Disclaimer: This document is an MFA transcription of an oral presentation. While it is believed to be accurate, it is not warranted to be so. Should any inaccuracies or omissions be found, please notify info@managedfunds.org *for correction.*

Richard Baker:
(2:46)

We are delighted to have Chairman Schapiro here today to meet, by way of explanation to her, with our industry leaders who are here in the room. We are grateful [that] the Chairman agreed to have a dialogue, as opposed to presenting a traditional method of a speech. She was the 29th selected chair of the U.S. Securities and Exchange Commission, and appointed by President Obama on January 20, 2009. And in these days, it should be noted, unanimously confirmed by the U.S. Senate, and sworn in January 27th. She is the first lady to serve in this capacity. Chairman Schapiro's priorities in the SEC include shaping a more effective and responsive agency, better protecting investors by implementing financial reform, enhancing the structure of American financial markets and reinforcing the agency's long-term commitment to transparency and disclosure.

In a unique bipartisan manner, I am delighted that former chairman, Harvey Pitt, has graciously agreed to moderate this session with Ms. Schapiro. As I noted, MFA has provided him with a number of questions, which he will present as he deems appropriate. Mr. Pitt is the CEO of the global business consulting firm, Kalorama Partners, and its law firm affiliate, Kalorama Legal Services. Prior to founding these two firms, Mr. Pitt served as the 26th Chairman of the United States Securities and Exchange Commission from 2001 to 2003.

I can say in my capacity as a former Member [of Congress], I've had the distinct pleasure of working with both, who are distinguished professionals in their respective regard exhibiting leadership that our country sorely now needs. I also would note that this may be one of the few current-day examples of where a bipartisan work can result in a very great end product. I am delighted to have both of my friends and colleagues here. Please join me in welcoming them for the next panel.

Harvey Pitt:
(5:13)

Thank you Congressman and Mr. Chairman as well. I usually start by saying you've just seen empirical evidence of why anyone who served as Chairman of the SEC much prefers to be introduced by friends as opposed to Members of Congress, but here we have someone who is in both roles.

I'll start by saying it's a real pleasure for me to be here with all of you and to be here with Chairman Schapiro. I just would add a word that in a very short period of time, in my view, Chairman Schapiro's efforts and accomplishments have been nothing short of phenomenal. Time wouldn't allow us to go through a listing of all of that, but my own personal list is now somewhere around 11 or 12 pages single-spaced. It includes reorganizing and reforming the Commission, restructuring the securities markets, dealing with the flash-crash crisis, setting the Guinness Book of World Records for congressional testimony, reinvigorating the Commission's enforcement division, and actually saving the Agency from near destruction as well as improving corporate disclosure and governance, coordinating with internal regulators; and in her spare time, taking on the new responsibilities of Dodd-Frank, a small legislative enactment with barely much of an impact on this group.

So, since former chairs, at best, should really be seen and not heard, I'm going to turn to the questions and we're very grateful to the membership for giving us subject matters that people thought would be interesting.

I think the first one we should talk about is Form PF because this is an implementation of Dodd-Frank, and reflects coordination with the Financial Stability Oversight Council [FSOC]. The question that has arisen, for example, with the CFTC's information, among other things, was the extent and breadth of information and the confidentiality. Senator Sanders released confidential CFTC data. As an opening, what are your thoughts on steps that the SEC can take to prevent [release of] sensitive data?

Chairman Schapiro:
(8:30)

I'd be happy to address that, and good morning everyone. It's a pleasure to be here, and it's always a pleasure to be with Harvey. Form PF, which I will tell you is the only news I might make is the Commission will vote on the final adoption of Form PF next week. We just noticed that publically. You won't be in suspense too much longer, about exactly what the requirements under Form PF will be. We appreciate, though, that it does ask for a lot of data. It's tiered by type of fund, it's tiered by size of fund, and we've got lots of comments on how to refine some of that. We will bringing in extraordinary amounts of non-public or heretofore non-public information that I know is of real concern to the industry in being able to protect your trading strategies and not have people take advantage of information.

