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THE FIFTH ANNUAL A. A. SOMMER, JR. LECTURE ON CORPORATE, SECURITIES & FINANCIAL LAW*

*Richard G. Ketchum***
Chief Regulatory Officer, New York Stock Exchange, Inc.

WELCOME & INTRODUCTION

DEAN TREANOR:[1] Good evening. I am Bill Treanor, the Dean of Fordham Law School, and it is my pleasure to welcome you tonight to the Fifth Annual A. A. Sommer, Jr. Lecture on Corporate, Securities & Financial Law.

Fordham Law School, with the support of Morgan, Lewis & Bockius, inaugurated the A. A. Sommer, Jr. Lecture Series in the fall of 2000 with the timely insights of the Securities and Exchange Commission's (the "SEC" or the "Commission") then-Chair Arthur Leavitt.[2] Since then, the Sommer Lecture has continued to bring to Fordham such heavyweights as Mary Schapiro,[3] President of National

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* Richard G. Ketchum delivered this address at Fordham University School of Law on November 9, 2004. It has been edited to remove the minor cadences of speech that appear awkward in writing and to identify significant sources when referred to by the speakers.

** Richard G. Ketchum was appointed Chief Regulatory Officer of the New York Stock Exchange ("NYSE") on January 8, 2004. From June 2003 until his appointment, Mr. Ketchum was the General Counsel of the Corporate and Invesment Bank of Citigroup, Inc. He also spent twelve years at the National Association of Securities Dealers, Inc. ("NASD") where he was president of NASDAQ for three years and of the NASD for seven years. Prior to that he spent fourteen years at the Securities and Exchange Commission ("SEC"), where he was Director of Market Regulation for eight years.

1. William Michael Treanor is the Dean of the Fordham University School of Law.

2. Hon. Arthur Levitt, Jr., *The First Annual A. A. Sommer, Jr., Lecture on Corporate, Securities & Financial Law, Inagural Address: Costs Paid with* Other People's Money, 6 FORDHAM J. CORP. & FIN. L. 259 (2001).

3. Mary L. Schapiro, *The Second Annual A. A. Sommer, Jr., Lecture on Corporate, Securities & Financial Law, The Regulation of the Securities Industry in the Wake of the 9/11 Tragedy*, 7 FORDHAM J. CORP. & FIN. L. 5 (2001).

Association of Securities Dealers ("NASD") Regulation, Inc., SEC Commissioner Harvey Goldschmid,[4] and last year William McDonough of the Public Company Accounting Oversight Board.[5]

Tonight we continue this great tradition with one of the most influential figures in the brave new world of corporate accountability. It is my great honor to welcome Richard G. Ketchum, who in eight brief months as Chief Regulatory Officer of the New York Stock Exchange ("NYSE" or "Exchange") has made important strides in restoring confidence in the world's largest equity market.

In addition to his important work at the NYSE, Rick is also a member of the Board of Advisors of Fordham Center for Corporate, Securities and Financial Law (the "Center"),[6] and an adjunct faculty member. We are pleased to call him a true friend of the Center and are grateful for his generosity of time and expertise.

The growing dialogue on corporate law and governance through the Sommer Lecture cemented the creation of the Center. Under the direction of Professor Jill Fisch, with the assistance of Professor Caroline Gentile, the Center has grown along with this lecture series over the past four years, continually shedding new light on an increasingly complex corporate environment.

I would like to recognize Professor Fisch, Professor Gentile, and Beth Young, for all their work in putting together this evening's lecture. Thank you, all.

They have also been working diligently to orchestrate the upcoming Albert A. DeStefano Lecture, and it is my pleasure to announce to you that New York State Attorney General Eliot Spitzer will deliver that address here on April 11, 2005. We will continue to share details with you about this event and other Center events that continue to further the discussion on issues that affect us all.

Now I am honored to introduce a dedicated alumnus and great friend of Fordham Law School, a man whose remarkable commitment to

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4. Harvey J. Goldschmid, *The Third Annual A. A. Sommer, Jr., Lecture on Corporate, Securities & Financial Law, Post-Enron America: An SEC Perspective*, 8 FORDHAM J. CORP. & FIN. L. 335 (2003).

5. *See* William J. McDonough, *The Fourth Annual A. A. Sommer, Jr., Lecture on Corporate, Securities & Financial Law*, 9 FORDHAM J. CORP. & FIN. L. 587 (2004).

6. For more information on the Fordham Center for Corporate, Securities and Financial Law, visit http://www.fordham.edu/law/faculty/fisch/source.html (last visited April 27, 2005).

the vision of the Center is a large part of the reason we are here tonight. John Peloso is Senior Counsel at Morgan, Lewis & Bockius, which is the same firm where Mr. Sommer practiced. In fact, Mr. Sommer recruited John Peloso to work there. So it is particularly appropriate to turn matters over to him at this point.

John has been instrumental both in creating this lecture series and increasing the profile and work of the Center. All of us at Fordham Law School, and all of us at Fordham University, are profoundly in his debt. It is my pleasure to introduce to you John Peloso.

