THE FEDERALIST SOCIETY—CORPORATIONS PRACTICE GROUP: PANEL ON THE SEC AND THE FINANCIAL SERVICES CRISIS OF 2008

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PROFESSOR BAINBRIDGE: Welcome to the Federalist Society Corporations Practice Group program on the role of the Securities and Exchange Commission ("SEC") in the financial services crisis. I'm Stephen Bainbridge, and I'll be moderating the panel today.

Back in September, when the presidential campaign and the financial services crisis were both roiling the waters, Senator John McCain remarked that if he were president at that moment, he would fire SEC Chairman Christopher Cox. This set off a frenzy in the media and the blogosphere, which oddly focused on the question of whether the president in fact can fire the chairman of the SEC. An interesting administrative law question to be sure, but it obscured the more fundamental issue of whether, in fact, the SEC bore any responsibility for the financial services crisis. Let's tick off some of the bullet points that critics of the SEC have raised: failure adequately to police holding companies and unregulated affiliates of broker dealers; the 2004 amendments to the Net Capital Rule allowing the Big Five investment banks to become significantly more leveraged; the failure of the voluntary supervision program for the Big Five investment banks; facilitating speculation by repealing the uptick rule and failing adequately to police naked short selling;

[1] The *Review of Banking and Financial Law* thanks the panel participants for their editorial input and participation.

antiquated disclosure rules that have failed to keep up with financial innovation; and failing timely to address the question of how mark-to-market and mark-to-model accounting would work during a serious financial downturn.

In response, the SEC's defenders point to such actions as enhanced enforcement of the rules against naked short selling, at least recently; a ban on short selling of financial institution stocks; providing guidance on the use of mark-to-market accounting; multiple enforcement proceedings, including proceedings involving market manipulation; and a memorandum of understanding with the Federal Reserve Board to promote better information sharing. They also argue that Congress failed to give the SEC either the enforcement budget that it needed, and, in cases such as credit default swaps and so on, they failed to give the SEC jurisdiction over the problems at hand.

Now, with time having passed, the waters having calmed a bit, and the presidential campaign behind us, we can now look back to examine two fundamental questions. First, does the SEC, in fact, bear any significant responsibility for the financial services crisis of 2008? Were there errors made at the regulatory agency that in some way contributed to either the coming of the financial crisis or its depth?

Second, going forward, what regulatory actions should the new Congress and newly elected President Obama take with respect to the SEC? We have heard many calls for financial services reform, a so-called “new New Deal.” This raises the question of what the SEC, a creature of the original New Deal, will look like this time next year. As you know, 2009 will be the 75th anniversary of the SEC. Presumably, the SEC will be around to celebrate that birthday, but will it look, or will it be preparing to look, quite different than it does today?

We have a very distinguished panel to address these issues. Paul Atkins was SEC Commissioner from 2002 to 2008, and during his tenure, he emphasized the need for regulation that considers costs and benefits and that fosters competitiveness of U.S. capital markets. Prior to joining the Commission, Mr. Atkins was a partner at PricewaterhouseCoopers.

Ed Kitch is the Mary and Daniel Loughran Professor of Law at the University of Virginia, my alma mater. His scholarly and teaching interests include corporation law, securities regulation, industrial and intellectual property, economic regulation and legal and economic history.

George Terwilliger is a senior partner in Washington, DC firm of White & Case and served as a presidential appointee in two administrations, first as the U.S. Attorney for the District of Vermont under the Reagan administration, and then as Deputy Attorney General, and acting Attorney General, under Bush the 41st.

Jon Macey is the Sam Harris Professor of Law, corporate law, corporate finance, and securities law at Yale University, and is the prolific author of numerous books and articles on insider trading, corporate finance, corporate and securities law, and banking law. He serves on FINRA's National Adjudicatory Council and FINRA's Council of Economic Advisers.

Each of the panelists will make a brief opening statement, after which we'll see if we can get a debate going amongst the panelists. And then we'll open the proceedings to questions from the floor. Commissioner Atkins.

COMMISSIONER ATKINS: Thank you very much, Steve, and good morning to all of you. It's a great pleasure to be here, and as a *former* federal official, I'm happy to say I don't have to give any disclaimers. There is no question that everything I say now is attributable to me, which is a great, liberating feeling. And also, I guess I could say I probably had pretty good market timing because my last day in office was August 1, right before some of the worst things started to pop. Today's topic is very important. I am very glad that you all are here today, and I look forward to the discussion.

I think in light of this month's election and outcome—although it's not necessarily finished yet since there are still two seats in the Senate that need to be determined (and those are going to be very important seats, of course, as we have discussed at this conference so far)—it's very important to get the lessons correct, the takeaways correct from the current crisis, which of course is still unfolding.

But, I think it's safe to say that the current situation is not the result of any so-called "Bush deregulatory philosophy," as was bandied about in the campaign by the President-elect and others. I am hoping that that was electioneering rather than any special analysis because when you look at the current crisis, it is global in nature, not limited to the United States. And, the most heavily regulated entities were the ones that suffered versus, at least so far, the lightest regulated entities.

For example, look at European banks and their leverage, compared to American banks. A recent Bank for International Settlements study[2] compared leverage in banks in the U.S. and in Europe starting in 2001 and going through 2008. The U.S. banks—commercial banks—are pretty steady at about a 15-to-1 ratio. The U.S. investment banks in 2001 had about a 25-to-1 leverage ratio, and the ratio went up to about 33-to-1 in 2008. It is interesting to note that, because of US capital rules, the U.S. investment banks maintained about a 15-to-1 ratio in their U.S. brokerages, but the increased leverage was built up at the holding company level because of the activities of their London-based affiliates, which are regulated by the UK's Financial Services Authority ("FSA"). Those activities went to London precisely because of U.S. capital standards.

When you look at European banks, however, their leverage ratio started at about 20-to-1 back in 2001 and rose to more than 40-to-1 recently. So, on those sorts of measurements at least, the U.S. was not off on one side of the distribution curve—in fact, just the opposite. Then, we also have to consider the state-run banks in Germany and elsewhere, which had some very faulty risk management and investment strategies. We cannot leave out the credit rating agencies, which of course have had a checkered period of oversight, where the last 30 years of regulation created a non-competitive oligopoly of three rating agencies, setting the fuse for the sub-prime crisis.