I will tell you that as an analogy or analogue, this year – this is in the public realm, not the Form PF realm which is non-public information - we started to collect vast amounts of information about money market funds, and it has been an enormous boon to the SEC to have the kind of granular information about money market funds and their exposures on a holding by holding basis to, for example, European banks and other institutions. It has allowed us to work much more closely with the money market fund industry as we try to manage through the risks of the turbulence in Europe among other things. We have high hopes for the Form PF data. Putting the agency and the **FSOC** in a position to do a much better job of understanding where the risks are in the financial system.

With that said, we know there is real concern; we got lots of comments about the concern, about our ability to maintain confidentiality of the information. Actually, comment letters gave us a number of very helpful suggestions about how we might encrypt the data, and what we might do about reporting time periods. So, while we still have the information that's useful, it's maybe not quite as current, if it were to leak, protections we can build within the SEC and within the FSOC member agencies to ensure that it has limited distribution. That we can make use of it, but that we don't have it spread too widely among the regulatory community, so there's a greater danger of it escaping. The statute does have some protections built into it as well. We will be very, very cognizant, I can assure you, of protecting the confidentiality of that trading information.

Harvey Pitt:
(11:08)

It's interesting. There was a provision in Dodd-Frank which would have given the Commission better ability to protect and safeguard proprietary data, but that's been repealed. We can't rely on that anymore. The Form may well require certification and for those who have hard-to-value securities, I guess the question is how does one certify when most people would say for liquid holdings that are not broadly traded, there is no right value. There might be a right methodology, but the value would change some. So, is there a way people can certify this and still feel comfortable?

Chairman Schapiro:
(12:08)

I don't want to front run what my colleagues and I will consider next week, but I will say we got a lot of comments on the certification provision; particularly the language upon penalty of perjury that I think focused a lot of people's attention. We're

highly sensitive to the issues surrounding valuation and the uncertainty of certain information and the ability to certify to that. I think you'll have to wait until next week to see how we handled it. I will tell you it's the same certification that exists on Form ADV.

Our goal is really to make sure we got data that has a high level of integrity and is in fact usable and fulfills the needs of the SEC, but also, again, more broadly because it's a systemic risk reporting data, the needs of the FSOC, but we don't want people to be afraid to provide us information and afraid to certify. We understand that balance, and hopefully you think we've been sensitive to it.

Harvey Pitt:
(13:10)

One question which comes up a lot in Dodd-Frank in a variety of areas is "Is there an effort underway for coordination with the CFTC, at least to do more with respect to Form PF and the CFTC's Forms CPOPQR and CTAPR?"

Chairman Schapiro:
(13:38)

It's an interesting question. Form PF is required by Congress to be a joint rulemaking, so we have done that jointly with the CFTC, and we've done a number of other in the Title VII derivatives area joint rulemakings with them as well. Form PF, absolutely, was done jointly with the CFTC, and in heavy consultation with the FSOC agencies, so the data, again, would be usable more broadly for bank regulators as well in their oversight of prudential regulation. We will be locked down with the CFTC on Form PF.

We also have our own forms. Each regulator does. We have Form ADV which is a demographic and registration information. CFTC has their registration forms. While we've worked very hard to assure, for our part, that ADV and Form PF complement each other and CFTC has done the same, and they've got it out for comment right now, so amendments to their CPO forms, they have to collect what they need to do their job. Just as we have to collect what we need to do our jobs. We've tried to coordinate; we've worked closely together. We've tried to assure there's no duplication, but there are unique areas where each of us has interests that we're trying to be able to fulfill.

Harvey Pitt:
(15:07)

Let me ask one last question on this, and that is "Is there any thought being given right now to coordination with international regulators?"

Chairman Schapiro:
(15:23)

It's interesting. A lot of what Form PF has in it is really based on the UK's hedge fund survey. We worked, starting over a year ago, before Dodd-Frank was even passed, as a result of our bilateral meetings that we do with the UK regulators twice a year, we started to talk about could the SEC participate in the hedge fund survey? (That has its own issues because of something called the Paperwork Reduction Act.) How could we work together to ensure that when Dodd-Frank did come to pass, we would be in a position to share information between the UK and the US. We would get the information of most value to both of us, and we would minimize the chances for duplicative regulatory reporting in slightly different forms or slightly different ways. It would just be a burden without any benefit.