MR. PELOSO:[7] Good evening, everybody.

My role here this evening is simply on behalf of Morgan, Lewis & Bockius to welcome you to this Fifth Annual A. A. Sommer, Jr. Lecture. As most of you know, the lecture series was established five years ago by Morgan, Lewis as a way of interacting with Fordham Law School to stimulate the study of corporate and securities law and as a way of jump-starting the Center here at the Law School.

We thought a good way to do that was to identify this lecture in the name of our partner who was most identified with the securities world. Al Sommer was a partner at Morgan, Lewis for many years before retiring in 1994. He was a practicing corporate lawyer for most of his career, but took time out to become a distinguished member of the SEC. He was very active in professional organizations, particularly with the accounting industry. He was an adjunct professor at a number of law schools. He was a prolific commentator—the recipient of many awards, too numerous to mention, particularly from the accounting industry.

He came to Morgan, Lewis in 1979 to develop a securities regulatory practice. He spearheaded the building of that practice lawyer by lawyer, so that today we think it is one of the finest in the country.

This being 2004, tonight we are celebrating the twenty-fifth anniversary of the establishment of that practice by Al and others at the firm, and so we have brought together people from around the country who are members of our firm, and also alumni, in order to celebrate the event. The response was so enthusiastic that we are thinking of making

7. John F.X. Peloso is senior counsel in the litigation practice of Morgan, Lewis & Bockius LLP as well as an Adjunct Professor of Law at the Fordham University School of Law. His practice has focused on all aspects of securities litigation, broker-dealer matters, and enforcement and disciplinary proceedings before the SEC, the NYSE and other self-regulatory organizations.

it an annual affair. We will let you know more about that later.

Al Sommer was with us for the first two lectures to introduce the speaker. Three years ago he passed away, after battling a deadly illness, but he is represented here this evening by his lovely wife Starr and his daughter Susan. They have been at all of these lectures and are our most loyal participants.

In a way, I think Al will always be with us for this event because the lecture is meant to stand as a monument to him as one of the great lawyers of our generation.

It is now my pleasure to introduce to you Professor Jill Fisch, who, as the Dean pointed out to you, is the Director of the Center. She is also the Alpin J. Cameron Professor of Law and is highly regarded, often quoted, and considered to be one of the really up and coming major players in this part of the world.

PROF. FISCH:[8] Good evening. I am Jill Fisch and I am Director of the Fordham Center for Corporate, Securities and Financial Law. On behalf of the Fordham Law School community I welcome you to the Fifth Annual A. A. Sommer, Jr. Lecture.

I would like to express Fordham's deep gratitude to the firm of Morgan, Lewis & Bockius for their generosity in establishing the Lecture. Additionally, because in 2004 we are commemorating the seventieth anniversary of the SEC, we have the honor of having the SEC Historical Society[9] join us as well.

I would like to thank Richard Ketchum for agreeing to deliver this year's lecture. I would also like to add my welcome to Starr and to Susan. I am delighted that you are here.

As you know, we consider the Sommer Lecture to be one of the real gems of the business program at the Law School. We have been lucky in being able to identify and to attract speakers who are at the highest levels of leadership in the profession. We here at Fordham have benefited from their insights into some of the most significant events affecting the business community. Of course, this year's speaker is no exception.

The Sommer Lecture is part of the Fordham program in corporate

8. Jill E. Fisch is the Alpin J. Cameron Professor of Law at the Fordham University School of Law and is the Director of the Fordham Center for Corporate, Securities and Financial Law.

9. More information *available at* http://www.sechistorical.org.

and securities law, a program that with the formation of the Center has continued to grow in quality and prominence. The program builds on Fordham's strong business law faculty, including an unparalleled adjunct faculty, and you have already heard that Rick Ketchum is a member of that faculty.

We also have the Securities Arbitration Clinic[10] in which our students represent small investors who lose money investing in the stock market—hard to see how that could happen.

[Laughter.]

We have a remarkable alumni base, which includes top leaders in the field of business law, many of whom are here tonight.

And we have a specialized business law journal, the *Fordham Journal of Corporate & Financial Law.* Many of the student editors and staff members are here in the audience. And, as with previous lectures, tonight's lecture will be published in that journal.

The predecessor to the NYSE was formed by a group of twenty-four stockbrokers in 1792 with the signing of the infamous Buttonwood Agreement.[11] The pact was referred to as the Buttonwood Agreement because it was supposedly signed beneath a buttonwood tree outside 68 Wall Street, where brokers often met in good weather to carry on their trading. The agreement established the NYSE as a self-regulatory organization ("SRO") controlled by its membership, and the contract remains largely intact through today.

The concept of what it means to be an SRO, and how such organizations should function and be regulated, is currently a hot topic. Last spring, the Center hosted a panel discussion at the Albert A. DeStefano Lecture[12] where participants from the SEC, the NYSE, and

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10. *See generally* http://law.fordham.edu/clinics.htm (for information about Fordham University School of Law's clinical legal education programs).

