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NOMINATION OF WILLIAM H. DONALDSON

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

ON

NOMINATION OF WILLIAM H. DONALDSON, OF NEW YORK, TO BE A MEMBER OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

FEBRUARY 5, 2003

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C O N T E N T S

WEDNESDAY, FEBRUARY 5, 2003

	Page
Opening statement of Chairman Shelby	1
Opening statements, comments, or prepared statements of:	
Senator Sarbanes	2
Senator Schumer	4
Senator Clinton	6
Senator Bennett	7
Senator Johnson	8
Prepared statement	48
Senator Enzi	9
Prepared statement	48
Senator Corzine	10
Prepared statement	49
Senator Dole	12
Prepared statement	50
Senator Carper	12
Senator Dodd	13
Senator Chafee	14
Senator Stabenow	14
Prepared statement	51
Senator Allard	15
Prepared statement	52
Senator Bayh	16
Senator Crapo	29
Senator Santorum	52
Senator Bunning	53

NOMINEE

William H. Donaldson, of New York, to be a Member of the U.S. Securities and Exchange Commission	18
Prepared statement	54
Biographical sketch of nominee	55
Response to written questions of:	
Senator Bunning	84
Senator Hagel	85
Senator Enzi	86
Senator Crapo	88
Senator Miller	88
Senator Stabenow	89
Senator Reed	90
Senator Corzine	91
Senator Dodd	92
Senator Santorum	94
Senator Bennett	95

NOMINATION OF WILLIAM H. DONALDSON OF NEW YORK, TO BE A MEMBER OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

WEDNESDAY, FEBRUARY 5, 2003

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:03 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The Committee will come to order.

Today, we are here to consider the nomination of Mr. William H. Donaldson, to be Chairman of the U.S. Securities and Exchange Commission.

Mr. Donaldson, we welcome you to the Committee.

Mr. DONALDSON. Thank you, Senator.

Chairman SHELBY. It is my intention to follow the same procedure that this Committee has used in the past. I will make my opening statement. I will then recognize the Chairman—former Chairman Sarbanes—I still call him that.

[Laughter.]

For his opening statement. I will then recognize any of our other colleagues who wish to make their opening statements. After Mr. Donaldson is sworn in and makes his statement, we will proceed to questions. I would ask my colleagues to limit their questioning to 5 minutes, and then have additional rounds of questioning, as necessary.

We stand at a critical time in the history of America's capital markets. Our capital markets, which are the envy of the world, have been shaken by scandal and corporate malfeasance. We have all suffered accordingly. Investors have seen trillions of dollars of market capital evaporate.

Despite the swift reaction of this Committee, led by my colleague, Senator Sarbanes, the Congress and the Administration, in passing the reforms embodied in the Sarbanes-Oxley Act, investor confidence continues to flag. And the reverberations of this crisis of confidence are felt beyond Wall Street. Its impact is felt throughout our Nation's economy and continues to impede a strong economic recovery.

We describe our capital markets with words like "efficient" or "transparent." And it is true we have the most efficient and transparent markets in the world. But the bedrock of our capital markets is integrity. Without integrity, there can be no such thing as rational investor confidence. Since our capital markets fuel the engine of economic growth in this country, the growth and strength of our economy relies on investor confidence in the integrity of our markets. And few people have as important a role to play in safeguarding the integrity of our markets as the Chairman of the SEC.

As the agency charged with investor protection, the SEC has always played a crucial role in ensuring the integrity of our capital markets. By and large, it has been highly successful in that role. Ours is the first society in history where equity ownership is commonplace among ordinary citizens.

But recent events have left investors nervous and morale flagging at the SEC. Rebuilding morale, I believe, Mr. Donaldson, must be a top priority of the next Chairman of the SEC. Today's SEC must be more nimble, more proactive, more efficient than ever before. This will require strength and take-charge leadership at the top. As Wall Street's "Top Cop," Mr. Donaldson, you will have to ensure that our securities laws are enforced zealously and without regard for wealth, position, or power.

As Chairman, Mr. Donaldson, you will be undertaking a tremendous public trust. We live in a world where technology is constantly reshaping the marketplace. The Commission must jealously guard the integrity of our capital markets in order to ensure that in an increasingly global economy, these markets maintain their preeminent position. This will require a firm hand, but also patience, determination, and resolve.

Mr. Donaldson, your leadership will be key to rebuilding the faith of investors in our markets. The next Chairman of the SEC will have an incredible opportunity.

Mr. Donaldson, your résumé speaks for itself. Your background and experience give you a unique perspective into the challenges that we face today. You have the credibility and standing in corporate America and on Wall Street to demand the high standards of professional conduct. Indeed, you have an opportunity to set a new tone for corporate governance and responsibility.

It could be a new day for our capital markets, a new day based on integrity and best practices, rather than cynicism and manipulation of loopholes.

I know that my colleagues on our Committee and I support the SEC in achieving its mission, but the SEC requires strong leadership from within. We will expect you, Mr. Donaldson, to provide that leadership.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman, I am pleased to join with you in welcoming Mr. William Donaldson this morning to the Committee. President Bush has nominated Mr. Donaldson to be a Member of the Securities and Exchange Commission and to serve as its Chairman.