So, we worked very, very closely with the FSA. As things evolved, and IOSCO got involved and we've worked closely with them as well on this, and the European Commission and [European Securities and Markets Authority] **ESMA**, the new pan-European securities regulator. ESMA's published for comment, a proposed template on hedge fund reporting, we've followed that and discussed it with them very closely because we would like Form PF and ESMA's form to be as lined up as possible. Again, so we get the information we need, regulators are speaking the same language based on the same data when we're comparing concerns or issues, but also we're not creating duplicative regulatory regimes without a good underlying reason for them to be that way.

I think we'll continue to work very closely with them and have a superb relationship with the European regulators right now on these issues, but also as you can imagine on the Title VII issues and now market structures issues as well, which perhaps we'll get to.

Harvey Pitt:
(17:21)

I'm aware you had a series of meetings with the FSA, which I was reading about and I think it's very impressive the level of coordination. This is a global industry and it's important.

Chairman Schapiro:
(17:41)

If I could just add something there. Again, we've largely been driven by Title VII, but not exclusively, been engaged in weekly phone calls with the European Commission and ESMA, and slightly less often than weekly with Japanese and Singaporean

regulators to try to make sure that we understand exactly where each other is going with our regulatory framework, so we can minimize the potential for gaps and regulatory arbitrage. And also, the potential for duplicative or conflicting standards that then put the regulated entities in a very difficult position of trying to figure whose regulatory regime are we really supposed to be following.

Harvey Pitt:
(18:23)

I think that's a very worthwhile effort. That's been ongoing. Let's turn for a second to inspections and examinations which I know is near and dear to everyone's heart, at least in this room. We now have about 8,000 more hedge funds that the Commission will have to examine and inspect along with private equity funds, venture capital firms, in some cases, security based swaps and their professionals. And, actually, even their customers, all of whom will have to be potentially examined. Rating agencies, SRO's, along with the 11,000 already registered investment advisors and 6,000 broker dealers. Needless to say, I'm sure the Commission has this well in hand.

Last month, the House Financial Services Committee Chairman Spencer Bachus, proposed legislation or indicated that he was supportive of legislation to permit one or more SRO's for investment advisors. Without getting into who or what, the real issue is what you can tell us about your views of using SRO's to help cope with this massive amount of additional work.

Chairman Schapiro:
(20:10)

I suspect this is an issue that goes back to your time, Harvey, and even before, is really the inadequacies of the SEC's resources to do the task that it's been given by Congress and continues to be given additional complex, important responsibilities. I think the public has an expectation that we're out there doing a job that quite frankly, we are really not equipped to do given the level of our resources. With Dodd-Frank, and we had over-the-counter derivative markets; we have a small of piece of it, the CFTC has the lion's share. But it's a $600 trillion market, and we've got to register all kinds of new entities, swap dealers, trade repositories, execution facilities, CCP's and so forth. Hedge funds now under the SEC's jurisdiction, municipal advisors of which there are thousands that will now come under the SEC's jurisdiction.

You mentioned credit rating agencies; we have an obligation to examine them annually, every one of them, annually, regardless of the level of risk that they pose to the investing public or the

financial system through their activities. So, we have dramatically expanded our scope and not expanded our resources very much at all.

The part that predates of all that, because that's just added on top, is that we only examine about nine percent of investment advisors every year. Investment advisors have tens of trillions of dollars of assets under management, and yet one-third of them have never been examined by the SEC. I think that would be quite a shock to the public to understand. They're used to the concept of broker dealer examinations, of bank examiners being present in banks, but the fact is on the investment advisor side, we don't have anywhere near the coverage, I think, people have a right to expect. I find the current situation completely, frankly, unacceptable.

To try to address this, Congress asked us to do a study about how can we do better coverage through examinations of investment advisors. The staff did a study which we submitted to Congress early this year. I actually didn't participate in it because of my long association with **FINRA,** [Financial Industry Regulatory Authority] which has been interested in participating as an SRO.

