundred and fifty dollars for an advance copy of the "Inside Wall Street" column of *Business Week*.

I took his testimony. He brought in a huge box of documents, knowing that a fairly junior lawyer was taking his testimony. Ira Spindler was such an ace that, as we conducted the testimony, he sat through and analyzed the documents, and just passed them over to me with cryptic, very pointed, notes. It was a fairly magical testimony situation; I know the transcript has been well-used in the trials, and that kind of thing. So it was very fun.

KD: Did you go onto the Senate Banking Committee shortly afterwards?

LU: No, I transferred to the Washington office of the SEC. After about a year and a half in New York, I moved over to headquarters, thinking that it was somewhat of a step up to be in the center of it, and that I would maybe no longer have to fight as hard for my cases. I found that it was, in fact, the center of activity. It was a little more bureaucratic than New York, and not quite as exciting in some respects, and very exciting in other respects. The part where it was very exciting was being in the same building as the Commission itself—i.e., the Commissioners.

KD: Just being there?

LU: Just being there so that, as a staff attorney in Enforcement, I could attend, and sit way back—where hopefully nobody could see me—in the weekly Enforcement meetings, and

really watch how the Commission set the enforcement policy. I thought that was probably one of the most exciting things about being in Washington. The Commissioners at that time included Commissioner Grundfest and Commissioner Fleischman, and again, Richard Breeden was the Chairman.

It was a very intellectually challenging environment, in terms of the Commission being very much expert in their discussions about the federal securities laws, the nuances of the cases, the nuances of policy, and the direction the Commission was taking in approving the cases. I found that to be so completely energizing and exciting and cutting edge that, for me, it was one of the most memorable things about being in Washington.

KD: Did you have people who were dominating the Commission in those discussions?

LU: I think the three I mentioned. Mary [Schapiro] was a Commissioner at that time, and Commissioner Roberts.

KD: And of course there have been a lot of times when there weren't the full five.

LU: I know, there wasn't a full five. Absolutely.

KD: Okay.

LU: But to observe Commissioner Fleischman, Grundfest and the Chairman sparring intellectually was quite a sight.

KD: So they really did spar?

LU: Oh, of course. That's well known. Now you have it documented.

KD: Right. Any notable cases in Washington?

LU: In Washington, for me?

KD: Yes.

LU: It was a lot more competitive for the high-level cases. I had some interesting cases, nothing that really stands out the way the insider trading case stood out. The other thing I enjoyed about Washington and the policy setting was that my division directors and associate directors spent time with their staff, talking about and integrating legal developments into the enforcement agenda and how we managed the cases. I remember particularly when Bruce Hiler was my associate director; he was very good about that.

I don't know if I should be saying this on tape, but one of the first weeks I was at the Commission in Washington, he called a four-thirty staff meeting on Friday afternoon. I

thought, "I cannot believe that! Gosh, these guys are really hard-core." I showed up in his office, and of course—there was beer! It was a cocktail party, which they did every Friday. It was a lot of fun. We actually did conduct business, but it was a very relaxed atmosphere, and we'd talk about the week, and we'd talk about any significant court cases, or failure or success the staff had with the Commission that week in the enforcement meeting. It was a very productive way, and a fun way, to end the week.

KD: A morale building exercise.

LU: Absolutely.

KD: Who was director of Enforcement at that point?

LU: I was there at the end of Gary Lynch, when there was a long period of no one, and the beginning of Bill McLucas. He was actually the acting head of the New York office when I was there, but he was going back and forth from Washington to New York.

KD: What made you take the jump over to the Senate Banking Committee?

LU: Although I never thought I would want to leave the Commission, because it was the most exciting place in the world to work, I was probably a little disenchanted with my case load, the types of cases I was getting, and I wanted something more challenging.

Someone had told me that Senator D'Amato was looking for a banking and securities legislative assistant. And I hate to admit it, but at that time—even coming from New York—I had no idea who Senator D'Amato was. I had no idea what the Banking Committee did, or what a legislative aide would do.

I went up, and I talked to some of the people. I found out how hard it is to get your call returned by anyone on Capitol Hill. They were very interested in having me come on as a legislative assistant, but didn't have the budget to pay a fairly experienced lawyer with a good background in the federal securities laws. I think I was probably making some big salary of thirty thousand at the SEC, or thirty-five thousand, and they just didn't have the budget to pay more than probably twenty thousand, if you want to put it in numbers. So eventually we worked it out so that the SEC would "lend" me to the Senate Banking Committee for a period of six months.

I recall being called down to Richard's office—Chairman Breeden. He had a good relationship with Senator D'Amato; the two of them spoke and reached an accomodation. I think it was what you would call a win/win, because the SEC would have someone who was knowledgeable about the federal securities and the agency helping the senator from New York with policy, budget and other issues that would be relevant to the SEC. The senator would get someone who was of a higher caliber, if you will, or more experienced than he would otherwise get.

I remember Richard calling me to his office, and saying: you're going to go work on Capitol Hill. You've got to be careful, it's a—I don't think he said a cesspool - but I definitely think he could sense that I did not have a huge context, or perspective, on what it would be like to work on the Hill. Now, I never saw the cesspool side of it, or whatever his exact terminology was, but he was very protective, and he was very considerate and thoughtful, and excited about the opportunity for me - which he was kind enough to facilitate.

I remember appreciating that quite a bit. And the Senator couldn't have treated me any nicer. He treated me like gold. It was a fantastic experience. At the time I originally went up, the first six months of the three six-month periods I ended up serving was as a Congressional Fellow. Senator D'Amato was the third senior member of the committee, and the Republicans were in the minority. Shortly after, Senator Garn retired, Senator Heinz was killed in a plane crash, the Republications took the Senate, and all of a sudden, Senator D'Amato was the chairman of the committee. So, it was quite an interesting time.