So, considering all that, one can hardly say that U.S. "deregulation" is the cause of this crisis. Hopefully, we will get down to the bottom of it next year and start to analyze where we have been and where we are going. Steve alluded to the 1930s. If you look at our current situation in the 21st century, we still have not necessarily dug ourselves out of many of the mistakes that were made policy-wise back in the 1930s. I am sure that there are going to be investigations next year by Congress, and there's an eerie similarity between these days and the 1930s.

You just have to go back to the Senate Banking Committee hearings of 1932 and 1933—the famous Pecora hearings[3]—which

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[2] *See* Herve Hannoun, Deputy Gen. Manager, Bank for Int'l Settlements, Policy Lessons from the Recent Financial Market Turmoil: Remarks at the XLV Meeting of the Central Bank Governors of the American Continent (May 9, 2008).

[3] *Stock Exchange Practices: Hearings Before the S. Comm. on Banking and Currency*, 73d Cong., 1st Sess. 6544 (1933-34).

led to the passage of many of the laws that make up today's securities regulatory framework. Those hearings led directly to passage of the Securities Act of 1933,[4] the Securities Exchange Act of 1934,[5] the Public Utility Holding Company Act of 1935,[6] the Trust Indenture Act of 1939,[7] the Investment Advisers Act of 1940,[8] and the Investment Company Act of 1940.[9]

So, are we in for another sort of legislative avalanche like that? I imagine that we may be. There certainly are things to be cleaned up—some of the gaps in regulation, overlapping or unclear jurisdiction, and similar issues that have been shown. But, we have to pay attention to what are the proper lessons to be learned, or we are doomed to affect our economy adversely. If you look back to the 1930s, one of the key laws, which we don't really think much about anymore because it was repealed in 2006, was the Public Utility Holding Company Act of 1935, which completely remade the electric and gas transmission and electric generation industry in the United States. The SEC's main job, believe it or not, for about 30 years, was to break apart the interstate utility industry and to make it into essentially what became a Balkanized system of utilities. Rather than address problematic practices that affected public utility holding companies in the 1920s, Congress remade the industry by breaking it apart. And so, that, of course, has effects to today, including inefficiencies, lack of investment, and a suboptimal power grid in that industry. The Act was finally repealed, like I said, just two years ago.

So, now you can hear people proclaiming the death of capitalism or that deregulation during the past eight years led to this market collapse. I'm sure all of us in this room would agree that you could hardly call last eight years deregulatory when you look at the Sarbanes-Oxley Act ("SOX"),[10] new SRO rules that came out from FINRA and the New York Stock Exchange and the NASD, new FASB rules, and new SEC rules regarding compliance and trading.

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[4] 15 U.S.C. §§ 77a-77aa (2000).
[5] 15 U.S.C. §§ 78a-78mm.
[6] 15 U.S.C. §§ 79-76z-6 (repealed 2006).
[7] 15 U.S.C. §§ 77aaa-77bbbb.
[8] 15 U.S.C. §§ 80b-1-80b-21.
[9] 15 U.S.C. §§ 80a-1-80a-64.
[10] Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of Titles 11, 15, 18, 28, and 29 of the U.S. Code).

They were extremely expensive, of course, and people had to pay attention to them and adapt their businesses to them. You could hardly call any of that deregulatory.

I did not necessarily agree with all of these rules when they came out, and now it turns out that that many of them were not aimed at the correct risk points of the system. That's the inherent problem with regulation. It's a blunt instrument at best, and it's subject to the frailties of human regulators. So, if the regulator does not use an effective cost-benefit system to analyze its proposed rules properly or doesn't listen to public comments, or tries to regulate through enforcement (like, for example, the research analyst case that was brought by Eliot Spitzer and the SEC and others), the consequences can be inconsistent, distortive, and not easily corrected in the long run.

I look forward to discussing more of this, but I think when you look at what's happened the last few years with respect to regulation, I would posit that the SEC was distracted by just this sort of "ad hoc-ery" as far as regulation goes. I point especially to the period of 2003 to 2005, with our Regulation NMS,[11] the Hedge Fund Registration Rule (which of course was thrown out by the courts as being, basically, *ultra vires*),[12] and then the mutual fund independent chairman rule.[13] Those rulemakings and attendant controversies distracted the staff, the Commission, and the industry right at a very crucial time. If you look at charts of the period 2003 to 2005, the issuances of collateralized debt obligations and credit default swaps look like a hockey stick. They took off. Unfortunately, most people were not paying attention to the essential risk management aspects of this growth—that is, back office operations and documentation, which ultimately had a direct effect on how investors distrusted the holdings of investment banks, especially Bear Stearns and Lehman Brothers. And unfortunately, we didn't push exchange trading or greater standardization of some of these instruments, although efforts were started relatively recently. We can talk about some of the reasons for that, including interagency turf battles, if time permits.

But with that, let me pass it on to my fellow panelists. I look forward to the discussions. Thank you.

PROFESSOR BAINBRIDGE: Professor Kitch.

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[11] Exchange Act Release No. 51,808, 70 Fed. Reg. 37,496 (June 29, 2005).
[12] Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006).
[13] *See generally* Shefali Anand, *SEC Remains Divided on Fund-Board Rule*, WALL ST. J., Mar. 16, 2007, at C13.

PROFESSOR KITCH: Thank you, Steve, and thanks to the Federalist Society for bringing this group together at this timely moment. I’m prepared to take the position that the SEC is not responsible, and I’ll intervene to defend it at any point in the discussion.

I'm willing to stipulate that there's more than one member of the United States Senate who believes that the function of the SEC is to ensure that stock markets always rise in a gradual and even fashion, thus providing a high-return, low-risk form of investment. I’ve never understood how this financial alchemy is to be achieved, nor do I think it is a mission assigned to the SEC by the relevant statutes. But if the SEC is not responsible, there is the question of who or what is.

I want to comment first on the timing of these events. In the discussion, there’s always much comparison to the Depression. There is one striking difference here. The market crash of 1929 occurred well before the presidential election and President Roosevelt's taking office. This crisis has been coterminous with the election and the transition of power. And I think that makes a difference because it makes the interpretation of the events much more difficult.

I’d like to offer two basic interpretations, which I think will be in play in historical investigation in years to come and are in play right now in policy discussions. The first interpretation is that this decline in markets is understood as the public proof, coming into full view, of a long series of policy mistakes by the Bush administration. The chickens, so to say, are coming home to roost.

The other interpretation is that markets are forward-looking and that these market actions are a response to the predictions about future policy changes that are expected or likely to be implemented as a result of the outcome of the election.