The staff laid out three options: One is user fees for investment advisors to actually fund an SEC program that could cover investment advisor examination. The second was the creation of an SRO or expanding the scope of an existing SRO, like FINRA, to do examinations. Broker dealers, about half of broker dealers are examined every year compared with the nine percent, and that's all because there is a FINRA. The third option was to allow FINRA to at least examine a subset of advisors: those were duly registered as investment advisors and broker dealers. All of the those require Congressional action. The options that were given to Congress, the ball is in Congress' court.

Chairman Bachus' bill would go forward with the SRO. Again, not naming who it should be, and I think it deserves serious consideration because if the SEC isn't going to have the resources to do this, somebody needs to do this. It just can't be okay that people who are handling the wealth of the American public are essentially not subject to oversight and regulation. I'm hopeful that Congress will keep an open mind about it, but we will have a solution to this at some point. I think we've stretched the limits of our ability. Stealing a page from your book, we tried to do some things with surprise audits when investment advisor assets are custodied at affiliate broker dealers to try to bring a third party into

it, and leverage their capabilities. The fact is we need serious regulatory oversight here.

Harvey Pitt:
(24:10)

I think it's a difficult problem and while people have very heated views on either side of this, the fact is if there is going to be some assistance, one advantage of an existing SRO is it already has a mechanism. Another disadvantage, however, is that it's used to doing things differently, and we'd have to learn an industry. People, I think, are polarized about what the right way to go is, but I would say I don't think the Commission can do it by itself. They haven't been given enough assets, and then people will start complaining if examinations aren't done at firms that then have problems and so on. It's difficult.

Moving to a different topic. There have been some discussions about rules that relate to private company share trading and indications that the Commission is looking at it. One hypothetical that people pose is if an investment advisor or an article appears about a hedge funds holdings and it's inaccurate, many advisors are reluctant to correct the story because of fear they could be charged with conditioning the market. The MFA has made some suggestions. One of the issues is "can you give us any insight into the types of issues the Commission wants to look at it, and things that might be on the table?"

Chairman Schapiro:
(26:15)

It's interesting. Obviously, there's lots of interest right now in facilitating capital formation to help our economy and create jobs. We've actually created a small business advisory committee to help us think through a lot of the issues that surround access to the public markets, but also some of the private securities offering exemptions that exist. That committee will actually meet for the first time the end of this month, and we've charged them with starting to think about a number of different things. One is the general solicitation ban I think you were referring to. Also, the 500-shareholder limit before public reporting is required. Issues like crowd funding that have become very popular and we read a lot about in the press.

In all these areas, we will tread a very careful path because we appreciate the desire for less costly access to the public markets, but we even more appreciate the desire for honest and truthful disclosure and investors having access to the information they need to make the right decisions. That will be paramount in our minds.

As we look at some of these rules and requirements that have been in place for 40 or 50 years and well before the Internet, for example, when you think about the ban on general solicitation, we have to think through whether there is a way to get a result that continues to protect investors, continues to provide them with the information they need to make their decisions, but also removes unnecessary hurdles.

The restriction on being able to generally solicit in a Reg. Doffering has been teed up for us in a couple of different ways. One is that if you can't buy unless you're an accredited investor, what difference does it make if you can solicit broadly because those people, who shouldn't have gotten the solicitation, can't buy it anyway. On the other hand, we have seen instances where it makes it easier for fraudsters to get to people, to find potential victims, and it is a mechanism to sometimes condition the market. We have to be worried about that.

So, we'll be very deliberative. We perhaps won't move quickly enough to make people happy, and I can't predict how much loosening up, if any, we will do. Again, we take so seriously our obligation to protect investors and if we have a bad experience here, if we have loosened up requirements to the extent that people are then defrauded, we will have damaged that all too precious investor confidence that will make it impossible for the good companies to come to market. We're going to cast a wide net for ideas and we're really going to push on issues so we can understand the implications of any action we might take.

Harvey Pitt:
(29:25)

I think there are views of one of the things the Chairman mentioned earlier is the Commission actually does read the comment letters you file. They're not always happy that they have to read them, but they do read them. If you've got ideas, thoughts, or suggestions, you really should put them in because you might find your idea-giving rise to a change in Commission policy.