As you have indicated, the United States securities markets have been an economic asset, a very important economic asset, not only of our own economy, but, indeed, of the world economy. The Chairman of the SEC plays a critical role in promoting the integrity, the strength, and the efficiency of these markets and inspiring trust and confidence among investors. In my view, protecting investors, ensuring the fairness and integrity of our securities markets, and aggressively enforcing the securities laws are the primary functions of the Securities and Exchange Commission.

Unfortunately, in the last few years, the securities markets have experienced a significant erosion in public confidence. Investors have seen too many instances of public companies with faulty accounting and inadequate or misleading disclosures, unreliable auditor certifications, and analysts giving misleading stock recommendations. As *Fortune* magazine observed, there were, and I quote them: "Rampant conflicts of interest on Wall Street. Wildly creative accounting. Auditors who didn't audit. Money managers who didn't manage. A stunning lack of oversight by regulators."

The consequences for American families, for American workers, and for investors have been profound. The aggregate value of the publicly-traded stocks has declined by trillions of dollars over the past 3 years. State pension plans have been really hard hit. The retirees have seen their retirement savings dry up, while millions of working Americans have had to put their retirement plans on hold. Tens of thousands of working men and working women have lost their jobs—at Enron and WorldCom alone, just those two, more than 30,000.

It was precisely to address these and other related urgent problems that the Congress last summer overwhelmingly approved the Public Company Accounting Oversight and Investor Protection Act, which the President signed into law and noting it as being the most far-reaching changes in our securities laws since the 1930's.

Now it is the responsibility of the SEC to promulgate regulations that fully implement the letter and spirit of the new law, to engage in strong oversight of the securities market participants and to vigorously enforce the laws. Clearly, the SEC needs to take decisive actions to restore public confidence.

In addition, the SEC must appoint for the new Public Company Accounting Oversight Board a Chairman, selecting someone, as the statute provides, "of integrity and reputation who have a demonstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers . . . and the obligations of accountants with respect to the preparation and issuance of audit reports. . . ." The naming of this Chairman awaits the arrival of the new Chairman of the SEC. It is a very important decision and, in my judgment, will be the first clear definition of the new Chairman of the SEC and the Commission.

Further, the morale of the Commission and its staff must be restored. It now appears that increased funding for the SEC will be forthcoming. The Omnibus Appropriation bill passed by the Senate, contains a significant increase, but not quite up to the level that was in the legislation. The President, in his budget request, not for this year, but for next year, has called for a further significant

increase. And if we can implement those increases, there will be significant resources available to the SEC.

But leadership—at the SEC, that traditionally has meant from the Chairman—will be required to restore the SEC to its historic place as the crown jewel among the Federal regulatory agencies.

These are all challenges that the new Chairman will confront. This morning, I hope to review with Mr. Donaldson a number of the key issues that confront the Commission and our financial markets, including, of course, the need for the SEC to reestablish its role as a strong, independent regulatory body.

Mr. Chairman, I join with you in welcoming Mr. Donaldson before the Committee and I look forward to the hearing to follow.

Thank you.

Chairman SHELBY. Thank you.

Before we go to the other Members' opening statements, I am going to recognize Senator Schumer and then Senator Clinton for any remarks that they want to make about Mr. Donaldson.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman.

First, let me say that this is my first meeting of the Banking Committee with you as Chairman. I want to congratulate you on that and say that we have known each other for 20 years. You are somebody who has a great mind, and who I think will lead this Committee extremely well, and I look forward to working with you.

Before I begin, I should note that among Mr. Donaldson's qualifications is that he is a life-long New Yorker. He was born and raised at one end of the State in Buffalo, and has lived and worked for almost his whole life at the other end of the State in New York City. And I must point out, Mr. Chairman, that his experience has spanned two of the greatest cities in this country.

[Laughter.]

Now, Mr. Chairman, I believe, and I am sure you and my distinguished colleagues will agree, that today's hearing is likely to be the most important hearing this Committee will hold this year.

For today, we are not only nominating the next Chairman of the Securities and Exchange Commission, but we—the Members of the Senate Banking Committee—are taking the first steps to get our Nation's economy back up and running again.

I have long believed that much of the current economic downturn is due to a crisis of confidence. People have lost faith in trusted institutions. That trust must be restored before we see any meaningful growth in our markets, and before any of the other measures we are considering at the Federal level will have effect. As James Madison observed, "The circulation of confidence is better than the circulation of money." And nothing is more damaging to the confidence of investors than a leaderless and rudderless SEC. I know the SEC can, and I believe that our nominee will, play an active role in restoring investors' faith in the integrity of their markets.

As I think of many of the challenges facing the new head of the SEC, I am reminded of the famous Chinese curse, "May you live in interesting times." As we well know, these are interesting times. And Mr. Donaldson, I certainly do not have to tell you, in regard

to the securities markets of this country, these are the most interesting of times.

On the one hand, we need to rapidly conclude the investigation and reforms of the securities industry that have resulted in the "global settlement" amongst brokerage firms, the SEC, and the States Attorneys General.