11. Stuart Banner, *The Origin of The New York Stock Exchange 1791-1860*, 27 J. LEGAL STUD. 113 (1998); *see also* William I. Friedman, *The Fourteenth Amendment's Public/Private Distinction Among Securities Regulators in the U.S. Marketplace – Revisited,* 23 ANN. REV. BANKING & FIN. L. 727, 738 n.50 (2004), (discussing the history and formation of the NYSE in regulating U.S. securities markets). For a full text of the agreement see, Gordon v. N.Y. Stock Exchange Inc., 422 U.S. 659, 663 (1975).

12. *See The Fifth Annual Albert A. DeStefano Lecture on Corporate, Securities & Financial Law: Crisis in Confidence: Self Regulation in the Securities Industry*, 10 FORDHAM J. CORP. FIN. L. 167.

the Securities Industry Association—Mr. Ketchum among them—debated the future of self-regulation.

Just this morning, the SEC voted to propose new rules relating to the governance, independence, and oversight of SROs such as the NYSE.[13] The Commission also voted to issue a concept release requesting public comment on a variety of issues relating to the efficacy of the self-regulatory system.[14]

In this environment, the role of the NYSE is subject to new challenges. No one is better suited to address these challenges than Richard Ketchum. Mr. Ketchum was formally appointed as Chief Regulatory Officer of the NYSE on January 8, 2004, and began work on March 8. As a result of the NYSE's recent governance reforms, Mr. Ketchum reports to the Board Regulatory Oversight and Regulatory Budget Committee.[15]

Mr. Ketchum came to the NYSE from Citigroup where he served as General Counsel to the Corporate and Investment Bank and was a member of the unit's planning group, the Business Practices Committee and the Risk Management Committee. Prior to Citigroup, he spent twelve years at the NASD and NASDAQ. He served as President of NASDAQ for three years and President of the NASD for seven years. Previously he had served at the SEC for fourteen years, eight of them as Director of the Division of Market Regulation. Mr. Ketchum earned his J.D. from the New York University School of Law and his B.A. from Tufts University.

As Dean Treanor noted, he has been a particularly good friend to Fordham Law School. In addition to teaching here as an adjunct professor—and one of our alumni recently told me that his course last

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13. *SEC Votes to Propose Changes in SRO Governance and Issue Related Concept Release*, SEC Press Release No. 2004-154 (Nov. 9, 2004) *available at* http://www.sec.gov/news/press/2004-154.htm. For the text of the proposed rules see Proposed Rules for the Fair Administration and Governance of Self-Regulatory Organizations, etc., Exchange Act Release No. 34,50699, 69 Fed. Reg. 71,126 (Dec. 8, 2004) *available at* http://www.sec.gov/rules/proposed/34-50699.htm.

14. *See* Concept Release Concerning Self-Regulation, Exchange Act Release No. 34,50700, 69 Fed. Reg. 71,265 (Dec. 8, 2004) *available at* http://www.sec.gov/rules/concept/34-50700.htm.

15. *See* NYSE Appoints Richard Ketchum Chief Regulatory Officer, *at* http://www.nyse.com/Frameset.html?displayPage=/content/articles/1075894220122.html (February 2004).

year on Selected Topics in Securities Regulation was, I believe these were her exact words, "unbelievably great"—he recently joined the Center's Board of Advisors.

Mr. Ketchum has a reputation on Wall Street as a "tough cop." He has been widely quoted as warning that the NYSE is going to increase its enforcement efforts and use stiffer financial penalties to address Wall Street wrongdoing.

Since his arrival at the NYSE, his efforts have been addressed to sales practices of brokerage firms and potentially manipulative trading practices. Recently he also assumed responsibility for monitoring listed company compliance with its changed standards.

The increasing importance of the Exchange's enforcement efforts, as well as the task of what *Business Week* calls "restoring the exchange's credibility,"[16] at a time when the reputation of Wall Street has been somewhat battered, call for extraordinary leadership. Responding to that call, it gives me great pleasure to introduce to you Richard Ketchum.

LECTURE

MR. KETCHUM: Thanks very much, Jill. And thank you as well, John and Dean Treanor.

It is a pleasure to be here tonight, certainly a pleasure to be here seeing so many old friends. But mostly it is an enormous honor to give this lecture tonight because of what Al Sommer stood for—an incredibly inquisitive mind, always open to new ideas, an absolute commitment to strong, transparent regulatory standards, and most of all reveling in the debate of ideas, always striving for the resolution of even fundamental differences with civility.

But those are mere words. Looking around here, along with a lot of old friends, I see some colleagues from the Exchange and some students. I think it is worth taking a moment, particularly with Starr here, to let you understand something about Al.

Understand that there are many definitions of a giant in securities regulation or in securities or in the law. Al was unique as a giant. He was unique as a mentor. He plucked, not one, but literally generations of SEC people, leaders within the industry, pulled them under his wing,

16. Mara Der Hovanesian, Big Stick at the Big Board (November 15, 2004), *at* http://www.businessweek.com/magazine/content/04_46/b3908076_mz020.htm.