KD: Did you help a good deal in the Private Securities Litigation Act?

LU: Yes.

KD: Tell me a little bit about that.

LU: That was interesting, because the whole idea of the PSLRA had been something Congress had been speaking about for some time. The champions of that were Senator Domenici from New Mexico and Senator Dodd from Connecticut. Senator Dodd is a Democrat, and Senator Domenici is a Republican. For their own reasons—and I don't think they had the exact same reasons—they were very concerned about the notion of private securities litigation cases draining capital formation, and the fact that most cases were completely frivolous. The cases distracted businesses from doing business, especially in Silicon Valley.

There was discussion about this issue for some time, which increased when the Lampf case came out in'91 or '92.

That case basically imposed a statute of limitations on bringing private securities class action lawsuits, and for a period of time—am I blending these two cases? The Lampf case imposed a statute of limitations of one year from discovery and three years from commission of the fraudulent act. The case wasn't clear about whether this applied to the SEC, so the SEC had an interest in making sure that the statute of limitations did *not* apply to the agency.

The plaintiff's bar wanted to extend that statute of limitations, which they sought to do legislatively. There was a lot of interest in seeing a piece of legislation pass. Whether

I'm getting the underlying facts precisely right or not, clearly the time was right to do something. Senator D'Amato, of course, had a strong interest in the legislation itself and a close relationship with both of the co-sponsors. His and my role was to broker a bill that balanced the interests of the business community with the interests of the plaintiff community, without precluding plaintiffs from being able to bring *real* private securities class actions.

It became a very controversial piece of legislation; there were two main controversial pieces of it. One was the English rule, or loser pays. I remember there was a long period of time when Senators Dodd and Domenici were pretty adamant about loser pays. They believed loser pays would be the only thing that would truly prevent frivolous securities class actions. However, the other side of loser pays is the chilling effect it would have on people who were justifiably bringing those cases. What we ended up settling with is now called proportionate liability. The other was safe harbor for forward looking statements.

There was another very controversial piece of the bill. It was extending the statute of limitations; that the quid pro quo was going to be extending it from one/three to two/five—two years from discovery with a five-year cap. That was just something that the business community did not want to do. But we ended up working out a bill that, while modest, I think has been effective. Then of course, what happened after the PSLRA of '95, was that a lot of these cases started getting brought in state courts to

circumvent the federal law. So in '96 or 7—right in the middle of Arthur Levitt's second confirmation hearing, contemporaneous with that, came the pre-emptive legislation that then applied the PSLRA to state court.

KD: You talk about the business community and the plaintiff's community. What about the regulatory community? What was the consensus from the SEC about this new legislation?

LU: They were very much against loser pays. They very much wanted to have the longer statute of limitations, because, as you know, the SEC can't bring every case. The private plaintiff's bar has always been an adjunct to the SEC's enforcement agenda. I think, while the SEC wanted to restore order to the litigation system, they were more on the side of: don't cut off any people's rights. But they were very helpful also, in some regards with the Rule 11 provisions, with "reckless" versus "negligence" definitions, and with interpreting duty to update. There were a lot of nuances to the law that had to be considered. The case of duty to update presented an opportunity to instill or impose a standard for what that duty should be for public companies.

Congress ended up remaining neutral on that issue, but it was after a lot of study and discussion as to whether the bill should impose a federal standard, or how we should approach it. So, there were a lot of very intellectual conversations, and a lot of very emotional conversations about the whole issue. There was also somewhat of a dearth of

factual evidence about private securities class actions. A lot of the discussion was intuitive, because most of the cases were being settled. And ultimately—of course they'd never succeed at this now—the accountants were driving this legislation, in large part. The firms had a keen interest, because they were always the deepest pockets. While there are hundreds and hundreds of law firms, back then, there were only eight accounting firms.

Of course, the eight firms bore the brunt of any private securities class action lawsuit, because the lawsuits always named the lawyers, the auditors, and the bankers. The auditors seemed to be the ones paying the most often.

KD: Getting into your time with the SEC. I was interested in that it appears there was talk about nominating you for the Commission in '95.

LU: I had two swipes at it. That's true. I first got the call in about '95. I'm trying to remember the time line, but it was in the midst of the end of PSLRA. Apparently, at or about the time, I was to be publicly nominated by President Clinton. It was about the time that the Senate and House were wrapping up the conference on PSLRA. By the way, Chairman Cox played a big role in PSLRA also—which is how I first met Chairman Cox.

Congress and the staff were wrapping up the PSLRA, and I guess the President was pretty certain he was going to veto the bill. He apparently did not want to nominate as a SEC Commissioner someone who had worked on legislation that he was prepared to veto. He did veto the bill. I believe it was *the* only bill he vetoed during his entire two terms. Congress then had the veto override, which the proponents led successfully—obviously. That was all around Christmas, so that took us into '96. I think he wanted a respectable cooling-off period, but lo and behold, in about April, the Senate Banking Committee started the Whitewater hearings.

That just didn't seem to be a great time to nominate one of Senator D'Amato's aides either. Then it sort of quieted down. Quite honestly, my recollection is I spent a year of being in the position where it didn't matter; where I could continue my daily responsibilities without being recused or having any awkward moments, even with a pending presidential nomination. I think Senator Graham expressed an interest in proposing a few candidates; and it was at that time that the White House decided to pick up my nomination again. By then, I had to have a second background check; I had to re-submit all my papers; and that was the time that they had chosen Paul Carey to be my counterweight, if you will.

