

**Questions from Senator Carl Levin for
Mary Schapiro, Nominee to be Chair of the Securities and Exchange Commission
January 8, 2009**

Market Oversight

1. In 1998, former Securities and Exchange Chairman Arthur Levitt, Treasury Secretary Lawrence Summers, and Federal Reserve Chairman Alan Greenspan all opposed an attempt by the Commodity Futures Trading Commission (CFTC) to examine the over-the-counter (OTC) swaps market and then supported statutory restrictions on the SEC's and CFTC's authority over swaps in the Commodity Futures Modernization Act of 2000 (CFMA). Former Chairman Levitt recently stated that he now regrets the position he took during those years: "The market was too large, too explosive in growth to merely allow pure market forces to suffice as self-regulatory mechanisms. I have some regrets about it, clearly." In October 2008, Mr. Levitt wrote: "Our nation's financial markets are in the midst of their darkest hour in 76 years. We are in this situation because of an adherence to a deregulatory approach to the explosive growth and expansion of America's major financial institutions. Our regulatory system failed to adapt to important, dynamic and potentially lethal new financial instruments as the storm clouds gathered."
 - a. Do you agree with former Chairman Levitt's statement that our regulatory system has failed to adapt to the development of new financial instruments and that the positions taken in 1998-2000 to deregulate markets was, in retrospect, a mistake?
 - b. Should SEC oversight be strengthened with respect to new financial products, including new derivative and complex structured finance products, and, if so, how?
 - c. Would you support repealing the statutory prohibitions in the CFMA on federal regulation of swaps? If so, should these swaps be regulated as commodities or securities?
 - d. What would you do to get credit default swap clearing functions up and running?

Response: As the events of this past year have made clear, one of the problems with our financial regulatory architecture is that there are large gaps in it, leaving important products and market actors beyond the oversight of regulators. Investors deserve to have quality disclosure about all products, actors, and strategies so they can make smart investing decisions, and our markets absolutely require this information, as well as a strong cop on the beat to enforce the rules of the road. With regards to swaps, I personally have supported the repeal of statutory prohibitions in the CFMA on the federal regulation of swaps and I believe that centralized, mandatory clearing of standardized swaps should be required.

2. Former Federal Reserve Chairman Alan Greenspan testified in October that he, too, now believes that the conceptual framework underlying the deregulation of swaps in the CFMA was a mistake. Mr. Greenspan testified: "I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such as that they were best capable of protecting their own shareholders and their equity in the firms. . . . So the

problem here is something which looked to be a very solid edifice and, indeed, a critical pillar to market competition and free markets did break down.”

- a. Do you agree with Mr. Greenspan’s recent statements that the financial collapse of 2008 has demonstrated the errors in the assumptions underlying the deregulatory approach in the CFMA? Can we rely on market participants and unfettered free market forces to prevent systemic risks and unreasonable price fluctuations?

Response: I believe that markets need oversight and regulation to ensure that operate fairly.

- b. Do you support stronger regulation of securities markets to protect market participants and prevent systemic risks, and, if so, how?

Response: I believe that all systemically important market participants and products need to be brought under the regulatory umbrella.

- c. Should SEC user fees be increased to fund additional oversight capabilities?

Response: I have not yet had an opportunity to do a thorough review of the SEC’s budget or resource allocation. It is probably safe to say however, that the agency has not been funded at a level commensurate with its responsibilities. I believe additional oversight capability is essential and I look forward to working with Congress to ensure that the agency has the resources it needs.

3. What are your views on whether and how SEC oversight be strengthened with respect to:

- a. the holding companies of securities firms?
- b. hedge funds?
- c. companies that are not broker-dealers, but buy and sell financial swaps and other products, like AIG Financial Products?

Response: I believe that all systemically important financial institutions need to be regulated. I would specifically endorse the registration of hedge funds .

4. Should the SEC strengthen capital requirements for broker-dealers?

- a. At the time they were made in 2004, did you support the revisions by the SEC to the net capital requirements rule? Do you support those changes at the current time or should the SEC restore the prior rule?
- b. Should the SEC impose stronger capital requirements on broker-dealers that trade in over-the-counter derivatives or complex structured financial products?

Response: I did not take any position in 2004 regarding the net capital requirements rule. Moving forward, I believe that we need to strengthen capital requirements across the board.

5. What is your view of the relationship between the SEC and federal banking agencies with respect to banks that buy and sell securities? How can this relationship be improved?

Response: It’s important that all the regulators in our system work collaboratively in ensuring that investors are protected and that the markets are operating soundly. Moving forward, we need to close the gaps in our regulatory system, a system that is too stove-piped allowing determined market actors to avoid oversight. As we work to reform the financial regulatory architecture this should be a priority.