Chairman Schapiro:
(29:55)

In fact, we have a special place on the website for ideas related to the offering process, so we do welcome those. We always welcome data. Any information or data you have – one of the things is we look at whether the 500 shareholder limit for public reporting is the appropriate limit. It was set after intensive study, but many, many years ago. We want to understand if that's raised what are the protections we might put in place, how should we be

counting that 500. There are lots of ideas out there, and we're interested in exploring them. But again, I think you'll see us proceed cautiously.

Harvey Pitt:
(30:37)

One of the things the Commission, which I thought was very creative, was in Dodd-Frank; they are required to set up a whistle-blower provision, which I'm sure everyone here is aware of. Before the Commission went out with proposals, it solicited the public for concerns, and then I thought did a remarkable job of at least articulating what people were worried about and trying to balance them. To my knowledge, I don't think that was done before your chairmanship.

Chairman Schapiro:
(31:15)

I don't know. We're trying to do it in a few areas. If people can help us understand. We did it with the Volcker Rule for example. If people can help us understand some of the issues even before we take pen to paper, to think about to propose a rule, it's enormously instructive for us. It shortcuts, lots of effort on the part of the staff that might have taken them paths that aren't very fruitful, if we can get thoughts upfront. We do appreciate it, and we do read all those comment letters. Form PF was an easy one. There were only 35. We have had some rules where we've had over 10,000 comment letters, so it's an enormous amount of reading.

Harvey Pitt:
(31:56)

Just a quick question. I think a lot of hedge funds have a concern about the Dodd-Frank provision that enables any financial related entity to be designated as a financially significant or non-bank financial company. I think there's a question about what qualifiers you think people should be focusing on as potential determinants of what may ultimately apply to the hedge fund community.

Chairman Schapiro:
(32:36)

We put out draft designation criteria. It's much more specificity than FSOC did in the first round. It talks about what the metrics are and the triggers are for being considered, and getting into the process of being considered, a systemically important financial institution. That just went out – we did it a week ago, so it's out for comment now. Comments will be helpful.

We try to appreciate there and show the world we appreciate that for certain kinds of financial institutions, non-bank financial institutions, like hedge funds, some of the metrics we have may not

work perfectly. We may need to be thinking more clearly about how to distinguish different kinds of institutions from one another. That's actually where Form PF data is going to be enormously helpful to the FSOC. As we think about what might trigger consideration of a particular institution for **SIFI** [Systemically Important Financial Institution] designation and; therefore, heightened prudential regulation. What does that data tell us about how we might think of that hedge funds or private equity funds differently? I think you'll see more to come on that, but we try to acknowledge that the metrics that are set out there may not be perfect for every kind of institution, but with some experience in working with the Form PF data, we think we can be more refined.

Harvey Pitt:
(34:02) This is, again, an area where people can meet with the staff, refer to specific pieces of data, and try to help educate the staff as to some of the problems that hedge funds might experience. I think you'll find that the staff is usually quite receptive to hearing about all this. They don't always agree, at least when I go in there, but notwithstanding that, they do listen, and they're usually polite.

Chairman Schapiro:
(34:39) I hope they're always polite.

Harvey Pitt:
(34:43) Let's talk a little bit about Title VII and the implementation. Both the SEC and CFTC have been engaged in marathon sessions of rulemaking and unlike all the other regulatory structures for other markets, this is one where there was no regulatory structure to begin with. In a large sense, it's being created out of whole cloth. I think, Gary Gensler, the CFTC's Chair, has recently indicated that some of the Title VII rules won't come out until the first quarter of 2012. I was wondering whether you have, recognizing the imprecision in this, any timetable you're looking at.

Chairman Schapiro:
(35:50) We have over 100 rules to write under Dodd-Frank and those aren't all Title VII, but the vast majority of them are. Unlike other areas where we have at least related experience, hedge fund registration, municipal advisor registration, even corporate disclosure rules for the use of conflict minerals and extracted industry payments and mine safety; some of the things you all don't think much about, but we have to think a lot about. This area and bringing this wholly unregulated market under the regulatory

umbrella does present unique challenges. And they're challenges for us as a first mover internationally.

The US, I mean, generally not the SEC as a first mover internationally in trying to coordinate with our colleagues around the world. They're challenges internally within the United States coordinating between the SEC and CFTC; our different statutory foundations, our different approaches to regulation that have grown historically over the years. And the fact that our markets, while they're all OTC derivatives markets are not exactly the same, and that calls for some differences as well. So, we've proposed or adopted three quarters of our required Title VII rulemaking.