Paul and I, of course, had a very close working relationship anyway, because he was the White House legislative liaison. He was also good friends with Senator D'Amato. Paul and I always said we had a symbiotic relationship in that he got my name out of the

White House, and I got his name out of the Senate. So that's pretty much how it happened.

KD: So it was a package deal.

LU: It was a package deal.

KD: Yes, that's happened a few times.

LU: Yes. Actually, that was somewhat of the beginning of the trend. Some initially had thought that I was going to be part of the Hunt/Johnson confirmation, but they couldn't push it that fast. Paul and I later became the package.

KD: But those two were still in there when you came in.

LU: They were the Commission that Paul and I served on, with Arthur as the chairman.

KD: Tell me a little bit about what you found when you came in. You've seen it from the enforcement and the staff point of view; did the institution look different when you came in as a Commissioner?

LU: I had already worked in the Washington office. We were in the same building. I had never really put down the SEC policy legislative issues—put down as in put aside, put to rest. For the entire time I was on Capitol Hill, which ended up being seven years, I was Senator D'Amato's legislative person, and then eventually counsel to the Senate Banking Committee for securities issues. While I was not *at* the SEC, I was never far from securities, or SEC-related issues.

I had, interestingly enough, worked on PSLRA, NSMIA, and the Government Securities Reform Act. Those were the big pieces of legislation, some other amendments, and the FDICIA. I was on the receiving end of all of those rules, and all of that policy when I got to the Commission. Many of the studies that we had ordered in NSMIA, the SEC was just implementing, or just finishing. It was actually a really interesting transition, to be at the agency then responsible for implementing a lot of what I, as a legislative counsel had helped draft.

KD: So you knew what the intent was in a lot of this stuff.

LU: I knew what the intent was. I knew the agency, certainly, really well from a staff perspective, I knew it from a leadership/Chairman perspective, but I didn't really know it from a Commissioner perspective. I had gone to lunch with, socialized, and had a business or working relationship with some of the Commission over the years. Nothing

fully prepares you for walking in the door and sitting at your desk on Day One at an agency that you knew a lot about, but weren't necessarily one of the policy-makers at.

KD: What is the Commissioner perspective?

LU: The Commissioner perspective? Well, it's not as if this was something I hadn't been thinking about on and off for two years, so I had plenty of time to plan my agenda. I had gotten a lot of advice. It's interesting; being a very visible public servant—obviously working on Capitol Hill at a fairly high level for a very senior chairman from New York. I knew a lot of people, and heads of the firms, people on the Hill, and of course all the senior lobbyists for all of the financial firms, and a lot of the SEC alums. I was just amazed at the groundswell of support, and people who called and said: Let's go to lunch, and let me talk to you about what it's like to be a Commissioner.

Most of the former Commissioners who were still around had time to sit down with me, reach out and give me advice. It was a very helpful exercise, both socially, and intellectually; to prepare myself for what I would be facing. I got advice both in a how to be proactive way and a what to avoid kind of way. I remember Commissioner Fleischman telling me that it's very easy to be overtaken by the SEC's enforcement agenda, and that you could really spend your entire tenure as a Commissioner on enforcement matters.

A couple of Commissioners said the same thing. Just keeping up with an agenda that you never set, keeping up with the Chairman's wishes, keeping up with the staff's wishes, the rule making, the enforcement agenda, and you could leave at the end of your four years without ever saying, "Here's what I did. Here's what I thought. Here's what I wanted to make a mark in, what I wanted to pursue, what I found interesting; or anything else." So, you needed to actually really work at being proactive in that way, or it would never happen.

KD: That's an interesting piece of information. It appears as if you did that.

LU: Yes. I took that to heart.

KD: But there's one thing I want to touch on before we get into that: At this point you're taking over the woman's chair…

LU: The woman's chair.

KD: Yes. Was it…

LU: Was it obvious they were looking?

KD: Was it really enough that there was still this sense that: "oh we need a woman's chair, and this is the way it's going to be."

LU: Absolutely, positively, totally, and completely. There was a search for a Republican woman—a Republican, a woman—who was knowledgeable, but not terribly controversial, who would probably be kind to the staff, and get along well with Capitol Hill. There were a handful of names; I don't know why the other candidates weren't chosen. I assume I was chosen because I fit all of those qualifications, despite having worked for Senator D'Amato—it was the good thing about me, and the bad thing about me. He was a champion, but not a vocal champion—knowing that it wasn't necessarily my best asset, and it wasn't my worst asset.

KD: Did you ever get people who acted on the assumption: Well, she's just here because she fit the demographic.

LU: No. I always felt that I was treated with respect. Although there were times when I'd walk in a meeting, and I could tell by the people I was meeting with that they were surprised that I was as young as I was.

KD: Yes. That might have been an even bigger factor.

LU: Young, and I was pregnant within a month of taking on the job. So, young and visibly pregnant, after a short time of being in office. That's right. But you know what? I worked right up to the day I had the baby; and in fact, that's probably the most energetic period of my life ever, when I'm having a baby.

KD: That's pretty good.

LU: Yes. That's right.

KD: It can make meetings and things awkward though, I guess.

LU: Well, as much as I, and other female professionals, would like to think that we've come a long way, there is clearly still a long way to go—particularly in the financial world. I deeply respect all of my colleagues that I work with now, that I've worked with before. I enjoy them, I don't ever feel slighted; I feel they take great pleasure and joy in working with someone young, with a sense of humor, who's somewhat knowledgeable—or perhaps very knowledgeable; but there's still a long way to go. I don't notice it anymore; but I'm still the only woman at the table, or in the room, a lot. And that's okay; it's better than not having any women in the room. But certainly, to be thirty-seven and with child, and a policy-maker, probably threw them off a little bit. That's good for them.