At the same time, I feel strongly that it is time we recognize the importance of our capital markets and financial services firms to our Nation's economic success. I believe our markets are truly national assets. I know that our financial services firms lead the world in innovation and excellence. The SEC has a vital role to play in ensuring that they remain a major competitive advantage of the United States and, of course, of New York.

The new head of the SEC must also reckon with the enormous, new complexity of our financial markets. Today, billions of shares trade hands daily on the major markets in the United States. In a short period of time, as this Committee well knows, we have gone from largely a single equities market, the New York Stock Exchange, with a few dominant firms trading on regular hours, to many new markets, after-hours trading, online trading, and an enormous array of players. More Americans are exposed to these markets, with, for the first time, over 50 percent of Americans now owning stock in some form or another. These statistics speak to the magnitude of the challenges before the new head of the SEC.

Finally, as we all know, the SEC itself is undergoing enormous change. As it attempts to reckon with the changes in its markets and the companies it oversees, it is also determining its own mission and mandate for the future. Given an expanding mandate, I join my colleague, Senator Sarbanes, in saying that I am delighted the SEC's funding has been increased substantially in the Administration's new budget. Simply put, the SEC cannot enforce the law without the quality and quantity of professionals it requires. Those funds are also critical to ensuring that the SEC can effectively enforce the governance mandates set forth in Sarbanes-Oxley.

With these challenges in mind, Mr. Chairman, I believe that Bill Donaldson's background ably qualifies him for the job. Mr. Donaldson has started and has run a major Wall Street firm—Donaldson, Lufkin & Jenrette—one, I might add, that was known for being ahead of the curve of changes in the financial industry.

Mr. Donaldson also served as Chairman of a major exchange, the New York Stock Exchange, during a period of tremendous market growth. But he has also been on the other side of the table. He understands the risks, responsibilities, and challenges of an executive, a Board member, and an investment professional. He has a perspective grounded in reality, and he is aware of the unpredictable, fallible and, at times, flawed human factor in our markets.

Finally, Mr. Chairman, Mr. Donaldson is known as a man of professional integrity. He is a straight shooter, who, I believe, will work well with both political parties. Those are personal qualities required of the head of the SEC.

In summary, he has the seasoned perspective of an issuer, underwriter, exchange operator, and investor. The very constituencies the SEC must consider in all of its work.

There is no doubt, Mr. Donaldson will live in interesting times. The challenges of the industry will be one thing. My hope is that the challenges of the political process will not outweigh the important work that the SEC needs to do. Our financial markets need to move forward. Our securities firms need to move forward. And the SEC needs to move forward.

I am very confident that Bill Donaldson's life-long involvement in the financial industry, coupled with his demonstrated service to his country, has adequately prepared him for the role of SEC Chairman.

I should conclude by saying that I have had the pleasure of knowing Mr. Donaldson for a long time. I am happy to see that the Committee has not disqualified him for service based on that fact.

Senator SARBANES. Not yet, at least.

[Laughter.]

Senator SCHUMER. I am delighted, Mr. Chairman, to join with my colleague, Senator Clinton, to introduce Bill Donaldson, and I support his nomination to be the Chairman of the Securities and Exchange Commission.

Thank you.

Chairman SHELBY. Senator Clinton.

STATEMENT OF HILLARY RODHAM CLINTON
A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator CLINTON. Thank you, Mr. Chairman.

I join with my colleague, Senator Schumer, in not only introducing Bill Donaldson, but also in endorsing the opportunity we have as a Senate to put into such a critical position a man of his experience and background.

It is not only that he was born in Buffalo and lives in New York City, but also his background and experience has uniquely qualified him for this position at this point in our history.

I would certainly associate myself with the comments of the Chairman and the Ranking Member, as well as my colleague from New York, in pointing out all of the reasons why this appointment at this time could not be more crucial and essential for the confidence and integrity of our markets.

I would also just add that on September 11, the financial capital of the world in lower Manhattan was attacked. There was a reason for that—because of what it represented, because of what it meant, not just to New York and America, but, indeed, to the entire global trading system.

The firms that are located there and, indeed, even the SEC office, which is downtown, have made heroic efforts in the immediate aftermath and in the months since, to make sure that America and the world were once again open for business.

It is essential to the conduct of that business that we have the rule of law and that we have confidence in the systems that we have established here in the United States.

You can find rich people and you can find traders trading nearly anything anywhere in the world. What you cannot find, and what no nation has ever constructed, is the unique public-private partnership to ensure the smooth operation and the integrity of our

capital markets. That is one of the great attributes of 20th Century America.

In the 21st Century, we have to ensure that the SEC and its Commissioner, who really epitomize and personalize that commitment, demonstrate to our investors and to the world, indeed, that we are not only open for business, but also for business that is well-intentioned, well-regulated, and extraordinarily successful.

So this is, as Senator Schumer said, an extraordinarily important hearing to nominate someone who I think was certainly meant for this position at this point in our time. And I look forward to working with him and with this Committee as we do what all of you know we must do, which is to restore confidence and integrity in the minds of our investors and in the reality of the investment atmosphere.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Bennett, any opening statement?