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16. Mara Der Hovanesian, Big Stick at the Big Board (November 15, 2004), *at* http://www.businessweek.com/magazine/content/04_46/b3908076_mz020.htm.

exposed them to ideas, exposed them to other leaders and great minds in the securities law, continually pulled people together to push ideas and to work through ideas, and reveled not in demonstrating that he was the smartest person in the world, but rather in people coming together, thinking things through, and reaching resolution on hard topics. It is a remarkable gift.

He is a man who was Commissioner at a time, I think, of the golden years of the SEC and at a time when no one could tell you who the Republicans were and who the Democrats were, a great statement that I think has much to say for the legacy of the SEC.

The topic I have chosen tonight also reflects one of the countless subjects that Al Sommer contributed to, the future of self-regulation. Al served as an independent director on the board of the NASD not once, but twice—I think, at least at the time, the first person to have ever done so—bringing his usual mixture of intelligence, wit, and mediation. He was in many ways precisely the model of modern, independent, yet knowledgeable, self-regulation.

The topic of the future of self-regulation seems to be particularly timely today. In part, it is timely because the SEC decided to put out two releases, as Professor Fisch indicated and I will not repeat. It was actually driven into my mind that it was timely, shortly after it was announced that I was taking my position, when Annette Nazareth first gave her first speech indicating that there would be a concept release on self-regulation.[17] And I realized the timeliness when I walked into my kitchen and my wife stood there dangling the story, saying, "Tell me, are we moving out in six months or when?" So that has a way of focusing the mind on where self-regulation's future really is.

It is also important because obviously, and having lived through some of this, there have been enormous changes in the nature of both the securities markets and the securities industry in the last couple decades.

First, the consolidation of the industry, globalization, and the elimination of Glass Steagall restrictions[18] have resulted in complex holding company structures overseeing wide-ranging banking and

17. *Speech by SEC Staff: Market Structure: 2000 and Beyond, at* http://www.sec.gov/news/speech/spch376.htm (May 24, 2000).

18. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1998) (codified as amended in scattered sections of 12 & 15 U.S.C.). *See also Gramm-Leach-Bliley Act, at* http://www.sia.com/capitol_hill/html/gramm-leach-bliley_act.html (last visited Apr. 21, 2005).

securities activities that by its very nature cannot help but underline the difference between the federal holding company banking regulation approach to regulation and the securities functional regulation approach. Along with it, is the question of where self-regulation fits in, both from a financial and operational standpoint and from an ethical and sales practice standpoint, within complex entities that are simply not managed across regulatory lines.

Second, in part because of these developments, a number of countries, including the United Kingdom, have shifted away from a self-regulation model to reposing most authority with a government regulator with responsibility for all financial and banking activity.

Finally, there have been troubling incidents of self-regulatory failures to react quickly enough to fraudulent activity in the NASDAQ market, the NYSE, and apparently the options exchanges as well. Moreover, neither the SEC nor the SROs can be and are happy regarding the timeliness of their response to abuses arising out of the financial firms' inability to manage conflicts with respect to their research and investment banking functions or the sale of mutual funds.

To properly consider the future of self-regulation it is important to first recall its origins, which Professor Fisch has already beaten me to the punch in doing, as well as its perceived strengths, which has allowed it to maintain such a central role in securities regulation for the last century.

The current system of cooperative self-regulation by stock exchanges and the NASD, subject to government oversight by the SEC, is both historically rooted and legally grounded in the Securities Exchange Act of 1934 (the "Exchange Act"). As Jill indicated, long before the NYSE was known as an SRO it functioned as such, establishing rules of conduct both for its member brokers and for its companies.

Indeed, as Jill noted, not only was the Buttonwood Agreement identified, but as early as 1797 a variety of regulatory requirements were built in as to how members would deal with each other. Perhaps most notably, infamously, and long lasting was the establishment of a procedure of fixed commissions,[19] which demonstrates one of the conflicts we will talk about later in self-regulation.

But beyond that, the Exchange continued throughout the 19th

19. *See generally* Banner *supra* note 11.

century both with regard to member regulation and issuer listing standards, setting standards for the listing of new securities by 1866, restrictions on watered stock in 1869, and rudimentary financial disclosure requirements before the turn of the 20th century.[20]

The Exchange Act, therefore, did not so much invent self-regulation as embrace it or if you prefer, accept it as a political compromise. The key feature that it added, a key and critical feature, was oversight by the SEC.[21] This was most colorfully described by Justice Douglas in a quote that many of you know: "Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well-oiled, cleaned, and ready for use but with a hope it would never have to be used."[22]

SEC oversight has long been deemed critical to address the two fundamental potential weaknesses of self-regulation: first, the risk of industry capture, resulting in insufficiently aggressive rule-making and enforcement activity; and second, the risk of an SRO engaging in anticompetitive activity to protect the economic interest of the industry as a whole, such as fixed commissions, or preferring the old school in some portion of the industry over new competitors.