KD: You talked about how important it was that you set the agenda. One of the first things you did was look at enforcement.

LU: Yes.

KD: Was that *your* initiative?

LU: No. That was Arthur's initiative. Some would say he was trying to throw me off from my other initiative, which was technology. But I was happy to do it, actually. People are always cynical about other people's motivations, but I thought the enforcement review was actually a *great* way to get started as a Commissioner.

And certainly, the Enforcement division did not embrace the notion of a top to bottom review. It could have been awkward for Bill, who was leaving, and Dick Walker, who was just coming on. I'm sure Bill was sensitive to perhaps being criticized without knowing what the outcome would be. But he also knew me very well, and knew that I would be fair and balanced. As far as implementation, it was a perfect time. It was the *ideal* time to build a record, and then pass the information on to an incoming director. It's much easier to effect change with a new person.

KD: And you actually had a hiatus there.

LU: Yes. Absolutely. But when Dick Walker came on board, I had finished the review, and sat down with him and went through the findings in my review. It was also a fun group of people that I had assembled *in* the building to conduct the enforcement review. But, as with anywhere, oftentimes you would ask a question and be met with blank stares, and "because we always did it that way." Contemporaneous with meeting with the staff, I met with the outside industry, including all the former General Counsels; I met with a lot of the Commissioners; I met with a lot of practitioners; I met with academics. And then of course, I had this whole inside working group.

I think I got a fairly broad perspective. Former General Counsels included Harvey Pitt and Jim Doty and all the rest of the names that would be very familiar to you. A lot of the issues are the same issues that we see today. It's a very big challenge to maintain an appropriate balance in the enforcement division between vigorous pursuit and over-zealous prosecution. It's not easy. And I know, having been one of the people in that division, how hard it can be and how you can get caught up in a case, in a fact pattern, in a gut reaction to knowing that someone's guilty, even if you don't have a shred of evidence.

KD: That was the finding that was really screaming out of this?

LU: No. When things get skewed, that's the public perception. What I developed as an agenda ranged from the fact that the staff was getting the highest ratings in their reviews,

that there was no self-selection among the staff, that the process for opening an investigation wasn't rigorous enough, and we didn't close enough cases. The enforcement program set by the division director didn't necessarily coincide with what the Commission wanted to set as policy. The messages weren't always clear; they weren't always presented contemporaneous with rule-making. A lot of times, Enforcement took liberties with making policy, either in something that was more appropriate for rule-making, or something that the Commission should have had more of an opportunity to opine on.

I also reviewed the timing of the cases themselves, the fact that they're often investigated, settled, and all the papers are drafted by the time the Commission first sees them. The kind of thing we call getting ahead of the ball. The group looked at why investigations take too long; people not knowing when an investigation's over, and other resource issues. So really, the review ran the gamut of every single piece of the enforcement division; every rock was turned over.

KD: What's the solution to that? More structure?

LU: Some of the recommendations you've seen implemented included sweeps, more real-time enforcement, which Harvey—I don't know whether it was from my enforcement review, or his original input colored my recommendation—where it exactly from, but certainly the real-time enforcement notion. One of the examples I pointed to was the bank sales of

mutual funds. By the time the SEC got around to bringing that case—which was Sovran Bank, or whatever it was at that time—there were already rules out prohibiting the conduct that we were bringing a case about. It meant nothing! It was a pathetic showing, really.

Recommendations also embraced the notion of the Commission being on top of things, and timely, and getting the message out better and faster; and not investigating every last defendant—the nth defendant, as people call it. Bring the case. Sometimes bring the nth defendant, but not always. If you've got to make the point, get in there, make the point, and move on, or bifurcate the case. There were suggestions about how to make the program more efficient. The fact of the demands for the enforcement chief's time, that's when I had the idea of bringing back the deputy, the job that went to Steve Cutler. Really doing a better job with what we had resource-wise. Now of course, the SEC has more now, so maybe it's time to take another look at the division.

KD: Well that's an interesting question. You were coming at the tail end of the Clinton administration; there had been a freeze on the SEC, as far as funding was concerned. Was the effect of that noticeable in the institution?

LU: It was a freeze: yes and no. Congress has always been very concerned, because of the extensive enforcement authority that the SEC has, of letting the agency get too big. There were a couple of members of Congress who had not personally experienced, but

had close friends who personally experienced a SEC enforcement action. They warned me and admonished me—I got admonished going up to the Hill, and coming back—about the Enforcement division, and that it's run amok. I think they called it Kangaroo Court, and the Commission needed to be mindful of the process.

That's not the impression of your agency that you want your appropriators to have, and these were observations coming from the appropriators. While there was a short-lived idea to have the SEC be self-funded—like the FDIC—that never really took off. Not to get sidetracked today about how the SEC gets appropriated, but part of the problem is that the agency is part of the Commerce/State/Justice budget. The SEC brings in fees, through registration and transactional fees, and these fees go into that pot of money. The Section 6B fees and the Section 30 fees are statutorily set, but every year the appropriators raise those fees to generate more revenue for the budget.

The contrast between what the agency was getting for a budget, and what it was bringing in, in terms of revenue, was just startling. SEC fees brought in revenue three to four times what the agency got for their budget. This prompted some legislators to call it a tax on capital formation. The first tax was the frivolous lawsuits; the second tax was this statutory budget. There was a bill that I worked on, that was passed, to bring down the fees over a period of time, so that the agency would become self-funded, in a sense. The appropriators would continue to set the budget every year, but the fees were set in this

piece of legislation, as was the budget, *kind* of; so that access fees did not go into the general pot of money.