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman.

I, too, want to congratulate you on assuming the Chairmanship of this Committee. I think your stewardship will be marked with a calm and even hand. And I think we will be well-served by your leadership.

I also want to thank Senator Sarbanes for his leadership as Chairman, and I appreciate the time and effort that he put in, not only on the Sarbanes-Oxley bill, but also the management of the Committee.

One of the nice things about service on this Committee is that it has been free of some of the more bitter partisanship that we have found on other committees, and I think the two of you are a demonstration of that, and I appreciate it.

I want to welcome Senator Dole and the other new Members of the Committee that bring us a little fresh blood and a little fresh outlook, which we need.

Mr. Donaldson, I will not go through all of the paeans of praise that my colleagues have heaped upon you, all of which is deserved. I simply want to thank you for your willingness, at an age when people think about taking time off to put time in.

Your service, your experience, and your background are very much needed and very much appreciated, not only by this Committee, but also by the country as a whole.

We have a remarkably resilient economy. It has sustained four major shocks in the relatively recent past. During the collapse of the dot-com era, companies would come on to the marketplace and not triple or quadruple, but exceed by 10, 20, or 30 times their offering price in a matter of days.

And anyone who remembers tulip time in Holland understands that those kinds of P/E ratios—there was no E, there was only a P—would come back down to earth, and the inevitable collapse of some of that bubble that hit the stock market and brought, as Senator Sarbanes has said, the loss of paper value at least of trillions of dollars, is a shock to the economy.

Then there was the over-capacity that was built into the worldwide economy as investments were made in a number of basic

industries, and there had to be a reaction to that. We have not repealed the business cycle. When over-investment produces overcapacity, it will produce ultimately a contraction. And that came at about the same time that the high-tech bubble burst.

Then we had the corporate governance scandal hitting us at the same time with the challenge of confidence in the markets and confidence in market information—a tremendous shock to the system.

On top of that, we have the geo-political risks that we are currently facing, the uncertainty of what will happen in the Middle East, the uncertainty in Venezuela, and the spike in oil prices that come as a result of that.

A fourth shock to the economy occurred. And yet, through all of this, last year, the GDP grew in excess of 2½ percent.

Now that is anemic growth, but it is growth, in the face of these four areas of tremendous shock.

So, as I say, we have a tremendously resilient economy. But it is still struggling. It is still in what Chairman Greenspan calls "the soft patch."

Your confirmation and your stewardship at the SEC can address one of those four shock areas and remove it from the table. The confidence in corporate governance will go up when you raise your right hand and take the oath. That is a tremendous responsibility for your country to put on you, but I do not know of anybody who is better equipped to shoulder that responsibility than you are.

So again, I thank you for your willingness at this time in your career, when you could just disappear and enjoy the many fruits of a tremendously productive life, to share the knowledge and the understanding that came out of that productive life with your fellow citizens.

I look forward to supporting with enthusiasm your nomination.

Mr. DONALDSON. Thank you, Senator Bennett.

Senator BENNETT. With that, Mr. Chairman, I have to be excused because I have another hearing that I have to go to where Secretary Chao will be reporting on what she is doing to help small business, which is another underpinning of the economy.

Chairman SHELBY. Senator Johnson.

STATEMENT OF SENATOR TIM JOHNSON

Senator JOHNSON. Thank you, Mr. Chairman.

Our Nation continues to confront a crisis of confidence in the markets that was precipitated by outrageous fraud in companies and their auditors, from WorldCom to Enron to Arthur Andersen. It is my hope that new leadership at the SEC will help to move America forward. Ever since Mr. Pitt announced his resignation on Election Night, we have been waiting for President Bush to show leadership in this area. I know I join my colleagues in welcoming a strong new head of the SEC, and we look forward to hearing Mr. Donaldson's thoughts on his vision for this critical position.

I would like to note to this panel the importance of setting the tone for the future of the SEC. As I am sure most recognize now, it is clear that Mr. Pitt made a grave error in the tone he set at the start of his tenure by declaring his intention to create a kinder and gentler SEC. As we have all learned since, most of us the hard way through a steep decline in the value of our retirement savings,

we must work to create a formidable SEC, a trustworthy SEC, and most important, an SEC that places the interests of investors above all else.

However, if the SEC is to become kinder and gentler, I believe it should be toward investors, who are now negotiating the difficult maze of arbitration to seek justice over the outrageous fraud that has gutted their life savings. I look forward to hearing Mr. Donaldson's views about the arbitration process, and how he might take steps to protect the rights of investors.

Companies must understand that in the long-term, an SEC that is trusted by investors will work to their ultimate benefit. Until we restore confidence in investors, we cannot get our economy back on track. Investors have not pulled out of the market because they want to avoid paying taxes on their dividends. They have pulled out because they do not trust corporate leadership and they do not trust the SEC.

I would like to note for the record that the SEC under Harvey Pitt has taken some very important steps toward implementing the Sarbanes-Oxley Act. And I would especially like to acknowledge the extraordinary leadership of Senator Sarbanes, along with Senators Dodd and Corzine, on that effort. We need to keep the pressure on implementation of this law, and I look forward to working with Chairman Shelby and this Committee to conduct strong oversight.