Over time, and as a result of incidences of perceived SRO failures, Congress has expanded the SEC's oversight responsibilities, culminating in the Securities Reform Act of 1975,[23] where the SEC was provided with wide-ranging approval authority over all SRO rules, the ability to amend those rules,[24] and the ability to discipline SROs for failing to enforce their rules and the securities laws.[25]

The SRO model with SEC oversight has indeed thrived, albeit with ups and downs, for seventy years with good reason. For along with the conflict concerns there are strong and discernible benefits to self-regulation. In simplest terms, self-regulation offers the benefit of greater expertise, the ability to leverage government resources, and the ability to impose non-scienter-based ethical standards that would be inappropriate to be imposed by a federal government. Finally, self-regulation provides

20. *Id.* at 120–40.

21. Securities and Exchange Act of 1934, 15 U.S.C. § 78d (2004).

22. W. O. Douglas, Democracy and Finance (Allen, ed. 1940) 82.

23. Securities Act Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (codified as amended in scattered sections of 15 U.S.C.).

24. 15 U.S.C. § 78s(b) (2000).

25. 15 U.S.C. § 78u (2002).

a means to leverage through industry user fees government resources, protecting against very meaningful and real periods of budget constraint and political impact as a result of that.

I could talk a lot more about the benefits of self-regulation, and I think many of you could elucidate them and discuss them in great detail. But in some way, as nice as those words are, and as passionately as I believe that they are correct, I recognize the reaction in some quarters is somewhat different right now, as evidenced by the SEC releases to some degree, and perhaps even within the audience, a reaction—politeness, perhaps—but noted with a belief that self-regulation has gone off the tracks. That self-regulation is perhaps not sufficiently alert to developments and conflicts in the marketplace in the securities industry; and at the same time, contrasting with an industry that has fears of "regulators on steroids" who are driven by fear of criticism to do duplicative and intrusive investigations. These investigations are done with a predilection for zero tolerance and punitive actions in their view that do not take into account the good-faith compliance efforts of the industry and the complexity of today's markets and the technological systems of the firms. This is combined with a lingering view of many in the securities industry that regulators are not sufficiently knowledgeable about how things really work and not adequately open to industry views.

And yet, compare this, on the other hand, with the common public view that regulators are slow, weak, and conflicted, and that the industry views noncompliance with laws and rules as a cost of doing business, and you have a general recipe for at least a perception of self-regulation in crisis.

Now, let me stop to say that is not my view of self-regulation and that is not my view of how it has performed, certainly not at the NYSE or anywhere else I have worked at. But I think the breadth in which some of those views have been held—and that each of you in this room have at a minimum heard, if not expressed yourself—underlies a need to step back and ask about where self-regulation goes from here.

A perhaps humorous but symbolic example of how far we as regulators in the industry have to go is that, as you know and Jill mentioned, I have recently taken a new job. In taking that new job I was welcomed back from the dark side.

[Laughter.]

What is interesting is that I was welcomed back from the dark side twice: once when I arrived at Citigroup, leaving NASDAQ; and again

when I left Citigroup and came to the NYSE.

It is, therefore, not surprising in this environment that the SEC has today authorized for publication two releases for public comment, as Jill noted, the first proposing rules imposing governance and transparency reporting requirements for SROs,[26] and the second a concept release on issues relating to self-regulation.[27]

In such an environment, I believe it is important to pause before we move forward and try to rearticulate the compact that should form the foundation of self-regulation. For years, the securities industry thrived based on a common viewpoint that growth was contingent on investor confidence, and investor confidence could only be maintained through a strong, collaborative regulatory partnership. If we are to maintain that consensus in a more open, consumer-oriented, and cynical world, then it behooves us all to try to articulate what strong, collaborative regulation means—or, if you will, what is the self-regulation compact?

First, we must recognize and face the fact that self-regulation involves three, not two, parties: the SROs, the industry, and investors. Our collective success is based on investor confidence. Everything we do, whenever possible, must include the investor's point of view. Their concerns must be represented by us in every possible decision.

Therefore, what must be the commitments? Let me try to speak personally from the standpoint of NYSE regulation, without trying to be pretentious enough to suggest this for other SROs.

First is knowledge. We must make every effort to learn about and understand our market and how the industry works so that our decisions are thoughtful and our regulatory requirements take into account costs as well as benefits. We can not do that alone. Indeed, we have to welcome the industry's help in training our staff, in providing input, and allowing us to be able to understand the developments and the pressures that exist in the securities industry.

We now provide our staff with effective training in the meaning of SEC and NYSE rules and interpretations, and I have found the level of their knowledge is extraordinary. But it is a challenge for them to absorb the constant change occurring in the market and in large, complex securities firms.

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26. *See* Proposed Rules for the Fair Administration and Governance of Self-Regulatory Organizations, etc., *supra* note 13.

27. *See* Concept Release Concerning Regulation, *supra* note 14.

In addition, we need to be thinking about enhancing the dialogue between us and senior executives at our member firms. We want to better understand their challenges, their risks, how they are dealing with conflicts and the competitive pressures that are inherent in the securities industry.