Which it is has a lot of importance for what one thinks the appropriate legislative and policy response is. The first interpretation leads to the conclusion that these events are vivid proof of the need for significant and dramatic policy changes, regulatory changes, new statutes, and new intervention by the government. And indeed, there may even be a kind of strong circularity in this if the forward-looking response is correct. If the forward-looking interpretation is correct, then it could be a vicious circularity because, as the market falls, it would simply increase the likelihood that the feared changes would take place.

Now, it's very important to have some view on the question of what actually is happening in the markets. My interpretation of it is that all of the principal players—and as Paul said, this is a global phenomenon, not a U.S. phenomenon—all of the principal players are in a deleveraging panic. They all, at about the same time, revised their estimates, first, of their liquidity needs and, second, of the liquidity properties of the financial assets which they held. This set off a massive effort to restructure portfolios, which involved selling some classes of assets and buying other classes—most dramatically and notably, buying Treasury instruments.

This appears to be the Federal Reserve diagnosis, which, under the leadership of Ben Bernanke (who has internalized Milton Friedman's more than 30 years of teaching and proselytizing on this question), has viewed this to be the cause and has responded with a very strong policy response. Milton always said that the problem in these situations is that the central banks are too cowardly. This central bank is not being cowardly.

In the last eight weeks, the Federal Reserve has doubled the size of its balance sheet. It is increasing high-powered money, in the last four weeks, at an annual rate in excess of 300 percent. It appears to be firmly set on this course. This creates a very dramatic "hockey stick" in the monetary statistics of a historically unprecedented sort, and it is going to provide a real, on-the-ground demonstration of whether or not Milton's teachings were correct.

Now, what's the cause? It's clear that there was a massive global mistake by a wide range of financial actors and institutions, individual citizens and consumers, all of whom made an error in their estimation of their liquidity needs and the appropriate structure of their balance sheets. This was encouraged by government policies. If you take the average citizen, the government encouraged citizens to mortgage their homes to the hilt, to view their home equity as a bank account accessible through equity lines of credit. It was also supportive of generous credit card lines of credit. The financial institutions worldwide did the same thing, and governments worldwide have done the same thing. Everyone cannot deleverage at the same time.

Why did these large and massive institutions make these mistakes? Well, as a matter of theory, we know the answer. The usual moniker is agency costs. In this particular crisis, one dramatic illustration is the compensation structure of investment bankers and hedge fund managers who take enormous shares of the upside but have absolutely no liability for or responsibility for the downside.

These compensation packages encourage them to increase risk, to grab for their share of the upside, and to simply walk away when the downside occurs, as we see in the case of many hedge funds that are now liquidating and closing up.

What to do about it? Well, there's bad news: We don't know what to do about agency costs. And there’s good news: I think probably, for at least a couple of decades, there’s been enough suffering, so this problem will not recur. It has a generational aspect. These financial storms seem to hit from time to time, but as they fade into the past and the people who have experienced them die, the new generation can never quite believe that they actually occur. And from time to time, the youngsters have to be taught exactly how treacherous and unreliable these markets can be.

Finally there's an elephant in the room, which doesn't seem to be discussed by anyone. It is that the largest global financial institution in the world is very reliant on short-term borrowing, and it is not subject either to effective regulation or self-control. That institution is the United States Government, whose borrowing has gone up from $5 trillion in 2000 to, now, above $11 trillion and moving up rapidly. That all depends on daily funding and the Treasury market, and of course, one might take comfort from the fact that Treasury rates are now at historic lows. That is, the government’s getting very inexpensive financing.

But there's one thing that we have learned from this course of events which should give us pause, and that is, these markets will turn on you on a dime. Lehman Brothers, AIG and others relied on daily overnight funding year after year after year after year without the slightest problem. And that went right up to their collapse, until suddenly they were shut out of the markets and they could not fund themselves. Do we need to worry that the same thing can happen in the U.S. Treasury market? And if so, what should we do to prevent it? Thank you.

PROFESSOR BAINBRIDGE: Mr. Terwilliger.

HON. MR. TERWILLIGER: Thank you, Steve.

Good morning. It's really an honor for me to join a panel with this kind of credentials and expertise.

I was really pleased to be asked to join this discussion because not only do I think it is an interesting question, but I think it's also a really important one. And for those of you who share the view that I do, that there is an element of a regulatory problem to the root causes of some of the problems we’ve experienced, I think as usually happens in a crisis, this may be a time of opportunity to speak to some of the issues that matter to us and maybe try to foster correction. I know that probably sounds very much like wishful thinking, given what the political outcome has been, but I really don't think that's the case. By addressing the questions that were posed to us, I'd like to try to explain briefly why.

Just to restate the question for a second, we were asked, does the SEC in fact bear any significant responsibility for the financial crisis of 2008? And I suppose in some sense, every element of the government financial policy and enforcement apparatus bears responsibility because preventing what has happened, and in fact what is still happening, is what they are supposed to do.

But I think the most focused area of responsibility here, looking at government in particular, is allowing political factors far too much influence in setting economic policy and what, for lack of a better term, I'll call economic enforcement policy, particularly in setting the regulatory framework that governs aspects of our economic engine. Addressing the full scope of that responsibility and accountability for the decisions which drive economic and regulatory policy is, of course, beyond this discussion but would be one worth having some time. But looking more narrowly to the SEC's role, both retrospectively and prospectively, provides a good window to some of the issues and the significant elements of responsibility for what got us here and some notions of how to get out of this trough.

I want to start by asking even more pointedly a question that Paul raised, and that is, fundamentally, what is the SEC's role? It's interesting that even have to ask that question. To my mind, and I think this is clear from the statute, the answer is clearly to promote investor confidence in the market for publicly traded securities. And by that standard, if that's correct, it might be easy to conclude that the SEC has performed very badly and blame it for the stock market's problems and some other economic issues that have arisen. I think that conclusion would, in fact, be wrong.

Investors lack confidence not in the market for publicly traded securities but in the economy in which that market functions. Now, again, it's beyond this discussion and clearly beyond my expertise to say why that's the case, but it's absolutely clear that no amount of regulatory policy or enforcement by the SEC could have prevented the erosion of economic confidence that has occurred or, perhaps more importantly at the moment at least, can restore that confidence to normal levels.

Now, there may be some specific exceptions to this. Abusive short selling, for example, may in fact be something worth a specific look. But apart from that and in addition to asking what the SEC's fundamental role is, it's time to ask what, fundamentally, is the role of the federal establishment in regard to commerce and the economic system and particularly what is its enforcement role? And here again, I don't think the answer to that question should be difficult.