I would ask, Mr. Chairman, that a complete statement and some additional questions be submitted into the record. And I once again thank the Chairman for convening the hearing and congratulate Mr. Donaldson on his nomination.

Chairman SHELBY. Without objection, your complete statement will be made part of the record.

Senator Enzi.

STATEMENT OF SENATOR MICHAEL B. ENZI

Senator ENZI. Thank you, Mr. Chairman. I, too, would like for my complete statement to be made a part of the record.

Chairman SHELBY. Without objection, so ordered.

Senator ENZI. I am pleased that you are holding this hearing. I appreciated the opportunity to meet with Mr. Donaldson last week.

Of course, you are coming at a time of tremendous turmoil, as the previous speeches have pointed out. I particularly appreciate the strong endorsement and recommendation you received from the two Senators from New York, who do a good job of keeping an eye on this particular sector, since it originates in New York.

I do believe that part of accomplishing the goals of the SEC come from penalizing the wrong-doers to the fullest extent possible. That has made the biggest difference so far. The purveyors of corporate fraud must be punished swiftly and severely. And the only way to punish these criminals is to deliver real sentences and harsh monetary penalties.

We provided the legislation that will allow that. Now, we need the action by the Commission.

In addition, I want you as the new Chairman to closely examine the Congressional intent during the Commission's rulemakings on Sarbanes-Oxley. I do not believe that anyone who was involved in the development of Sarbanes-Oxley believed that the Financial

Accounting Standards Board would not be the accounting standard-setting body described in Section 108. However, the SEC has yet to officially notify FASB that they are that body. It is my understanding that while naming the standard-setting body, that we would be giving the FASB more independence. By giving them an independent funding source and statutory authority, they would have a better ability to make independent decisions on accounting matters.

This section was not intended to give the SEC significantly more authority over accounting standard setting. The Commission does not have the expertise to set the accounting standards. This lack of acknowledgement by the Commission has left FASB in a funding crisis. Private companies are no longer supplying the funds to FASB because they were intended to have the mandatory funding mechanism outlined in Sarbanes-Oxley.

The Commission, I think, should immediately name FASB as the standard-setting body in Section 108, or at least make clear what is going to happen on it.

This point brings us to, I think, a bigger issue, and that is throughout the rulemaking, the SEC has gone beyond the statutory requirements of last year's legislation, whether it is the auditor independence rule, the Section 307 lawyer provision, or the naming of FASB, which I mentioned.

The Commission seems determined to go beyond these statutory requirements. Some of these issues, in particular, the nonaudit services provision, went well beyond the statute. However, I am really glad there is some clarification on the cascading down to the smaller bodies.

A large part of Sarbanes-Oxley was the construction of the new Public Company Accounting and Oversight Board. It was designed to be the front-line regulator of the accounting industry, including the establishment of nonaudit service prohibitions. It was unnecessary for the Commission to go as far as the proposed rule did when we were a few months from having the PCAOB operational. They, not the Commission, will be in the best position to make the determination regarding what is and is not a conflict.

I also know the salary levels of the members of that Board have received a lot of attention, particularly from the members of the Commission. This Board was constructed to be private and not a Government agency and part of this was to ensure it would attract and retain qualified members of the Board by offering competitive salaries. I think we need to ensure that that Board is able to continue to attract those people.

I thank you for the opportunity to have you here today, to get to meet your family, and to move this process along.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Corzine.

STATEMENT OF SENATOR JON S. CORZINE

Senator CORZINE. Thank you, Mr. Chairman. Let me begin by congratulating you on your role as Chairman. I look forward to working with you. I know you have the interest of making sure that our financial markets are the best in the world, the deepest, strongest, most committed to integrity.

I also want to compliment the Ranking Member on his leadership and commitment to the same principles. And I do believe that we have the capacity to be a positive oversight element in the construction and execution of these markets.

Last, I have a longer statement for the record that I will include. I, too, am one that respects the President's choice with regard to the individual selected for the SEC. Not only did he visit with me last week, but also I have had more than ample opportunity in my own personal experience to spend time with Mr. Donaldson. I respect his vast knowledge, character, independence, and ability with regard to the issues that the SEC will have to deal with.

I want my colleagues to know that I both respect him as an individual and also I think he can bring to the SEC his leadership.

The agenda is an enormous one, and the challenges of restoring confidence and clarity to the marketplace's sense of integrity, those hurdles are very high. And so, the challenges, even for an innovator and an honorable person who has this experience, I think, are going to be quite serious.

The first place we start, in my view, is making sure that this Public Accounting Oversight Board is independently staffed and resourced. I concur entirely with Senator Enzi that we need to make sure that FASB is in that same position, gets the resources to make sure that it is representing investor interests as opposed to any other presumptions, not necessarily other interests-dominant. But we need to make sure that it is independently financed, and that process needs to get going forward.