I know and have heard many concerns raised regarding candid conversations between NYSE regulation, other regulatory entities, and the firms and the potential exposure to disciplinary actions. Together we have to get past that and recognize that if the SROs are to do their job, effectively identify risk to investors, and effectively contribute to providing a culture of compliance in the firms, we need to find an ability to communicate with the firms, being comfortable over the level of exposure that that communication involves.

Second, transparency. We want input into rule-making, something that perhaps at the Exchange we have not always been perfect on from the transparency standpoint. We want our members and member firms to let us know when our rules are unfair or our interpretations are problematic.

One step toward that goal will be our effort to revitalize our regulatory committees, which will require time and commitment on both sides.

To solicit investor involvement, our new website, launched just this week—nyse.com/regulation[28] for those who would like to see it—has a prominent new section explaining how investors who feel they have been subjected to unfair or improper business conduct by a member or a member organization can file a complaint.

Next year we will move towards launching a significant investor outreach initiative on top of this. I hope this will include investor town hall meetings, both over the Web and across the country. I hope through those forums we can gain a better understanding of the concerns of investors, both individual and institutional investors.

As I said previously, our collective success is based on investor confidence. We will not regain that confidence until we reestablish communications with those who make our industry possible.

The third commitment of the NYSE regulation is independence. The first priority of the NYSE regulation is protection of the investor. If

28. More information *available at* http://www.nyse.com/regulation/inqcomplaints/1088808969148.html.

that occasionally brings us into conflict with the business side of the Exchange, then that is all right. There must never be a question in the eyes of investors that our regulatory decisions are blind to the interests of the business side of the Exchange.

Similarly, there must never be the slightest doubt by anyone in the industry that the NYSE's regulatory decisions, whether in an examination or in an enforcement action, are based on anything but our best judgment; it is not on whether a particular firm may be competing with or providing orders to a competitor of the NYSE.

The NYSE governance changes, proposed by Chairman John Reed and approved by the SEC in December of 2003,[29] address this goal directly. Because of these changes instituted by the NYSE Board, CEO John Thain, as much as I admire him and admire what he is doing at the Exchange, is a respected colleague but not a reporting relationship of mine.

The Chief Regulatory Officer, of which I am the first, reports directly to the Board, to the Regulatory Committee. The Regulatory Oversight Committee—or "ROC" as we affectionately call it—has oversight and accountability for the NYSE's regulatory program. Our compensation and ultimate success relate solely to our performance as a regulator, not the success of the market, with the hopes that the market continues to succeed so that it can pay somebody.

I think this is a particularly important point often missed in the cynicism with respect to the conflicts of self-regulation. My experience over the decades of self-regulation is seldom that the people involved do not care about regulatory goals—in fact, they do. The concern and the legitimate issue is their focus, and the fact that, as is often—and maybe even perhaps inevitably—the case, the compelling competitiveness and investor issues involved in running a market can cause directors to lose focus on the self-regulatory program.

It is through identifying accountability with respect to the members of the Board, whether done as an affiliate of the Board in ways that the NASD has done at different points of its development in the last five

29. *See* A Conversation with Interim Chairman and CEO John Reed, *The Exchange* Vol. 10 No. 10/11 *at http://www.nyse.com/pdfs/xnlv10n10-11.pdf,* (discussing Chairman Reed's proposed governance changes); *see* SEC Press Release No. 2003-173 *at http://sec.gov/news/press/2003-173.htm* (discussing the SEC's approval of the governance changes).

years, or done as a regulatory committee, that I think it is absolutely critical to the success of self-regulation operating within a marketplace organization.

Our fourth commitment is to eliminate duplication. Frustrations of regulatory duplication led to a Securities Industry Association ("SIA") proposal for a hybrid sole self-regulator.[30] This is something that I think is part of the number of strange cites raised in the SEC concept release today, where markets retain responsibility for surveillance but all member firm examinations are focused on one single SRO.[31]

The concerns of duplication are real, and in many ways they are more real than at the time the SIA made that proposal. They are real today. While some of our efforts have moved both us and the NASD to try to address those duplication concerns, they relate to the oversight exam and the firms' ability to ensure that there is a consolidated oversight exam between the NASD and the NYSE.

They do not relate to the evolution of the SROs' and the SEC's exam programs in which far more of the examinations related to cause exams and specials focused on particular issues that often midway can morph into enforcement investigations. That environment requires a different level of escalation that cannot be focused entirely on planning. It requires real-time information between each of the regulators and, frankly, requires the cooperation and participation of the SEC just as much as the NASD and the NYSE in successfully addressing it.

But it is worth the effort. While I will not linger on this, I think the alternative of a single SRO, particularly for an exam program, is a flawed alternative. It fails to recognize that the efforts of market surveillance drive an examination program, that the ability to separate the two creates a lesser degree of knowledge and understanding of the particular markets that the SROs are responsible for, and it is likely to result in more burdensome, less knowledgeable regulation, not better.

The fifth commitment of NYSE regulation is that serious violators will receive stern and effective discipline. We must eliminate the public perception that regulatory fines that address noncompliance are an acceptable cost of doing business.