The system that our Founders set in motion has as a core purpose promoting commerce for the general benefit of the people, and it stands to reason that its enforcement role should be centered on protecting the means and instrumentalities of commerce from the harm of fraud, dishonesty, outright theft, lack of transparency and so forth. Chief among the instrumentalities of commerce that the government should be protecting are the financial institutions and firms that create and leverage the capital that's necessary for economic activity and growth. And again, we could easily conclude that the federal establishment has failed of late in that mission because we've witnessed before our very eyes the collapse of major financial institutions.

Putting this question another way, did the government fail to protect these institutions from failure, or did it pave the way for failure by what some call, and I think Paul alluded to this, a laissez-faire regulatory scheme that permitted these institutions to, in fact, kill themselves by participating in financial overreaching to unprecedented levels, at least in the United States? Again, I take Paul's point about comparing the leverage in the United States to Europe is a really important one—but did we allow these institutions to so over-leverage themselves that they in fact were committing suicide?

The answers to all of these, which I think are debatable questions that provoke debatable points, make the discussion interesting, at least as an academic matter. But this isn't an academic matter. The pain of the circumstances that have been created is very real to a lot of people. I really fear that over the next six months, the next two quarters, the economy is going to get a lot worse. It's vital to our citizens and to the future of our country, and frankly to the security of our country, that we find some answers to these questions.

So, my own view is that our patchwork quilt of regulations and regulatory agencies is in fact concentrated very much on creating and enforcing exacting standards as to what must be done to fell and harvest the trees, but no one is really watching the forest being managed. Rather than regulate and enforce in the first instance with the fundamental objective of protecting the means and instrumentalities of commerce, we engage in political feel-goodism by passing regulations to satisfy a political need.

What does this mean for the SEC on a prospective basis, which was the second question we were at least asked to tee up. And I'm afraid I have what may be viewed, at least in some quarters here, as some heretical views. In concept—and I want to underscore the term "concept"—I'm forced to agree with Senator Schumer's conclusions (though perhaps not his reasons) and those of others that we need unified financial regulation and enforcement at the federal level.

When I served as Deputy Attorney General in the early 1990s, I chaired the Interagency Financial Crime Task Force, which was designed to bring together all the agencies that had a role in financial crime enforcement to deal with the fallout from the savings and loan crisis. It was apparent to me at the time that both policy and enforcement was extremely fragmented among the agencies that were responsible at the federal level and, in addition and perhaps more importantly, the agencies' perspective on the problems and how to deal with the enforcement issues that those problems caused was very narrowly focused on each agency's jurisdiction and its own peculiar statutory and policy concerns.

But unifying the regulatory structure is not enough. And if that isn't accompanied by a clear course change in both our regulatory and enforcement policy, it could be counterproductive. A unified agency should have as its primary goal the core components of the federal establishment's role in regard to commerce, and these could be built into such an agency's DNA by simply having Congress identify in the statute what those core components are while requiring that every regulation made and enforced by the agency be in harmony with those goals and that courts respect those parameters for the federal role.

I think this presents us with a very, very important opportunity to restate what those goals are and in fact get them embedded into our law and thereby prevent the sort of political knee-jerk reaction to regulate retrospectively for last year's problems without a view towards managing the forest.

Thank you very much.

PROFESSOR BAINBRIDGE: Thank you, Mr. Terwilliger.

Professor Macey.

PROFESSOR MACEY: First let me say it is a great pleasure to be here. This really is—people always say this, but in this case it actually is true—an extremely distinguished panel.

I do want to indulge myself in something I've wanted to do for quite a while, which is to say that, particularly single out Paul Atkins. I'm a longtime student of the SEC and a student of the SEC both as an administrative agency and as a bureaucracy. To steal a little bit from Federalist 10, Madison of course is right that enlightened statesmen are not always at the helm. Paul Atkins shows us that sometimes they actually are at the helm. Unfortunately, you had to share the tiller with some less enlightened folks, but I really appreciate your work in Washington, and now that you're no longer in a position to subpoena me or anything, I feel as though I can say that.

What I'm going to do, consistent with sort of my general approach to the Securities and Exchange Commission, is to first talk a little bit about my perspective and then make, within about a minute each, some discrete points about what I think is going to be happening in the future and what is appropriate.

So when I say that I study the SEC as a bureaucracy, what I mean is, as many of you know, I am concerned with the extent to which the Commission is subject to capture by its constituents. I also ask questions such as to what extent is the SEC motivated by concerns about its budget? To what extent are people in the SEC motivated by their own professional career concerns of going to work in law firms or investment banks? And to what extent do those public choice incentives cause maybe the agency to behave in ways that are inconsistent with publicly articulated general purpose justifications for the agency?

Because of our time constraints, I'll just make one point about this issue, which is to say that until today, just as a matter of fact, every time we've had a problem in the markets for which the SEC might justifiably or not be blamed, the ineluctable reality is that this has led to an increase in the SEC's budget. We may all recall when Eliot Spitzer was the Attorney General of the State of New York, he really attacked the SEC vociferously and said that heads should roll at the SEC, that a lot of people at the SEC were incompetent. And the SEC took maybe more than its share of blame for the accounting crises, the market timing and late trading problems, and a variety of others—the price-fixing among securities firms and the odd-eighth quote scandal.

But despite the tremendous number of complaints about the SEC's performance, with each crisis, their budget increased dramatically, and the Enron era actually brought a doubling in the size of the SEC's budget. Now, what's interesting about this from the standpoint of what we're supposed to be talking about, what's the future of the SEC, for the first time, people are, things seem to be different for three reasons that predate the crisis. One is that the SEC has been subject to much greater criticism than ever in its history. Not only Eliot Spitzer but lots of people have been charging its incompetence. For the kind of marquee regulatory agency in the United States, this is quite a come down.

Similarly, for the first time, and I think this criticism of the Commission is entirely unjustified, the SEC has been charged by other government agencies with corruption, really, of favoritism, allowing certain regulated entities to have favored access to certain Enforcement Division officials. That also has hurt the SEC's political strength as an agency.

And then we also had—this is, to me, the most shocking of all, of this litany—we had with the original Paulson plan. Before the market crash, Henry Paulson, Secretary of the Treasury, had a blueprint for the complete overhaul of the financial services industry, a great consolidation, which actually called for the eradication of the Securities and Exchange Commission as an independent administrative agency and to be tucked into the Treasury and other parts of the federal bureaucracy.