These two institutions ultimately will be responsible for making sure that the auditing of our public accounting firms, of our public companies, is done in a way that the public will develop trust over time and FASB needs to be able to write rules in an independent way, that has not always been clear in the public's mind.

I think there is also the issue of making sure that we use these resources, and I think we are all very pleased that both the President and the Congress are now on one page with regard to providing the SEC, are soundly used and managed. Your experience will be great in that.

But there is a need for a national market. And if the SEC is not strong in its voice with regard to how our markets are integrated and work together, I fear that we will see a deterioration of the quality, depth, and breadth of those markets.

I think it is absolutely essential that the SEC be the leader in this. And I look forward to your efforts along those lines.

There are a whole host of fairness issues, the arbitration issue, which was already mentioned by Senator Johnson, the interpretation of the rules and making sure that they are administered fairly and consistently across all elements of the industry, are important.

I know you are an individual who cares deeply about this and I endorse completely what I know to be a strong and experienced leadership who will do a great job at the SEC.

Chairman SHELBY. Senator Corzine, your complete statement will be made part of there record, without objection.

Senator Dole.

COMMENTS OF SENATOR ELIZABETH DOLE

Senator DOLE. Yes, Mr. Chairman. As a new Member of the Banking Committee, let me say how much I look forward to working with you as Chairman.

Chairman SHELBY. Thank you.

Senator DOLE. And with former Chairman Sarbanes. I appreciate your leadership on the Sarbanes-Oxley Act.

It was my great pleasure to get to know Bill Donaldson on a trip to Poland when I was a leader of that delegation, during my time as Secretary of Labor.

I certainly look forward to strongly supporting your nomination.

I do have some questions, Mr. Chairman. I have another committee hearing that was scheduled at the same hour, and so, I will submit my statement for the record and look forward to a couple of questions before I have to leave.

Chairman SHELBY. We will see that that is done. Thank you.

Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. My statement was so strong, I broke the microphone.

[Laughter.]

Senator CARPER. Mr. Chairman, thanks very much.

Chairman SHELBY. Thank you.

Senator CARPER. Mr. Donaldson, welcome to you and to your family this morning.

I just want to say for the record that the Chairman and I served together on the House Banking Committee a number of years ago. And as I look around the audience, I see some people with whom we served, either in that capacity or in a staff capacity.

I remember saying to people, some day, Richard Shelby will be Chairman of the Banking Committee, but I thought it would be the House Banking Committee.

[Laughter.]

I thought he would be a Democrat.

[Laughter.]

But I knew from the outset that he would be Chairman and I am happy to be here with him.

Chairman SHELBY. I loved the House, but I am glad to be in the Senate.

[Laughter.]

Senator CARPER. Thank you for being here. Thank you for your willingness to serve. The others who have known you longer and better than I have have spoken to your credentials and I won't go over those again.

I want to thank your family for their willingness to share you with us and with the people of this country.

The President is interested, as we all are, in getting the economy moving; and he has proposed an economic stimulus package, to help do that.

In my own conversations with business leaders in Delaware and around the country, my sense is what we need maybe more than an economic growth package is some certainty in a variety of areas, and I just want to mention a few of those.

One of those is certainty with respect to who is going to be in the majority here? Who is going to be in the majority in the Senate? Who is going to be the leader of the majority?

Certainty with respect to the situation in Iraq, the Middle East, the availability of oil, the price of oil, energy, what kind of impact are we going to see there?

Certainty with respect to North Korea. Certainly with respect to the stock market—can people really trust and believe the numbers that are presented to them by the companies whose stocks they are investing in, whose bonds they are buying?

You in this new role won't be dealing all that much with Iraq or North Korea. The die is cast there and it is what it is for now.

But you will have a whole lot of say, and those who you will lead will have a whole lot to say about whether or not people are willing to put any stock or confidence in the Sarbanes-Oxley bill, to make sure that it, as passed, is not just well-funded, but also well-implemented.

It is a very heavy burden to carry, but I am encouraged by what others have said about you and the brief conversations that we have had, that the President has found a very good person for this job. And as we head down the road toward greater certainty and economic recovery and growth, that you just very well may be the right person to help move us along that road.

Good luck. We are here to be of support.

Mr. DONALDSON. Thank you.

Chairman SHELBY. Senator Dodd.

STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Thank you very much, Mr. Chairman. Let me echo the comments that have been made by others in congratulating you on your assumption of the Chair of this Committee.

Chairman SHELBY. Thank you.

Senator DODD. And we commend as well our colleague from Maryland for the terrific job he did as Chairman. We sat next to each other for years on this Committee and the Foreign Relations Committee. We served together in the House, as I did with the Chairman. So it is a pleasure to see you taking on this role.

Let me join as well, Mr. Donaldson, in congratulating you and thanking you for your willingness to do this. There are times when you certainly wonder whether or not it is worth all the effort.

But I appreciate intensely your desire to once again serve in the public sector. I thank you. I thank Jane, your wife, who I have known for a long time as well, and your involvement in my State, Connecticut, with Aetna, is certainly one that we appreciated during some very difficult days.

I just have a couple of thoughts, and I appreciate you coming by the office the other day.