6. What lessons should be learned from the recent collapse of the markets for asset-backed securities, collateralized debt obligations (CDOs), structured investment vehicles (SIVs), and auction-rate securities? Should the SEC attempt to restore the markets for these products? Should the SEC make distinctions between these categories of products and, if so, how and why?

Response: The biggest lesson from these market collapses is that we cannot allow financially important products that have a massive impact on our markets and our economy to operate in our system without high standards of oversight, transparency, and accountability. As Chair of the SEC, I will move aggressively with my fellow Commissioners and working with members of Congress to close the gaps in our regulatory structure and bring these markets under control.

7. What needs to be done to resolve the conflicts of interest affecting credit rating agencies? What can be done to restore their credibility?

Response: As early as 1994, I've called for stronger regulation of credit rating agencies when, at that time, it became increasingly clear that their importance to the markets was outstripping the amount of oversight. Since then and especially this year, there are real questions about conflicts of interest and transparency that have surfaced. Moving forward on credit rating agency reform is a top priority of mine. We need to examine how the rating agencies are compensated, how they manage conflicts of interest, and what role they should play in our markets. There are some interesting proposals out there that need to be studied. I look forward to working with you on this issue.

8. In 2004, Congress enacted legislation imposing a one-year cooling-off period before federal bank examiners could take a job with a bank they oversaw. If confirmed, would you support a similar cooling-off period for securities regulators?

Response: Now more than ever, it's critical that the SEC is able to attract a new group of highly qualified and motivated individuals to serve in the agency. As we do that, we need to balance this need with the highest standards of ethics and accountability for SEC employees to ensure that the public good is always first and foremost in their minds. I look forward to working with you on this matter and to learning from the bank regulators about their experience with post-employment restrictions. .

Financial Accounting Standards

9. What is your view of the relationship between the SEC and the Financial Accounting Standards Board (FASB)? What is your view on whether Congress should legislate accounting rules?

Response: The SEC needs to diligently oversee the FASB to ensure that accounting rules are keeping pace with innovations in the markets and the needs of investors of clear, usable financial

reporting. I believe that FASB needs to be shielded from outside economic and political pressures, and that they and not Congress should write accounting rules.

10. The SEC recently issued a report supporting the existing mark-to-market valuation rules, but recommending some improvements. What is your view of the current mark-to-market valuation rules?

Response: We know that certain banks were not presenting investors with the full picture of their financial health, utilizing off-balance sheet vehicles and other accounting methods. This was a disservice to investors as the integrity of the numbers is critical to their making smart investment decisions and to the smooth functioning of our markets. While there are a lot of different views on whether mark-to-market accounting contributed to this crisis, my personal view is that it was not a significant factor. As Chair, I will read the recent SEC report on this matter fully, talk with other regulators, and get their views as we move forward.

11. Do you believe U.S. banks have fully applied mark-to-market valuations to the structured finance transactions on their books, including asset-backed securities, credit default swaps, and CDOs? Do you believe inaccurate valuations are currently impeding U.S. credit markets? If confirmed, what actions would you take to insure accurate book valuations for U.S. banks?

Response: I am not in a position at this time to opine on whether US banks fully and appropriately applied mark to market valuations. See above.

12. Current SEC Chair Christopher Cox has indicated that he thinks the SEC should allow U.S. publicly traded companies to use international financial reporting standards (IFRS) issued by the International Accounting Standards Board (IASB) instead of U.S. generally accepted accounting principles (GAAP) in their financial statements.

- a. Do you believe the Sarbanes-Oxley Act allows the SEC to delegate the development of U.S. accounting standards to the IASB? If confirmed, would you try to advance such a proposal?
- b. Section 404 of the Sarbanes-Oxley Act requiring auditors to review a company's internal controls has still not be applied to publicly traded small businesses. If confirmed, would you allow Section 404 to take effect for small businesses without additional delay?

Response: When it comes to international accounting standards, it's critical that these standards are converged in a way that does not kick off a race to the bottom. American investors deserve and expect high standards of financial reporting, transparency, and disclosure -- along with a standard-setter that is free from political interference and that has the resources to be a strong

watchdog. At this time, it is not apparent that the IASB meets those criteria, and I am not prepared to delegate standard-setting or oversight responsibility to the IASB.