That bill imposed a lot of discipline on the appropriators for the other programs that were formerly the recipients of SEC fee money. That was a way to grow the agency, and have the funds that it generated go directly towards funding that growth. And then of course, the corporate scandals hit. All the time we had been saying—myself, in particular—that we need closer to a *billion* dollars than a half a billion dollars. Then, of course, everybody wanted to make sure that *they* didn't have their fingers pointed at them in short-shrifting the Commission's budget.

KD: And of course, fines are getting bigger all the time too.

LU: Right, but the fines don't go into the budget. That money went into the Treasury. Otherwise, there's the danger that the SEC would become even *more* of a kangaroo court.

KD: Like setting up a speed trap.

LU: Exactly.

KD: Let's talk a little bit about technology. You already said that this was your agenda item. What influenced that decision?

LU: First of all, I found technology very fascinating, personally. I'm not a gadget person—I still have a hard time figuring out how to use my Blackberry—but I'm intrigued by the notion of how it would revolutionize the way the SEC regulates the markets. The fact that it touched on everything the SEC did, both in providing information to investors and the way the investors accessed information, and made investment decisions. Technology changed the way investors ran their own accounts, and it changed the way that markets worked.

It was this *huge* sea change in how the agency could leverage this free flow of information, and these faster moving markets into really doing a hell of a job in getting information out to investors, and making trading more efficient and transparent. The whole notion of transparency would be greatly facilitated and revolutionized by technology. I thought this was something that the agency really needed to take a close look at, and figure out how we could make capital formation more efficient, how we could make trading more efficient, and how we could make investors a little bit more self-reliant, in terms of how they make investment decisions.

KD: Was this a matter of regulators keeping up with the innovation?

LU: Right. This was an attempt to get ahead.

KD: Talk a little bit about the steps. There's the on-line brokerage...

LU: What, if anything, should the Commission be looking at, in terms of the current regulatory regime that provided obstacles to harnessing the powers of technology to improve the way investors invest, and the way the markets function? And much as I would have loved to look at the entire universe of that proposition, I realized that I could not, and ever finish a report. Instead, I took on-line brokerage as a subset of the bigger picture. I looked at what was really vexing practitioners and investors—and the Commission—including suitability. And looking forward: if there was the sort of Amazon.com notion of "you liked this book, then you'd also like these books."

The whole mass customization, or customization of one idea, where you would take information about people's habits, left by the cookies they left at various websites, develop a profile, and "push" them investment ideas. I was pretty convinced that was a possible model of the future.

What kind of regulatory challenges did that entail? The whole idea of the on-line trading systems failing a substantial amount of times, where they'd have systems problems; what were their obligations in terms of having back-up? Investor education: What did the Commission have to be doing about warning investors, or making sure they understood how on-line trading worked? Execution: How did it impact best execution, and the broker's obligation? Obviously, that's something that we're still talking about. So those

kinds of ideas that were fairly traditional, well-accepted notions—not all of them clearly articulated in regulations—but the basic principles of investing.

KD: At the heart of this, is it that there's no longer the face-to-face between the broker and the customer?

LU: The disintermediation of the industry. Now remember, this was coupled with the completely—dare I say erratic?—marketplace, where people were sort of crazed, and anybody could invest in anything and make money. A lot of the basic principles of investing had been tossed by the wayside.

KD: This was '99?

LU: Yes. At the same time, the actual mechanics of investing had changed, where people were empowered by information. No longer did an investor have to wait for a broker to send a research report, or get a stock quote. All of this information was available on websites. People took that information or felt that they *could* take that information and make their own investment decisions. So it was a confluence of a number of events that really made the markets a little crazy.

KD: Did they complain to the SEC when things didn't work out?

LU: *Only* when things didn't work out.

KD: Of course.

LU: The complaints really were more about the mechanics, during the vibrant period. Once February of 2000 hit, the complaints shifted dramatically to suitability—it was my broker's fault, or the system was down, I couldn't get on, I tried to cancel the trade a million times—that kind of thing. That always happens. That's the interesting thing about regulation generally. When markets are good, nobody wants to impose layers of regulation to make it harder to make money or to raise money.

But when things are bad, that's when all the regulation hits, like Sarbanes-Oxley—right at the very time that companies are being hit by a million other things so they're struggling to make money as it is. It's tough. It's very tough to maintain investor confidence during the hard times without layering on the regulation.

KD: This issue of suitability: It seems that that really dominated for a while in this down period.

LU: Yes.

KD: Did you ultimately come up with a policy? Was there a way to make rules having to do with suitability?

LU: There was a way to provide some guidance through interpretation. We ended up going round and round with the staff, some of whom embraced the idea of giving more guidance and suitability, and some of whom were completely dead-set against it. Granted, it was my report, but you didn't want something that was completely uncredible; you wanted something that was constructive. So we ended up coming up with a set of hypotheticals, and providing guidance on specific hypotheticals, about whether there was a recommendation made, because really, the whole notion of suitability is triggered on a recommendation.

The notion of when a recommendation has been made—and I'm saying it in the passive tense, because that's what it is—in the area of technology, there's much more potential for there to be much more subtle recommendations. That's what really drove the discussion on suitability.

KD: So were these hypotheticals circulated to the industry?

LU: These were included in the actual report itself.

KD: I'm wondering if they had some statutory standing, in that people would look at those, and view those guidelines.

LU: Well, yes, people did. It represented not just what I thought, because it was my report, but what was credible to the agency. People clearly thought that the agency wasn't going to back away from anything that was in the report.

KD: You had an opportunity to really take a snapshot of this emerging industry in '98, '99. What did you see? Was it wildly different from company to company, website to website?