The one that is outstanding still for the SEC is capital margin and segregation requirements. I expect we'll do that over the next several weeks to the next couple of months. Then we'll have everything out there for public comment. Many comment periods have obviously closed already, although, we continue to take comments on any rule that's not final because as new rules comes out, it sometimes changes how people feel about prior rules.

Then our plan is to publish for comment, a detailed implementation plan, so investors, market participants can see very holistically how we would expect to sequence the rule implementation in a way that's logical and rationale so we can build off a found by asset class, and by institution. So, we can move forward with the clearing and then it's reporting that's next, and then trading comes after that, and you deal with the interdealer market first, and then you move to major swap participants. You start with the most liquid markets; you start with interest rates.

You'll be able to see what we hope will be a rational sequencing of all the rules effective dates and be able to comment on those, and give us some guidance; good information and data about what will it take to put each of these rules into place. What's the technology that gets built in the first instance that gets built upon and changed as new tranches of rules come into effect? I'm hopeful we'll be able to publish that implementation release this year.

Related to that are all of the international questions which are extraordinary in this space. As Harvey said, we were recently in London last week for our bilateral meetings with the FSA, but also we held a one-day closed door session of major market regulators to talk about market structure issues, high frequency trading,

undisplayed liquidity, and a number of other things. We took a little bit of time at the end of that to talk about the extra territorial implications of Title VII and the rules that we're required to write in the US, and what does it mean for foreign institutions facing US customers, facing other US institutions or having affiliates in the US.

It's so clear to me that these questions really permeate every rule individually. Our approach to that is going to be a holistic one. We're going to lay out a broad international release that we hope will, again, for comment from investors, market participants, and foreign regulations to see how we're thinking about what the reach is of the US rules into different institutions around the world. And try to get very holistic comments about that from the public to inform us about what the reach of rules would be, so we don't create opportunities for regulatory arbitrage or opportunities for anti-competitive impacts on US institutions. Hopefully, we'll have that out also by the end of the year, and be able to think through the comments we get on that early in the New Year.

Harvey Pitt:
(40:46)

It's interesting because in the area of derivatives coordination, both domestically and internationally, is really critical because, although the SEC and CFTC have a fairly clear demarcation, the firms don't. If the rules aren't quite the same, they run into difficulty.

Chairman Schapiro:
(41:11)

We're benefited by the fact that the FSB and most of the international jurisdictions have a common framework with us, so we agree on a lot. The devil is so in the details when it comes to these issues. We appreciate that. It's one reason we've been having weekly calls to go line by line through our rules, and what they expect out of **MIFID** [Markets in Financial Instruments Directive] and **EMIR** **[European Market Infrastructure Regulation]** in Europe and how they think that will translate into real regulatory frameworks in Europe and how those might match up. And where we might have gaps we're concerned about, and where we might have the opportunity for duplication. Those weekly sessions of going through this in detail has been enormously helpful for all us. I think the regulators genuinely want to try to land in the same place. They want to have high standards that are achievable around the world so we don't create any distortions or dislocations. There's a lot of work to do in this regard.

We, again, have the benefit of being leaders and all that comes with that in terms of laying out a path, but we also have the challenges that come with being a first mover and wanting to make sure we all continue to move down the same path.

Harvey Pitt:
(42:36)

Turning from an area where coordination is terrific, there is at least one area where coordination may not be all that worthwhile, and that's at least in the area of short selling. This past summer, some European nations reprised the 2007 and 2008 efforts to ban short selling and the [Securities and Exchange] Commission did not follow suit, which I think the [Securities and Exchange] Commission deserves a lot of credit. One of the questions is whether there are any circumstances where the pressure for international coordination might lead to a different conclusion under certain circumstances.