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30. *Reinventing Self-Regulation*–White Paper for the Securities Industry Association, *available at* http://www.sia.com/market_structure/html/siawhitepaperfinal.htm#_Toc52859676.

31. *See* Concept Release Concerning Regulation, *supra* note 14.

Self-regulation is not about low penalties. It is about the wisdom of being able to discern differences between a technical and a serious violation.

We recognize that there is a difference between a firm that has violated a rule despite a serious commitment to compliance systems and ethics, and a firm that is a consistent recidivist with insufficient commitment to compliance. We need to be able to demonstrate that from the standpoint of our penalties as well. We are beginning to do that and will continue to do so, hopefully on both sides, not just on the side of large penalties.

We also need to reduce the time it takes before a serious law violator is disciplined and, if appropriate, barred from the industry.

Now, let us briefly look at the SRO compact with regard to the responsibilities of the firms.

First, there must be active participation in the process. That participation requires a securities firm to represent its customers, not only its bottom line. I think it is important to reiterate to firms again and again from a self-regulation standpoint that their voices will always be given a chance to be heard as long as they address the question of what is best for their customers, not just for their bottom line.

Second, a commitment to a culture of compliance. I am an optimist here. I see and have experienced real changes in the securities industry. The business today I believe generally does understand the cost of noncompliance and cares genuinely about trying to develop an ethic and culture to eliminate that.

The challenge is that it is not enough to try; you have to get good at it. In the complex securities environments, one of which I lived in, that is not an easy challenge at all.

Firms have to recognize that their legal and compliance staffs are their lifeline to building that compliance foundation. Access to senior management must be regular and unconditional. Firms must get better at assessing their compliance risks. In particular, they must capitalize on the self-assessments required by Sarbanes-Oxley[32] and FDICIA[33] and make those regulatory reviews matter, not something that is instinctively

32. 15 U.S.C. § 7262 (Sarbanes Oxley self assessment and internal controls requirement of management).

33. Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. § 1831m.

part of a broker-dealer's culture. A broker-dealer's culture from its very bones is outstanding at being able to fight fires and respond to opportunities. It is not very good at intellectually stepping back and evaluating how they have done and where their risks and exposures are.

After having served as General Counsel of Citigroup's investment bank, I understand that major firms have substantially improved their processes to review new and proposed transactions. However, I have also noticed that some firms tend to take their eye off the ball when looking at ongoing businesses that may be under new profit pressures or growing dramatically. Firms need to emphasize again and again the importance of escalation to traders and operations people for whom consideration of a culture of compliance is far from natural.

There is a need to push hard at technology risks, including flaws in regulatory reporting, changes in e-mail supervision demands, and capacity issues. These concerns must be identified and escalated. A proper self-regulation will remind firms to constantly look at this area and constantly examine the investment in and attention to technology areas.

Third, forthright relationships. Firms need to report improper and illegal conduct when it has occurred and when it is discovered. Now, part of that just comes from our rules, which require firms to raise their hands and self-report problems.[34] That, while we recognize and respect firms that swiftly do that, is not all that I would suggest is involved in a forthright relationship with respect to regulatory compliance.

An example of this comes as follows. I understand the need for internal investigations with respect to complex brokerage firms and understand that firms may often reach conclusions in good faith on legality that we or other regulators differ. But if we commence an investigation, it is just not okay to fail to bring to our attention troubling parts of the firm's investigation, no matter what your legality conclusion might be.

My talk today is not intended to even begin to be a complete list of all that must be done, but instead a beginning. Self-regulation at its best requires the participation of us all—the industry, the SROs, the investors, and even the SEC—but I believe it is an effort worth making, one that allows us never to forget that our collective success is based on

34. *See* New York Stock Exchange Rules 440g–440h *available at* http://rules.nyse.com/NYSE/NYSE_Rules/.

investor confidence. I believe that together we can move past some of the bitter disappointments of the moment to breathe new life into a self-regulatory system that has, since it was created in the 1930s, made the U.S. securities industry the envy of the world.

With that, I thank you and I would love to have questions.

[Applause]

QUESTION: You mentioned changes in e-mail supervision in a technological way. Can you give us a little more insight into that?

MR. KETCHUM: Well, I think there are two different challenges with respect to e-mail. One, which all corporations, including the NYSE, are struggling with, is from the standpoint of retention. I think on the whole the securities industry is getting a handle on that.

I guess the piece on the e-mail side that I would focus people's attention and thinking on today, and that is an area that we are talking about with our Compliance Committee and is a concern of ours, is the obligation and the efforts to meet the supervisory review requirements with respect to salespersons' communications. As all of us live in the e-mail world and deal with steady incursions, yet each quarter-generation there is increased facility and dependence on electronic communications, I think we all are regularly, if not continually, overburdened and overwhelmed by the level of e-mail that we have to review. That is clearly true for your managers to the extent that you advise or are involved in a securities firm as well.

What we were seeing with a variety of firms is attempts to triage that in one way or another and recognize that it would be a good idea to find ways, either through technology or throwing additional bodies at it, to do the type of issue spotting that you do once you are being investigated while you are outside of that investigation from a compliance standpoint. As I said, we were seeing that being done in a variety of securities firms.