In addition to thanking you for doing this, I thank the President for choosing someone who is as knowledgeable as you are. I fully endorse the notion that we need bright, young people at the SEC; but I have also felt that we need not only bright people, but also we need people with wisdom.

The fact that you have the age and experience is not a value that is appreciated enough, in my view. And the fact that you bring

such a wealth of experience over so many years, both in and out of public life, success in the private financial market areas, is going to be of great value to the SEC and to the country.

So, I thank you.

All the things said by my colleagues, Tim Johnson, Jon Corzine, Paul Sarbanes, and Mike Enzi, I would endorse thoroughly. The importance of restoring confidence in our markets is the critical job that you face.

The one piece of advice that I offer, having sat on this Committee now for 22 years, and I have been through a variety of Commissioners and Chairs of the SEC, is the independence of the SEC.

The toughest moment you are going to arrive at is when you are going to have a slew of people up here, possibly including this Member, who will be browbeating you about trying to get you to do something that you do not think is right. It is those moments that will really determine whether or not your tenure is a success or not. The independence of the SEC, staying away from the political agendas.

The idea that this will be a Cabinet officer is ridiculous. We need to keep the SEC as far removed from the political life, if you will, of this city as much as we can.

So, I have confidence that you have reached a point in your life when the attractiveness of being associated with the political swirl is beyond you, and I think that is encouraging and it is confidence-building, in my view. I urge you to really insist upon that independence and I am confident that you will do that.

Those are the only parting words I have as we begin the process of a confirmation hearing this morning. Again, thank you. Thank your family. And I look forward to working with you. I think you are going to do a great job and we are lucky to have you.

Mr. DONALDSON. Thank you.

Chairman SHELBY. Senator Chafee.

COMMENTS OF SENATOR LINCOLN D. CHAFEE

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Donaldson, I want to thank you for stepping forward and agreeing to be nominated to this hot seat and I look forward to your testimony.

Chairman SHELBY. Thank you.

Senator Stabenow.

STATEMENT OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman. I want to first congratulate you on the Chairmanship as well.

Chairman SHELBY. Thank you.

Senator STABENOW. And thank Senator Sarbanes for his incredible leadership and producing a very important piece of legislation that I think will have a real impact on investors and consumers and the country as a whole.

Welcome, Mr. Donaldson. It was a pleasure to speak with you in my office yesterday. And welcome to your family. Thank you for being willing to serve.

I think it is incredibly important, as we all do, that we have a strong, confident, independent leader at the SEC. There have been tremendous problems that my colleagues have articulated and that we are all aware of. And so, we are looking forward to very strong leadership.

When I was talking with you yesterday, I spoke specifically about the amendment that I authored that relates to corporate whistleblowers and the importance of having a system through corporations and a process through the SEC for employees and others to come forward in a confidential manner, to be able to share information, hopefully, before we find the disasters that we have seen. Hopefully, that provision will be implemented in a way that is helpful.

I would also concur with what Senator Dodd said in terms of the independence of the SEC. And as I mentioned to you yesterday, I believe that relates to the funding mechanism.

The SEC is one of the only financial regulatory agencies whose funding goes through the appropriations process. It is not separate. I hope that is an issue that we will address in the Committee thoughtfully, looking at whether or not that is in the best interest of the ongoing operations, of being able to function in the independence of the SEC.

I would also share the comments and concerns that my colleagues have expressed about the fairness in the securities arbitration process.

We have been hearing from many people about the concerns of who serve in judgment on that process and the transparency, or lack of transparency, in that process. I will be anxious to hear your comments regarding your willingness to look at that arbitration process and the concerns that have been raised about those who have gone before the arbitration panels.

Finally, I would just urge that although the Enrons and the WorldComs of the world are not in the daily news, we are now certainly still in a process that involves thorough examination of the wrong-doing, and the people and the companies who have committed crimes must be held accountable.

I hope that we will be vigilant and be fair as we look at those, some receiving right now more scrutiny than others. And when we look at the WorldCom situation, for instance, very serious, systemic problems that still need to be addressed and people that still need to be held accountable.

I am looking forward to hearing your thoughts on that as well.

Thank you, Mr. Chairman. I would like to submit my full opening statement for the record.

Chairman SHELBY. Without objection, it is so ordered.

Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, I would like to make a few brief comments at this time, but have a full statement that I would like to make a part of the record.

Chairman SHELBY. Without objection, it will be made a part of the record.

Senator ALLARD. Mr. Donaldson, I want to wish you well as you assume your new duties here at the SEC, assuming that you get confirmed, and I believe that you will.

I would just second many of the comments that you have heard from the Committee. I think it is important if we are going to expect recovery of the stock market, that the consumer—the person who buys the stock—has confidence in the value of the company, and that it truly reflects the liabilities and assets of that particular company.

I think consumer confidence is an important factor in order to help our stock market. You are part of the team that restores that confidence; Congress has that responsibility; the SEC has that responsibility. I think the accounting profession also has a responsibility there that they have to face up to.

The sooner we can get that done, I think the better; and the sooner we can expect some results considering the bursting of the bubble that we have just been through.