LU: I wouldn't say wildly different. People had the same goals in mind. I think, of course the on-line brokerage firms wanted to stay as far away from having any suitability obligation imposed on them as they could, because their business model couldn't sustain that potential cost. The potential cost goes back to our conversation on frivolous litigation. If they have a suitability obligation, they've got to do a whole lot more. Yet, they were looking for different ways to distinguish themselves from on-line broker to on-line broker. You can compete based on execution, and you could say: Well, I'm only $6.95, I'm $7.95, I'm $8.95; but that really only takes you so far.

You have to have the quality of execution; you have to have people believe your systems are going to be there for them. You have to believe there are going to be people

answering your call, if the system's not working. You have to believe in, basically, the integrity of the organization—that they're going to be there tomorrow. A lot of where these firms *were* making money was in margin loan. They were making margin loans to customers. I think that was something that we, at the Commission, talked about that I had a revelation about in my visits to the on-line brokerage firms. The firms were charging a lot of money for margin loans, and there was huge exposure there, because of the leverage obviously, both for the firm and the customer. That was a little bit frightening.

Clearly, these firms treated different customers differently, in terms of what they could access information-wise. For example, the IPO allocations: I talked a little bit about that with each of the firms when I was visiting, but I didn't include that in my report. The IPO allocations were made based on the biggest customers. Pure and simple. No big surprise. Nobody tried to hide that ball. "Our biggest customers get first crack at the IPOs." And you know, at some point in time, the Commission found that surprising; but nobody ever made any bones about that—that was kind of interesting also.

KD: Carrying on a venerable tradition, I guess.

LU: Well, so when you say: what was different about the firms; there was some difference in execution quality, but it was probably mostly the margin loans, and the IPOs, and that kind of thing; where they were able to attract and retain customers—and service.

KD: Did the aircraft carrier concept have anything to do with this idea of changing technology?

LU: There was a piece of the aircraft carrier that we tried to take out of the aircraft carrier—my memory is not so clear on this, because it was a small piece of what I was doing—but there was a technology component of it. When the aircraft carrier was out for comment, my staff and I tried to separate a piece of it into a different rule-making, because the aircraft carrier was dying of its own weight. And I think we did end up providing guidance on it. That was more about the road shows; what's a "writing," and what's not; what's permissible—that kind of thing. It was the more capital formation, capital raising side of technology.

KD: Rather than secondary trading.

LU: Yes.

KD: I'm interested in where the impetus for regulation of fair disclosure came from.

LU: Arthur.

KD: What was he responding to?

LU: He perceived an unfair advantage in that analysts had material non-public information, although I'm not sure he would have put it that way, but that analysts had information that investors didn't. The analysts were taking advantage of having this information, and passing the information on to firm clients, who were trading on that information.

KD: And wasn't he correct in that?

LU: He probably was correct about that. I didn't disagree with the notion of the problem he identified. We didn't really know the order of magnitude, nor could we point to any attempt to bring an enforcement case for that type of behavior. I thought the Commission should have brought the difficult case and lost it, before it resorted to a rule that really went to communications, and not trading. If it's about trading, bring the case about trading; don't write a rule about communications. There's no parity of information, as clearly recognized in the federal securities laws, and in many case dicta. I think parity of information is what FD seeks to accomplish; and I think it's unworkable. I think most companies hate it, and I think it's dramatically reduced the amount of information that the marketplace receives. I say that with great certainty.

KD: And a few years' perspective as well.

LU: Serving on public company boards, I see it. I see how it's implemented; I see what it does; I see that everything is scripted. If that's what you want, then that's what you got.

KD: Weren't things scripted before though?

LU: Things were scripted as a beginning point, but not a beginning, middle and ending point; and that's what it is now. And scripts are fairly benign.

KD: Did the SEC put this out as a concept release, or something like that, beforehand?

LU: Yes.

KD: And get feedback?

LU: Yes.

KD: What was the feedback like?

LU: The feedback was mostly from the press, who was completely out of sorts that they were included originally in the definition of who FD applied to. It would have encompassed the press, or the reporting public, but that was later refined to be just financial professionals. The SEC has read a legal duty for purposes of imposing insider trading

laws into other relationships—into a husband and wife relationship; into doctor/patient relationships – where that type of duty doesn't necessarily exist. So if it was about something that's clearly wrong, which would be an analyst passing information on to firm clients who traded, I think you could have found a creative way to bring that case. The SEC has done that many times.

KD: Your point is it's going around the back door …

LU: …with a much more onerous approach to curing the problem. You don't have to trade to violate Reg. FD.

KD: Was this one of the few times that the Commission was split when you were sitting on it?

LU: Yes. Actually, Ike Hunt was very vocally against it, but he ended up voting for it.

KD: Who was?

LU: Commissioner Hunt. That's my recollection. He might tell you differently.

KD: Was it the same grounds?

LU: Yes. And I think the staff failed to make the case that we really needed it. It didn't point to a whole lot of instances of trading.

KD: But you know that this came from Arthur Levitt.

LU: Yes.

KD: Did he detail somebody on the staff to make this case, and put this whole thing together for the Commission?

LU: It was based on intuition, and there's nothing wrong with intuition, but it should be the starting point, and not the ending point, or the foundation of a rule. Call me old-fashioned. I'm not saying that lots of rules aren't made that way, I'm sure they are. But this was one I found particularly onerous and not compelling.

KD: Was this pretty close to the end of Arthur Levitt's tenure?

LU: Yes. But he completely respected and understood that I disagreed, and he was fine with that.

KD: He got it anyway.

LU: Of course he did. It was somewhat contemporaneous with the auditor independence hearings—that was in '01, where we finally passed that rule. And FD—I did a six-month review of that when I was Acting Chairman, so maybe that was in May. So it must have been one of the last things that Arthur did. It must have been the fall of '01—early or late fall.