It is not part of the regulatory requirements, but I think we recognize how difficult the basic review requirements that are in Exchange rules are today, and we are trying to look at the right ways to be able to move forward with the industry on some at least Best Practice standards.

QUESTION: Rick, staying on the e-mail, a number of clients have told me that they produce approximately a million e-mails a day. I think, if you go back to the original rule, it would be like paper mail, and a manager could review every one of them, which is clearly not possible.

You would have to have some sort of smart system for review. Is there any thought to rethinking the basic regulatory approach to e-mail review?

MR. KETCHUM: That is why we have a Compliance Committee to help advise us on that, Bob. But I think it is a valid point. It has not changed the rules that are in place now, which do not impose absolute requirements to review all e-mail but do expect a substantial sample to be reviewed by the managers, and we are going to continue to expect that.

The question is: how does a firm recognize the burdens that may be placed, at least on some of your managers, and come up with a better approach to it? I think the answer is we are interested in ways that firms can do that. In fact, we would encourage firms to think creatively on that, because we recognize that the burdens of the rule may simply be placing impossible, or at least difficult, burdens on some managers.

The challenge is not to just say, "Man, this is just impossible, it is ridiculous." The challenge is then to question: "Okay, what next?" That is the question we would love to see the industry start to ask.

QUESTION: Toward the end of your remarks you made the point about responsibilities of firms to not just share only the good parts of their investigation. Were you making the limited point that you cannot pick and choose your sword and shield, or were you making a point towards privilege?

MR. KETCHUM: No, I am not making a point towards privilege, but I am saying that in situations where you self-report and where the regulator follows up and is focused clearly on the subject matter in which your investigation has identified some troubling facts, even if you concluded that those facts do not raise legality, at some point where the interest of the Exchange or the interest of any regulator is focused on that standpoint, without arguing privilege or the rest, you should not be surprised that we will not be amused if the firm in that situation does not forthrightly indicate in pretty clear indication the sum of what they found in their investigation.

And again, that will be your choice, but in those circumstances where you are outside and making a conclusion and where we have determined it is an area of concern, I think a little bit more than just the fact of self-reporting would be a good thing.

QUESTION: Don't you have to link the self-reporting issue that you just addressed with your earlier comment about distinguishing on

sanctions between major sanctions—these are my words, not yours—and less significant ones?

MR. KETCHUM: They are close to my words. I am sure I am going to hear them back at some point.

Yes, I think we do. As I say, I see enormously praiseworthy cultures in some securities firms in which we hear quickly when they identify problems and where their summaries of those problems are broad and forthcoming.

That alone to me is not the end of the question. The question is: "Well, how have those firms done from a compliance effort, what is their commitment from a compliance effort standpoint, have we seen problems in literally the same area before with respect to the firm?" and a variety of other things. And you know the type of things that people consider in sanctions and have read all the speeches and releases from the SEC, so I do not need to go into any great detail there. So we look at a lot.

But I know, particularly in this time of what some might perceive as somewhat escalating sanctions, it is difficult to perceive the difference. I can guarantee you—and it is a conversation we have regularly in the Enforcement Division in the Exchange, and which Susan Merrill[35] is very focused on—there are distinctions and each of those issues are considered with respect to the sanctions. We are not just looking at historical precedents; we are trying to evaluate exactly that type of issue.

We do not live in a banking culture, for better or worse. We live in a culture that is fundamentally consumerist, where there is an expectation that enforcement is an important part of encouraging compliance. Even great firms will receive and be the subject of enforcement actions sometimes.

But I absolutely agree with you that an organization that is not looking at exactly those points is not doing its job, and we are committed to look at those points.

Brian? Another great ex-NASD Regulation Board member.

QUESTION: Well, I was going to ask a question that sort of relates to that. I am trying to understand the new organization that you head and your role. How do you contrast—because you know Mary Schapiro's job—how do you contrast your structure and your organization with the one that we are a little more familiar with, and that

35. Susan L. Merrill is Executive Vice President of Enforcement at the NYSE.

is NASD regulation?

MR. KETCHUM: I think the NYSE operates very similar to the way that Mary Schapiro operated, except for the reporting relationship, which is cleaner at the Exchange than it was at the NASD in the first three years after Mary came there and before the private placement in NASDAQ. The NASD operated with an affiliated NASD Regulation Board that effectively, with the oversight of the Holding Company Board, or the Association Board, the NASD Board, effectively had the accountability for the regulatory program and the oversight.

The Regulatory Committee acts as that NASD Regulatory Board prior to the spinning off of NASDAQ. I think it works remarkably similar vis-à-vis Mary's relationship with Frank Zarb[36] and my relationship with John Thain,[37] albeit the major difference being that Mary did still report to Frank Zarb and I do not.

With that, it seems to be time for refreshments. Thank you very much.

36. Frank Zarb is a former Chairman and Chief Executive Officer of the NASD.

37. John A. Thain is the Chairman and Chief Executive Officer of the NYSE.