And the idea that this could happen with cadres of SEC alums populating Wall Street, an extremely loyal fan club, the SEC Historical Society and other institutions, that this really is a "lo, how the mighty have fallen" situation. And I'm not going to say that history will necessarily predict in the sense that I'm not sure the SEC's going to come out of the latest round of problems with the same amount, the same increase in budget and increase in salaries and better jobs, et cetera.

Now, turning now to the core question of the Panel, and I think it's a great question, is the SEC to blame for the financial crisis? And what I want to focus on is the fact that in order to be able to blame somebody or something for a bad outcome, there are a couple of preconditions. One is that entity must have some sort of responsibility for preventing the outcome. And second is that market participants, people in the public, must have somehow relied on that entity. Did we rely on the SEC to keep us out of trouble?

And the critical thing, the most important point I want to make today is that, no, of course the SEC isn't to blame. To blame the SEC for this financial crisis would give the SEC far too much credit. It would require us to take the SEC far too seriously, far more seriously in a way than it deserves to be taken. The SEC—the other panelists have alluded to this—can't really be thought of as keeping markets healthy. But even the task of regulating debt-equity ratios, of looking at these, really responding to sort of the red flags at Bear Stearns that so many people have pointed to, is asking quite a bit too much.

At best, the SEC is a consumer protection agency. It should focus on its central responsibility of protecting small investors. It has failed miserably in doing this. In fact, the SEC's rules generally favor large institutional investors at the expense of small investors, whom the SEC has essentially shut out of the financial markets. But as ineffectual as the SEC has been over the past few decades, it still is unfair to say that they actually caused this financial crisis. On the other hand, I will argue that we would not have this financial crisis, however, had the SEC taken seriously its job of protecting the small investor in the following way.

In the securities industries, if we had simply applied or if the SEC had had maneuvered to apply the same protections, in the form of the know-your-customer rule, the suitability rule, the shingle theory, that have applied to people buying a hundred shares of stock in Microsoft also to people who were getting subprime mortgages—people in the mortgage markets were getting these pick-a-pay mortgages and negative amortization mortgages—we wouldn't be in this crisis because people's financing decisions would be much better tailored to their actual economic needs in ways that they obviously were not with respect to this recent crisis.

Finally, I just want to say a word about Enron. We haven't talked about Enron, and I just want to say in my last minute a couple of things about it. Number one, and most importantly, Enron was a trading firm. If you'll remember, many journalists, scholars and regulators, when Enron was in financial distress, wondered how this venerable, old-fashioned utility company to morph unnoticed into a massive, highly leveraged and exceedingly risky investment bank? Well, what's relevant about that is that we had no problem whatsoever with allowing Enron to fail, unlike the nine similar financial institutions in which the Department of the Treasury has bought preferred stock and, of course, unlike, Bear Stearns. If we could let Enron fail, which was really functionally in our economy no different than these other trading firms, then the "too big to fail, too interconnected to fail" story, which provides the argument for everything that the government has been doing in the face of the crisis, loses a lot of its force.

Finally, I'll close with a word about the Sarbanes-Oxley Act of 2002. The failure of Enron was the pretext for this massive federal intervention into corporate governance. The specific problems that SOX was supposed to address were mark-to-market accounting (this, you will recall, was Jeff Skilling's great achievement at the SEC), lack of financial statement transparency, too much leverage, rules versus standards accounting, and, most of all, the failure of internal risk management systems and controls. These were the problems addressed by SOX in general and in particular by the infamous [Section] 404 [of] Sarbanes-Oxley, which deals specifically with risk management. SOX also was supposed to deal with the problems created by credit rating agencies' incompetence and with the shortcomings of stock market analysts. In other words, if one simply reads his way through the Sarbanes-Oxley Act, the very public policy problems and the exact same concerns with excessive risk-taking that SOX was directed to solve obviously weren't even mitigated, much less solved by that massive and sweeping statute. These are exactly the same problems that we're seeing being blamed for today's crisis. If we ever are going to address these problems effectively, we are going to have to turn to market-based solutions and give up our futile reliance on regulatory solutions for what are, in essence, incentive incompatibility problems.

So, thank you very much,

PROFESSOR BAINBRIDGE: I'd like to thank each of the panelists for their very informative remarks.

I take it that we're in general consensus that what we have here is a financial crisis that was largely outside the jurisdiction of the SEC. No one on the panel seems to take very seriously the arguments, for example, that the repeal of the uptick rule is the source of all evil, that mark-to-market accounting explains everything about the demise of Lehman Brothers, or what have you.

I would like, however, to address with the panel the going forward question for just a minute and tease out a few more thoughts. My good friend Larry Ribstein, who's a professor at the University of Illinois, wrote a wonderful little article called *Bubble Laws*[14] in which he goes back and he looks at asset bubbles through history, going back as far as the South Sea bubble. And he finds that consistently the bursting of an asset bubble results in what he called a "bubble law," with the very first bubble law having been passed to solve the South Sea bubble crisis. He remarks, I think quite correctly,

[14] 40 Houston L. Rev. 77 (2003).

that bubble laws have two characteristics. First, they tend to fight the last war. That is to say to say, they are addressed to the economic problems of the past bubble, and therefore do little to anticipate where the next asset bubble will come from or what problems it will create. Second, they tend to restrict market flexibility, discourage entrepreneurship, and the like.

What will the bubble law of 2009 look like? I think there is almost certain to be a bubble law, although I would be interested to know if any of the panelists disagree with that prediction. If not, what might the bubble law look like?

Mr. Terwilliger gave us a very interesting possibility, which is that of unified financial regulation, which is what I'd like the panel to briefly address before we open it to the floor.

Mr. Terwilliger, if I could get you to just elaborate on a couple things. You suggested unified financial regulation. How much of the alphabet soup of Washington financial regulation do you anticipate bringing together? We have the SEC and CFTC, for example. I've never completely understood why, as a policy matter. They are separate agencies. Indeed, I think a litmus test for how serious the Democrats are about reform is whether or not there is serious consideration being given to merging the SEC and CFTC. Doing so would require the old bull committee chairmen—either in agriculture or financial services— to lose control of an agency.

Do you anticipate the SEC and CFTC merging, or are you also talking about bringing together not only the securities side, but also the banking side with Fed and OCC and the FDIC, and ending up with one sort of super economic regulator.

Relatedly, do you also anticipate preempting state laws such as Martin laws or the Blue Sky laws? Do we do want to continue to have a situation in which, for example, Eliot Spitzer or his successor, Andrew Cuomo, can try to run the national economy using some 19th century New York statute? Could I get you to just elaborate on that briefly?

HON. MR. TERWILLIGER: Sure.