Chairman Schapiro:
(43:39)

I guess you never say never, but it's hard for me to imagine the SEC doing any kind of short selling ban again. Obviously, that was tried at the height of the crisis in 2008. When these European nations did variations on the theme of banning short selling, we made it very clear that we put the **modified uptick** rule in place, I guess, it started in February of this year. We have Reg. SHO , we have our long-standing requirements and we weren't inclined to go any further and do anything additional. We have made it clear to market participants that regs show does apply in full force and effect. There needs to be sensitivity where there are short selling bans in other jurisdictions about your ability to locate and deliver on short sales. I can't envision the SEC doing another short selling ban.

Harvey Pitt:
(44:46)

Let's take a second market structure if we can. The Commission has really had a lot of activity in this area and deserves a lot of credit for dealing with the flash crash and other things. Is there some kind of overarching vision that the Commission is moving toward that might help people predict in which markets will evolve?

Chairman Schapiro:
(45:17)

I think our markets have changed so much in the last ten years. I think regulation didn't keep up with it, and while there's lots of good that came from Reg NMS (and yes, spreads are narrower and

the cost of trading had never been cheaper), we do have some serious market structure challenges ahead of us. I think May 6th was a great example that encapsulated all the issues that had come from our not really keeping up on the regulatory side with the fact that we have so many execution venues from internalization at 200 or so broker dealers to 13 exchanges and dark pools and ECN's.

The steps we put in place after May 6th have been really important. I think they've been enormously beneficial to the markets. We went through the volatility of this past August with pain, but without anywhere near the kind of disruption or damage that was caused after May 6th. So, single stock circuit breakers, the elimination of stub quotes, banning naked access to the markets, having rules about when clearly erroneous trades would be broken. I think all have been important to bolster the resiliency of our market structure.

Now, we're looking at going from single stock circuit breakers to limit up, limit down, which is a concept borrowed from the futures markets. We've got it out for comment right now, modified market-wide circuit breakers, which weren't triggered on May 6th, which would tighten those up and use as a reference the S&P 500 instead of the DOW. I think those will be important.

We've also put in place, finally, a large trader reporting system, so we at the SEC have access to data about what's the impact of high frequency traders and individual traders on the markets and on the price discovery function. We still need to deal with issues, in my view, around dark pools and we're continuing to work on that. We've got a lot of ideas we've thrown out there in our concept release that deals with market structure. It focuses a lot on high frequency traders and their role. We're continuing to work through those issues. I can't tell you what the end game will be.

I can tell you we've done a lot in increments that I think have been very important. I think one of the most important things, frankly, the SEC does is ensure we have a market that is fair and efficient, and that companies feel they can go to market and sell their stock, and that there will be a secondary trading mechanism that will allow people to resell their stock if they chose to. That investors feel like they're treated fairly; that the market won't drop extraordinary amounts in a matter of seconds and then rebound. Then they'll have a $40.00 stock trade for -three cents. That's a completely unacceptable result we had in May of a year ago.

We will do all the things we can do in incremental ways to bolster the resiliency of the markets and then we continue to take a broader look at what else needs to be done. Again, we'll do that in close consultation with collogues around the world because our markets are so intertwined.

Harvey Pitt:
(48:43) Perhaps one last question. There's been a lot of attention paid to the use of expert networks. I was wondering whether you had any thoughts with respect to ways in which careful portfolio managers can avoid some of the problems we've seen occur and the record number of convictions that the government has secured in these cases.

Chairman Schapiro:
(49:17) That's a hard one for me to answer, especially since we're right in the middle of so many cases and investigations. I guess what I'd say broadly is that the cases we've brought have really underscored the need for hedge funds to have really robust compliance policies and procedures, really train their people to understand what the issues are, and to be extraordinarily careful. There is nothing wrong with doing tremendous due diligence and working hard to analyze and understand everything you can about a particular stock.

There is a line – I think it's a pretty bright line when you cross over into insider trading. For all those who would like to argue it's a victimless crime, it is absolutely not a victimless crime. It absolutely undermines confidence and the integrity of our marketplace. It is a problem of tremendous magnitude. I would just encourage people to be incredibly rigorous in policing your own businesses to avoid it.

Harvey Pitt (50:30): We actually had about another 20 topics. I think everyone will agree with me, it's rather amazing the broad diversity of issues that the Commission is dealing with, and I think it's good to know the Commission is in such great hands.

Chairman Schapiro: Thank you.

[End of Audio]

Duration: 51 minutes