Regarding, SOX 404, accurate, robust, and easy-to-understand financial reporting -- and the internal controls that guarantee it -- are critically important to investors and to the efficient functioning of our markets. Right now, we have a system where some issuers are complying with 404 and others are still exempt from it. It's time that we bring uniformity to the system so that investors know what to expect from companies, while being sensitive to the needs of small businesses. I look forward to working with the small business community in making sure they have the tools they need to comply with 404.

13. What is your view of FASB's accounting standard requiring stock option compensation to be treated as an expense on corporate financial statements? If confirmed, would you support efforts to change this standard? If so, what changes would you support?

Response: No, I would not support changing this decision.

14. In 2004, the Office of the Comptroller (OCC) and the Office of Thrift Supervision (OTS) in the Treasury Department, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Securities and Exchange Commission (SEC) issued a proposed Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities ("Interagency Statement on Sound Practices"). In 2006, the same agencies issued a revised proposal and, in 2007, a final statement.

- a. Did you participate in any discussions or provide any comments on the 2004, 2006, or 2007 guidance? If so, please describe the circumstances, including the date, persons involved, and the issues addressed.
- b. Did you support the proposed guidance at the time it was issued in 2004?
- c. Did you support the revisions proposed in 2006 and adopted in the final guidance at the time it was issued in 2007? Do you support those revisions now?
- d. The Interagency Statement on Sound Practices became effective on January 11, 2007. According to the statement, the OCC, OTS, Federal Reserve, FDIC, and SEC were to use the Statement as guidance for reviewing the internal controls and risk management policies, procedures, and systems of financial institutions engaged in Complex Structured Finance Transactions (CSFTs) as part of their ongoing supervisory process. Were you aware of this guidance, and do you know if the guidance was regularly applied and adhered to by securities firms since its effective date?

- e. The Interagency Statement indicates that CDOs and credit default swaps (CDS) typically would not be considered to be CSFTs subject to the guidance. In light of the role played by CDO and CDS transactions in the current financial crisis, would you support revising this approach so that CDO and CDS transactions are covered by the Interagency Statement on Sound Practices?

Response: I did not participate in discussions surrounding the 2004, 2006 or 2007 guidance. I think it would be appropriate to consider whether the Interagency Statement should be expanded.

Public Company Accounting Oversight Board

- 15. What is your view of the relationship between the SEC and the Public Company Accounting Oversight Board (PCAOB)?

Response: In addition to its oversight responsibilities, the SEC should ensure that the PCAOB has what it needs to enforce the rules of the road for auditors.

- 16. Chairman Cox has indicated that he thinks the PCAOB should stop inspecting auditing firms in other countries and instead delegate its inspection authority to foreign oversight bodies where those firms are located. Do you believe the Sarbanes-Oxley Act allows the SEC to make this delegation? If confirmed, would you try to advance such a proposal?

Response: No, I do not; and no, I will not.

Financial Institutions Facilitating Tax Abuse

- 17. The U.S. Treasury loses an estimated \$100 billion each year from offshore tax abuses, some of which are facilitated by broker-dealers. If confirmed, would you work with the IRS to curb such activities? Do you support enactment of S. 681 from the 110th Congress, the Levin-Coleman-Obama Stop Tax Haven Abuse Act?

Response: Yes. I look forward to working with the Internal Revenue Service, you, and other Senators to curb such activities.

- 18. Some financial institutions are facilitating tax-dodging by non-U.S. persons. In particular, the Senate Permanent Subcommittee on Investigations, which I chair, held a 2008 hearing showing that U.S. firms like Morgan Stanley, Lehman Brothers and others have helped offshore hedge funds and others to avoid payment of U.S. taxes on U.S. stock dividends, by assisting them to convert taxable U.S. stock dividend payments into allegedly tax-free dividend equivalents or substitute dividend payments. If confirmed, would you support ending this activity by securities firms?

Response: Yes.

Investor Rights and Protections

19. Former SEC Chair William Donaldson proposed establishing a mechanism to allow certain shareholders of publicly traded corporations to nominate a candidate to the board of directors. If confirmed, would you support a rule to allow shareholder nominations of some board members?

Response: Yes. A central tenet of our market system is that shareholders are the owners of the company in which they hold shares, and they should have a way to hold their representatives – members of the board of directors -- accountable for their actions. Access to the proxy has been debated for many years, and I believe it is time for a thoughtful approach to proxy access for significant, long term shareholders.

20. What is your view of the compensation paid to executives and market traders at financial institutions? If confirmed, would you support a rule to allow shareholders to express an advisory opinion on executive compensation?

Response: Yes. Like you and millions of Americans, executive compensation has been a concern of mine for some time now, and I believe that it's an appropriate measure to give shareholders an advisory vote on these matters.