I'll be glad to briefly answer a question that would require a couple of hours to answer substantively. Realistically, we can only, at this point, address that in the broadest possible strokes. I think that it requires some pretty careful and studied analysis before we do make major moves like that. And I want to really underscore, if I may, the importance in terms of—this is part of the bubble law that comes out of this one—of really hoping that there is a bipartisan, substantive approach to this and that politics and gaining some incremental and rather temporary political advantage, isn't what drives this thing, as has so often been the case.

It does make sense to me that the regulatory structures and the enforcement structures that govern the financial community, if you will, ought to mirror what actually goes on out there in the real world, and thus having the agencies that regulate the securities markets, which include the SEC and the CFTC, joined, does make sense to me, to put the securities agencies under one umbrella. Likewise, there is at least superficial appeal to having the banking agencies be under one umbrella, although that may require some redefinition to reflect reality of what the FDIC's role is beyond merely being the insurer of bank accounts.

The state law question is certainly politically more difficult, but also this circumstance may present and opportune time to address that, and without casting aspersions on any particular individuals you may or may not have mentioned—and I did notice that you left the infamous district attorney from New York County out of your litany—the fact of the matter is that there is rivalry, and including political rivalry often, between some of the state authorities and the federal authorities to be the first to jump on this bandwagon.

All that being said, however, I think we all can easily recognize that a lot of the market itself overlaps, particularly since the repeal of Glass-Steagall.[15] Goldman Sachs is now a regulated bank holding company, which is going to fundamentally change the way it's regulated. We ought to hear not from the people whose ox would currently be gored but really from the academic community and some people who really understand the practical effects of regulations.

Finally, let me try to just reiterate the point I made at the end of my remarks earlier. I think this is a golden opportunity to return the purposes of federal regulation to the core purposes that the federal establishment exists to serve in regard to commerce, and that is by promoting commerce, by protecting the means and instrumentalities of commerce, and protecting the institutions that are necessary to the flow of commerce from fraud, both externally and internally.

If we start from the premise that that should be the objective of this whole regulatory environment, I think we will wind up with

[15] Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (codified in scattered sections of 12, 15, 16 and 18 U.S.C.) (repealing Glass-Steagall Act of 1933, Pub. L. No. 73-66, 48 Stat. 162).

something much better than we've had to date, and perhaps quite different.

PROFESSOR BAINBRIDGE: Thank you. Just on the state issue, many of you may know I blog at a website called www.professorbainbridge.com. One of my earliest blog posts was entitled, "Can you be a competitive Federalist and still want to put Eliot Spitzer out of business?" The answer I gave was an affirmative one, and I'll link to it on my blog when I get a chance for those of you that want to go back and see that.

Professor Macey, you said we already take the SEC too seriously. Would we take a unified financial agency even more “too seriously"?

PROFESSOR MACEY: No, that’s a very good and fair question. Just to allow myself to clarify, to some extent, my analysis would also apply not only to the SEC but to the credit rating agencies. People say, “Gosh, the credit rating agencies did a really lousy job in rating all these CDOs, these collateralized debt mortgage obligations, and so maybe they’re to blame for this crisis too.” It’s a non sequitur, because if you look at the prices at which these assets traded, the market discounted heavily the very, the high AAA, these AAA ratings that these securities really got. People didn't take it very seriously.

I completely agree with this idea of consolidating, but why is it that we want to consolidate? The reason we want to consolidate regulation is to make it rational, to have similarly situated competitors regulated in comparable ways. All the arguments that are made for rationalizing our patchwork quilt of regulation, many of them I find amenable. But it's not addressing the financial crimes.

The only way to address the financial crisis is to cause the firms and the individuals who are taking big risks and getting big rewards—this is exactly Professor Kitch's point—to internalize the costs associated with taking those risks and getting those rewards. We don't do that. We're running away from that, and I don't think that moving to a single regulatory agency would do much to correct that problem, in fact, so I don't think it would—my short answer, Stephen, is no, I don't think that would help.

PROFESSOR BAINBRIDGE: Professor Kitch, you defended the SEC against accusations that it had been responsible for the financial crisis. Would you defend it from efforts to merge it into a single, unified financial regulator?

PROFESSOR KITCH: Well, I'd have to see the proposal. The idea, of course, is modeled on the structure of the English regulation which has not done any better in this particular crisis.

Let me speak up a bit for Chicago. You can argue the CFTC and the statute has played important role in introducing to world financial markets very important instruments that probably would not have been introduced or introduced as quickly if the SEC had had exclusive jurisdiction.

There's regulatory competition between the New York and the Chicago markets, and the CFTC structure gave the Chicago markets freedom to experiment and innovate. The problem with a unified master regulator, if you're going to go that way, is that its ability to control competitors means that it can suppress useful innovation. For instance, should a unified regulator control both the securities industry and the banking industry? Query: why shouldn't a unified financial regulator control the criminal side of the enforcement of their statutes, rather than have the Department of Justice handle criminal cases?

If you create a super regulator sitting astride the financial services industry, including the banks, and you gave it the full range of powers, I think it would lead to a lot of rigidity. The lower offices that would focus on one part of this huge swath of the economy would, of course, have to get clearance up the line from the top people. That would slow things down and could have very bad effects.

The discussion in a way reminds me of the discussion about the organization of the intelligence agencies and the need for centralization and the creation of the intelligence czar. It’s not clear whether that's an improvement or not. Centralization/decentralization involves very difficult trade-offs.

PROFESSOR BAINBRIDGE: Certainly, all the evidence suggests that the creation of the Department of Homeland Security has not been a stunning bureaucratic success, and the idea of replicating that on a part of the economy as important as financial services is certainly questionable.

Commissioner Atkins, I don't know if this is a question you care to jump in on, or—

COMMISSIONER ATKINS: I think it's clear that there will be restructuring. There will be some sort of law that comes out of Congress. I agree with George and others about some of the dangers that are coming up. When you look at what the SEC is overseeing now, there are, as George said, there are no more large international investment banks anymore. They're either out of business or acquired by bank holding companies or they have themselves become bank holding companies.

So, with an FSA-type entity in the US, would that work? The blueprint that you alluded to sets out three different regulators, and the SEC would morph into a sort of a conduct-of-business regulator.

The simple merging of the SEC and CFTC might sound appealing, but it has a lot of issues to be resolved that are not so simple. There are culture issues as well as big differences of legal framework. The CFTC regulates mainly—on the financial services side—the institutional marketplace; SEC is more retail. There are also global issues. Some of the problems, for example, regard CDSs. They were mainly booked in London, not in the U.S., because of capital issues and other compliance issues. So, the investment banks then went overseas, so you have an international component.