KD: Let's talk a little bit about the auditor independence hearings. Was the SEC ahead of the curve on this one?

LU: I'm on page five hundred and four of the Enron book, *Conspiracy of Fools*, and it does sound like Arthur was pretty ahead on this one. I wasn't as focused on what he was doing with his speeches - finding the accounting issues incredibly dull, quite honestly. I must have been off doing something different at the time. But when I read it in context now, I have to give him a pat on the back for that.

KD: Do you remember the discussions in the Commission?

LU: Oh yes.

KD: What was the tenor of those? Was it consensus: "Here's the problem; here's how we fix it?"

LU: There was consensus on the problem; there was not consensus on the solution. But I take my hat off again to Arthur for undertaking a *very* brutal way to lay the foundation, and establish what the issues were, and put some color and texture to the issue. That was the hearings—the public hearings—that the Commission conducted in Washington and New York about auditor independence. All of the firms participated, many practitioners and public companies; it was a very thoughtful cross-section of the industry. And we sat through at least a hundred—I remember counting it up at one point—a hundred and five, or a hundred and ten witnesses, and I think five to seven days of hearings, and a lot of documents. I sat through almost all of it—probably 95 percent of it, for which Arthur was very grateful.

In exchange, he was very gracious about me voting against FD. But I thought it was also a very intellectually stimulating conversation—although not every point of that ninety-five percent that I attended—but it was curious to me to find that audits became a loss leader in the industry. That was something I really focused on during my questions. I found that mind-boggling.

KD: In the auditing industry.

LU: Yes. Exactly. The auditors have a regulatory mandate that all public companies must have financial statements audited by an independent auditor. It doesn't get much better than that for job creation. For the auditors to not take that seriously, and for it to become

the minor point of their business, or corollary to their consulting business, was a very dangerous proposition. Clearly, it was more dangerous at some firms than others. I give him, again, kudos for taking on that issue. It was not an easy issue.

KD: Did you get a sense that there was a public following for what the SEC was doing at this point?

LU: I think people were very grateful that the SEC was raising the issue, and very curious to see how it would end up. Having seen the accounting lobbying force during the course of PSLRA, I knew how compelling and wide-ranging their support was. and how difficult a battle it would be if we couldn't come up with something that they felt they could live with. Some spun off their consulting business—during the course of the time that we had the hearings, a couple of them had, or were thinking about it anyway. So it was really one or two of the firms who were putting up a huge fight.

KD: And this was this before Enron.

LU: Yes. Not so much before, though. About a year before.

KD: And you became Acting Chair.

LU: Yes. February of '01?

KD: Yes, '01.

LU: '01.

KD: What did you see your role as being?

LU: Well, I know most people said I was a gatekeeper, but I saw it as more than a gatekeeper, more than a steward. It was not a time for me to develop a huge rule-making agenda or policy-setting agenda. Certainly all of the agency had been told *not* to do that by President Bush in the first instance of his new administration. But I saw it as a chance to have a somewhat limited agenda to make good on what the Commission needed to be doing. People couldn't think that, because there was an acting Chairman, and because the President said no new rule-making; that there was no one home. Right?

We still had to be involved, and in the mix, and I needed to keep the morale going. The number one item on my agenda, which I knew I could accomplish and which people had made some progress on, was pay parity for the SEC staff. I knew, having been an SEC staffer, having worked on the Hill, and still having a lot of relationships on the Hill, that I was probably the best person that will ever sit in a Commission seat to make that case. So I was relentless in going to all of the key members of Congress to push for it. And we did eventually get it.

I thought that was a very productive way to spend my time, and to really seize the opportunity to make a difference. The staff promised me a statue. I haven't seen it yet. I think they've long forgotten that I was even the one who closed that deal because the White House signed that piece of legislation right as Harvey came in the door, and I didn't even make it to the signing ceremony. That aside, I also made good on the promise of the Commission to conduct the FD six-month look back in New York. We also did a report on that.

I had hoped to also do some public thinking, by the Commission—which was myself and Ike Hunt at the time, and the staff—about global markets, which is something I think the Commission really needed to spend some time on. That just wasn't something that Ike was comfortable with. That was really pretty much it, other than keeping the division directors' feet to the fire, and developing thirty, sixty, ninety, a hundred and twenty day plans, and that kind of thing.

KD: The Reg. FD look back…

LU: Yes?

KD: Any surprises?

LU: I was very glad I did it. People were happy that I followed up, and that we actually did what we said we would do. Any surprises? No. I don't think so, actually. I knew it was a bad rule. I think that was sort of the general gist. There were people who supported it. I didn't have an unbalanced panel or anything. I didn't try to skew it to support my position on it. It was a really completely neutral hearing, as far as that went; it was supposed to be informational. But no, I don't recall anything terribly surprising; nothing stands out in my mind.

KD: Then Harvey Pitt comes in.

LU: Yes.

KD: Did you get more than three people on the Commission?

LU: No. And in fact, I would have left when Harvey came, as much as I was looking forward to working with Harvey, because I had known and respected him for a long time. I felt that leaving as acting Chairman, I was leaving on an uptick. And to go back to being a Commissioner, and just sort of resuming that position, wasn't really necessary. I had spent my four years there; my term had expired that June; it was August. It would have been a very perfect, graceful time to leave. The problem was that Ike Hunt's term had already expired, but his statutory carry-over period was also about to expire in October, when Congress went out. Here it was August; and if I had left, then there was no

candidates in sight that were about to cross the threshold into 450 5th Street, so I had to stay on, or leave Harvey by himself—which would have been historic, but not very nice.