You look at Lehman Brothers—it was unfortunate that it failed. Its failure really was a catalyst for a lot of the current problems. But, there was an important international component. Many of the problems arose because the FSA apparently was not willing to step in and guarantee some of the instruments that were booked in London.

So, we have other issues that will come up in any sort of re-jiggering of the laws, like remember *Stoneridge* [*v. Scientific Atlanta*[16]], that case that the Supreme Court that decided just about a year and a half ago? I guarantee that that will be raised in the debate of any new law, when you consider the make-up of the new Congress. That case concerned so-called scheme liability, where even if you were not an issuer of securities, you could have Rule 10b-5 liability with respect to investors in a publicly traded company.

So, I think ultimately we have to remember what Friedrich Hayek said in his book, *Fatal Conceit*, back in 1989. He said we cannot shape the world around us as much as we might like to try, and we could do more harm than good if we try.

PROFESSOR BAINBRIDGE: Thank you.

It is fascinating to me that a year ago, I was traveling around the country talking about problems with capital flight, companies going private, the IPO market in the United States shifting abroad, and the resulting need for reform of Sarbanes-Oxley.

The mood is very different today. Those of us who believe in free markets and free financial markets have gone, in very short order, from being on the offensive to being on the defensive in an environment that is as hostile to preservation of free markets as I can remember.

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[16] 128 S. Ct. 761, 169 L. Ed. 2d 627 (2008).

Let's open it to the floor for questions and answers.

JOHN ROLAND, CONSTITUTION SOCIETY: I'd like the panel to focus more on creative solutions that have not yet been discussed here. It seems clear that the conventional approach of yet another post-bubble law, new regulatory standards and rules are not going to do the job. Nobody ever got hired, promoted, rich, or popular by pricking bubbles before it was their time to burst. We need to find a way to bring in an intervention is not bound by rules designed for the last situation.

And I'd like for you to address the possibility of using the traditional grand jury system as an investigatory arm to simply go in, poke around with no particular rules in mind, other than to look for ways that things could go wrong and look for ways that creative money managers may be trying to avoid, any regulation, any rule, any law that anyone might try to devise, and thereby reducing the overconfidence that tends to result in bubbles developing.

PROFESSOR BAINBRIDGE: Thank you. Anybody want to take that?

HON. MR. TERWILLIGER: As somebody who's spent a lot of time grand juries—fortunately as a prosecutor, not as a subject—I'll just take a quick crack it and also use as a segue to react to something that Professor Kitch said in his remarks a few minutes ago.

I want to note at the outset that I thought Professor Kitch made a really good point about the existence of the Chicago futures market leading in products that we might not otherwise have, and I took it, if you weren't express about this, that a stifling regulatory bureaucracy may have just proven too much for those things to come into existence, and that's a point well taken. It doesn't dissuade me from the need to change the way we're doing things, but I do think it's a good point.

I think the last thing we ought to do is encourage more criminal enforcement, whether it's by giving criminal enforcement power to regulatory agencies or, as John just suggested, empowering grand juries go around in the financial market.

What we do need, however, is more discretionary enforcement and the power of persuasion to look at larger goals. If any of you have ever dealt with a Federal Reserve inquiry, one of the things you understand is, unlike a lot of regulatory agency inquiries, there are really two sets of rules at work. There are the rules that govern what banks and bank holding companies can and cannot do, and then there are the rules of the club. And it's just as serious to violate the rules of the club as it is to violate that the technical terms of the regulation. There is real power and benefit in that.

BRIAN WALSH, HERITAGE FOUNDATION: First, I'd just like to thank Commissioner Atkins for his leadership on the attorney-client privilege issue. I bring it up partly because the SEC has changed its policy, and it's a good example of how the federal government overreacted to some of the problems of the last meltdown.

I'm deeply concerned that we're still trying to solve a problem that doesn't exist to some extent. Before I went to law school, I was a software engineer for a number of years, and there's a saying that says "garbage in, garbage out." I think really that's what we're looking at in this instance, and there's been a huge and very successful campaign to message that the underlying asset is not the problem here. But we know that the Cleveland Fed, for example, reported that from 2000 through 2006, the default rate on subprime mortgages was 400 to 600% higher than was on prime mortgages. And an economist in our shop said last month that the default rate about 60 days ago was above 50%. So, that's really what we're looking at.

We had a meltdown in tech stocks, we had a meltdown in telecom, both of which had something to do with violating the fundamental principles of what an asset should look like and whether it's a sound asset. Here again, we're looking at a robust unprecedented regulatory scheme for the United States, and yet the messaging on Capitol Hill has been entirely looking at the back end, not looking at front end, that we had a terrible asset that failed and it's continuing to fail in unprecedented numbers.

So, I'd just like to know what your response is to that and how do we change that messaging if my own analysis is correct.

PROFESSOR BAINBRIDGE: Actually, I'd like to take a crack at that. It goes back to the question of what can we do positively. I don't expect it to happen given the politics of the situation, but one of the things that ought to come out of this episode is a fundamental rethink of housing policy in this country and, in particular, the Bush administration ownership society policies. Home ownership peaked under the Bush administration and it's not clear to me that that was a good thing. There are people who are too risky for them to give long-term loans, particularly on the terms that were available during the bubble.

This presents, I think, an interesting opportunity for a conservative-liberal coalition to rethink housing policy. One result of the "everybody ought to own their own home" policy has been sprawl, because almost everybody wants a single family residence on their piece of land. So there is an interesting opportunity here for constructive dialogue with the left on how we construct a housing policy that's both financially and economically and environmentally sustainable.

But that is way beyond the scope of this panel.

HON. MR. TERWILLIGER: Steve, can I just react to one piece of what you said there for a minute because I think you and I have both said this is a time of opportunity to address some things that are important.

One of the reasons I was particularly honored and gratified to join a panel, I won't put Paul in this category, but of such distinguished academics here, is because I think it's critically important that the people who have the time and the inclination and the ability to sit and actually think about these issues be heard in this because there are many people in this room and in the Federalist Society who have watched the sausage being made. It is an ugly, unthoughtful process. And these are critical issues to our future, so I really encourage that—I know it is beyond this discussion, as you say—but it is really important that you and your colleagues be heard on these things.

PROFESSOR BAINBRDIGE: I blogged on it with some regularity.

AUDIENCE PARTICIPANT: It seems to me that multiple hedge fund managers published pieces about the condition of financial services firms, including, well, basically all of them, signed and disclosed that they had an interest. The regulatory sort of response seems to be a great deal of concern about their motives and whether they might be manipulating markets again and not about the substance of their arguments, particularly when what they're putting forth that have inaccurate financial statements. Would not a regulatory regime that focused on speech and disclosure and actually encouraged that kind of thing be a better regime?

I can tell you, I mean, the SEC is completely unhelpful on questions of disclosure. You should tell them here are company's financial statements, here's what we think we should know, here's what we think are material questions that are in there, and a company won't put out an 8-K; would you be helpful? No.

COMMISSIONER ATKINS: Well, a lot of this comes down to the fear of litigation. Until we really have litigation reform in the country, it's a problem because people are afraid to speak out and say things. Then the whole panoply of rules that have to do with what you can say before, during, or after a public offering, including Reg. FD and others, all impinge on that.

HON. MR. TERWILLIGER: Exactly—it seems that most of the regulation is directed, or much of the regulation, is directing at limiting speech —

COMMISSIONER ATKINS: Control of speech.

HON. MR. TERWILLIGER:—and control of speech as opposed to a sort of disclosure of your interest and substance of your argument. As long as you disclose sort of your interest and it's signed, should not the SEC be encouraging speech and encouraging disclosure and so forth, instead of being concerned that their nefarious motives behind—

COMMISSIONER ATKINS: A departure from that norm is after the whole Enron and the WorldCom and the research analysts, some of the practices that came out of the regulations that the SEC put out to require analysts to disclose their holdings and that sort of thing.

PROFESSOR BAINBRIDGE: There is, I tell my class in securities regulation, the little-known codicil to the First Amendment which says the SEC can do whatever it wants.

Jon, Ed, would either of you like to address the question?

PROFESSOR MACEY: I completely agree. It's a given, other than to say it's probably not a little-known codicil, but it's certainly a codicil.

PROFESSOR BAINBRIDGE: All right.

MIKE FRANSELLA, MORRISON & FOERSTER: I was at a conference about a month ago, where there was a panel that discussed likely regulatory changes coming out of this. And the predominant view there seemed to be that it was more likely than not that we would move to an FSA-style single regulator or to, I think it was referred to as Twin Peaks regulator, the Australian model I think it was, where you have one agency dealing with consumer protection issues and the second dealing with sort of standard practices, the way that the firms themselves operate.

I'm hearing more skepticism on this panel about that kind of fundamental change, so I guess I was wondering if any of the panelists would care to put on their prophets' hats and have any ideas about the relative likelihood of moving to one of those or the other versus staying as we are, with little or no significant change, perhaps just a merger of the SEC, CFTC and what not.

PROFESSOR MACEY: Steve, I'd like to just very quickly go back to something Stephen said. One of the things you have to focus on when you're trying to predict what consolidation will look like is a look at the committee structure in Congress, look at kind of who's gaining power, who's losing power. And one of the big problems with consolidation is that people are going to have to give up chairmanships and oversight and budgetary controls.

So, one thing that I think is useful to do is to think of where can we have regulatory reform which will result in a net increase in power for Congress? And the obvious answer to that, of course, is preemption of state law. So, the idea that, it's kind of an amazing thing to step back and think about it, that the one exception to the systematic nationalization of law has been U.S. corporate law, which until Sarbanes-Oxley remained vastly in the province of the states, and we have a robust jurisdictional competition for public chartering.

My guess is that we're going to see more of what we got with Sarbanes-Oxley in terms of incursions on state corporate law, which will move power to Washington without hurting anyone's committee positions. And I think that I think that Paul Atkins is absolutely right with respect to [*Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*[17]] and *Stoneridge*, that, this is going to be an open buffet for the plaintiffs' class-action lawyers.

PROFESSOR BAINBRIDGE: We'll take one last question up here, up front, and then we have to break.

BONNIE WACHTEL, SECURITIES BROKER: My question is for Commissioner Atkins.

In the course of my career, I remember after the crash of 1987 and, I believe, after the events of 2001, the SEC took some immediate steps.

In this case, you have, the SEC has its finger directly on the pulse of three intensely pro-cyclical elements of the problem, one being naked short selling, which is a rule that is still not being fully enforced. The second is mark-to-market accounting. I have no objection to having it in a footnote for information purposes, but it's there currently for regulatory purposes other than whatever has been cooked up in the last week or so. And the third is the monopoly of the rating agencies, which the market may not give a damn about them, but they're written into debt covenants and insurance contracts, which is the problem.

[17] 511 U.S. 164 (1994).

Now what I would have hoped that the SEC would do—and I'm a big believer in countercyclical action as part of what a regulator can do, and even if you can't pinpoint bubbles and crashes, you can measure them by standard deviation or in some independent, unbiased way and be countercyclical in your regulations. I would expect the SEC to have had some crisis management team here to act very quickly to be moving in that direction, to be changing things, boom, because they see some magnitude of the problem led by the feds.

And I'm just wondering, is that happening and I'm not seeing it? Can that happen? Any hope for that? That's just under the current structure. You don't have to put everything together, even preempt the states.

PROFESSOR BAINBRIDGE: Paul, I need you to answer that in crisis management speed mode.

COMMISSIONER ATKINS: In two seconds, yes.

Well, there's a huge amount, obviously, to talk about on that topic. I have a lot of confidence in most of the folks that are at the SEC. For example, similar to after 9/11, they did ease restrictions to allow corporations to buy back stock. During the recent crisis back in September, I think they had a rule that came out to allow that.

Then, with respect to naked shorting, that's a huge issue. Some steps that I had thought they were going to take immediately when I left the Commission, unfortunately, did not get done. For example, I think it would be helpful to have a penalty if you short a stock but do not follow through in borrowing it and delivering it because you don't want to pay for borrowing it. You sort of kick the can down the road. That sort of thing, if it is allowed to go on, is a problem. I think that fosters some of the issues in short selling.

But some of the ad hoc rulemaking—for example, outlawing shorting completely in the market place—contributed a lot to the panic in September, caused a lot of problems for hedge funds, and exacerbated the volatility of the marketplace. It's a huge issue. We'd have to treat it some other time when we have more time, but I agree generally with your sentiments.

PROFESSOR BAINBRIDGE: Thank you all very much.

I would first like to single out for special thanks Commissioner Paul Atkins, although not only for his excellent participation in this forum to day. As Jon Macey said, Paul was an exceptional SEC commissioner and a powerful voice for free markets and American competitiveness during his time in the Commission. So I'd like to us to single him out for special thanks.