KD: He had troubles enough to deal with.

LU: Yes.

KD: That's one of my questions: You were in there with him for a while; is it your sense that because of everything that had happened with Enron and the accounting scandals, that there was just so much more pressure on the Chairman of the SEC? Was that part of…

LU: His downfall?

KD: …what happened with him and the press?

LU: Harvey is an incredibly able lawyer; someone I used to confide in and/or seek input from. As Congressman Schumer said, he was the Zeus of the Federal Securities Bar. I don't think that was his best performance, when he was Chairman. Were he challenged with purely intellectual issues, he probably would have had a very different outcome; yet his political judgment clearly was lacking; and he failed to give his very excellent advice on more than one occasion. It snowballed, and got worse and worse, rather than step back and say, "Look, this isn't working. Let me talk to some people who can maybe help me."

He may have done that, but I wasn't one of the people he reached out to. Clearly, I was a colleague who was experienced as a Commissioner, and who had worked on Capitol Hill. I would have happily been a powerful ally for him. It's easy to have 20/20 hindsight; it's easy for me to look at decisions he made, and what he said and did, and say, "I would have done it differently." But, you can never say that with certainty.

KD: Right. Well let's talk about what you did…

LU: He made me look really good as Acting Chairman. And I thank him for that. Obviously, I'm joking. And he remains a good friend, so it's hard to be too critical of a good friend. But I'm obviously just very honest and straightforward in my answers—always, and he just was the wrong person for the wrong time.

KD: You left the SEC without anything lined up apparently.

LU: Yes. It's the only way to do it. You can't be a sitting Commissioner and interview. I don't see how you do that.

KD: How did you end up with JP Morgan?

LU: Actually, that was not my first job. My first job out of the Commission was CNBC. I was approached by the then chairman and CEO, Pamela Thomas Graham. My second job was a seat on the Borland board of directors. My third job was a private consulting project, and my fourth job was JP Morgan.

I left this out of our conversation about Acting Chairman. One of the issues that I raised in a speech at Northwestern—the Ray Garrett Institute—in April of '01 was analyst conflicts. I also testified on that issue a number of times, as Acting Chairman. In fact, I testified a *whole* lot when I was Acting Chairman—on the budget and on, I think, technology, or something.

In any case, *that* was my pet issue to talk about, and I had an internal task force from each of the divisions—with representation from each of the divisions—about analyst conflicts, to come up a) a picture of what the issues really were; b) what each different division saw in those issues, and whether they had any ideas about how to solve the problem, if there was one; and c) to come up with some ideas; some rule-making, a concept release, or an admonition to the industry generally about analyst conflicts, and what they should be doing. Right about that time, the SIA came up with some best practices, and Chairman Baker had his hearings.

In any event, that got the ball rolling, and there was *keen* interest in analyst conflicts at the press level, at the investor level, at the congressional level, at every level. It really

resonated, given that particular time, given what information was coming out. So everyone knew how passionate I was about this issue. Harvey had kind of shelved it when he came on board. Even if not a be rule-making, we had to be a proclamation; we needed closure on it. That ended up being very true. In any case, the issue got taken up by Eliot Spitzer. People had thought I would be a perfect person to be one of the independent consultants for the settlement. Three or four of the firms submitted my name. I interviewed with three of them.

KD: This is the global settlement?

LU: Yes. The process was that each of the firms would have to pick three names for independent consultants. I think it might have been one name first, and then it ended up being three names. They would submit those names to the regulators, who then would approve or disapprove, partly based on an interview with that person. It was hysterical. There was an article about me being the Belle of Wall Street, because a press person was convinced that everyone had submitted my name. The SEC assigned me to JP Morgan. That happened in May of '03.

KD: So the SEC gave you this job.

LU: Yes. They did, for five years. So I got to be, once again, on the other side of an issue that I knew a lot about, and was passionate about.

KD: What's the nature of this job as an independent consultant?

LU: I procure the independent research in compliance with the global settlement. So basically I choose independent research providers for each of JP Morgan's covered company universe, which includes all equities, and a portion of foreign companies for which the U.S. is their primary trading market. And that's it in a nutshell. It involves, obviously, a lot more than that.

In fact, all of the independent consultants just submitted an annual report about the first year of the settlement's implementation. The reporting period is July 27, '04 through July 26, '05, but the report itself was due October 31st. So Spitzer's office is planning to release them all publicly; and so there'll probably be some discussions and press interest in a lot of the statistics that were given.

KD: In general, is it working?

LU: I think it's a little too early to tell, quite honestly. The independent research provider universe coverage quality—our product needs a little improvement in some cases. The settling firms are picking up more coverage, not less. It's been a huge challenge to go from roughly seven hundred covered companies to fourteen hundred covered companies, with a limited dollar amount, and with a limited universe of independent research

providers, some of whom really have bad product and a couple of whom have a fantastic product. Competition's not there yet; it's not as robust as it should be—as broad, and robust.

KD: Terrific. Is there anything that we haven't talked about that you'd like to bring up?

LU: No. We could talk about the independent director stuff, but we don't need to go there.

KD: Sure. Is that something that you are deeply involved in?

LU: No. I sit on three public company boards.

KD: And that's part of your later career.

LU: Yes.

KD: Which ones?

LU: MBNA, Ambac Financial, and Computer Associates.

KD: Oh.

LU: With Walter Schuetze.

KD: And again, you're looking at the other side of things that you put in place.

LU: For Computer Associates, I joined the board the month before they signed the deferred prosecution agreement, knowing that it was about to be signed.

KD: Well terrific. I'd like to thank you for talking with me.

LU: Sure. And thank you.