I also ask that you stay in touch with this Congress and hope that you will take time to keep us informed as to what is going on. There is a lot of interest on this Committee and I personally have a lot of interest.

One of the things that I personally have an interest in is the Government Performance and Results Act. It is something I bring up to nearly everybody that appears before the Committee because Congress is working to implement it so that we can measure the results of what is happening in the various areas of the budget.

We do not measure performance based upon how much money Federal Government agencies receive, but we measure performace based upon what really happens, and what really makes a difference in the lives of Americans.

When you spend taxpayer dollars, what actually happens as a result of that?

That is something that is important to me and I hope you will pay particular attention to that.

Thank you, Mr. Chairman.

One more thing, Mr. Chairman.

Chairman SHELBY. Okay.

Senator ALLARD. I probably won't be here for the full hearing, but I will hopefully be here for your full statement. I apologize in advance if I have to walk out while you are speaking.

Chairman SHELBY. Senator Bayh.

STATEMENT OF SENATOR EVAN BAYH

Senator BAYH. Thank you, Mr. Chairman. I want to compliment you for moving this nomination so expeditiously. We are getting off to a good start under your leadership.

Mr. Donaldson, I want to congratulate you. I appreciated your visit in my office. As I indicated at that time, I will reiterate publicly today, I intend to support your nomination. I think you are well-qualified for this position. And I would urge you in two areas.

First, as my colleagues have indicated, the vigorous enforcement of the new law. As others have commented, along with the geopolitical risks, Iraq, the continuing war against terrorism, there is

little doubt that the uncertainty about these accounting issues has helped to hold the economy back.

Through the right kind of leadership from you and your organization, we can help to alleviate that cloud, and hopefully, get some additional momentum behind this economy.

I would urge you in that respect.

Our whole system of free market capitalism is based on the efficient "functioning of markets" theory. But that all breaks down when the information provided to the markets is fraudulent. And so, we need to work to try and remove that element. Also, it undermines the confidence that people have in market-based solutions of any kind. If the public gets the idea that markets are essentially just a large confidence game where the insiders reap all the profits and leave everybody else holding the bag, that is not very helpful to good public policymaking in other areas as well.

So, I would urge you in terms of vigorous enforcement of the new statutes.

The other thing I would say is that we need to start the right balance. We need to vigorously enforce the interests of shareholders. But at the same time, it would be an irony if we imposed undue costs on those very shareholders by not going about protecting their interests in the most efficient way possible.

If you have recommendations about how to most effectively and efficiently implement the new statutes and other actions we might take to refine what has already been done, I think we would all be most interested in that because at the end of the day, that is what it takes to protect the rights of shareholders.

I wish you well. I know you will be back testifying before us on many occasions. I will apologize in advance for that. But we look forward to hearing from you then as we do today.

Good luck.

Chairman SHELBY. Mr. Donaldson, at this time, if you will stand, I would like to administer the oath to you.

Do you swear or affirm that the testimony that you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Mr. DONALDSON. I do.

Chairman SHELBY. Do you agree to appear and testify before any duly-constituted committee of the Senate?

Mr. DONALDSON. I do.

Chairman SHELBY. I note that you have family members here. If you want to introduce them to the Committee at this point, you can do that.

Mr. DONALDSON. I am delighted to do so. Right behind me is my wife, Jane Donaldson. My two sons, Adam Donaldson; and sitting behind him, Matt Donaldson. My daughter, Kim McKowski, and her husband. And an unviewable, but also present, first grandchild.

[Laughter.]

Chairman SHELBY. I understand that.

[Laughter.]

Thank you. Your written statement will be made part of the record in its entirety. You proceed as you wish.

STATEMENT OF WILLIAM H. DONALDSON OF NEW YORK, TO BE A MEMBER OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. DONALDSON. Thank you.

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, it is my distinct honor to come before you today as President Bush's nominee to be Chairman of the Securities and Exchange Commission. I thank you for this opportunity, and I thank you for your comments. I want to especially thank both Senator Schumer and Senator Clinton for their warm introductions.

The U.S. capital markets have long been the most intelligently regulated, efficiently functioning, and widely-admired markets in the world. Because of this strength, America's financial system has become synonymous with an entrepreneurial spirit and free flow of capital that is unparalleled throughout the world.

Over the past year and a half, our Nation and its financial systems have been faced with extraordinarily new challenges. The evil of global terrorism attacked a great symbol of our financial strength. Soon thereafter, we witnessed revelations of corporate and financial corruption that accompanied the market's retreat from the boom of the 1990's.

Many Americans' individual savings, accrued over a lifetime, were devastated. This loss was more than simply monetary—it was the loss of their hopes, their dreams, their futures, and, in many cases, their security. The reports of fraud and manipulation only fanned the flames of their distrust and outrage with corporate America and Wall Street. Their loss was profound; and, in many cases, the violation of trust was great. Such circumstances required a response just as serious.

The groundbreaking Sarbanes-Oxley legislation, passed by the Congress and signed by President Bush responded with the most sweeping reforms of American business since the New Deal. But just as the war on terrorism cannot be won overnight, neither can investor confidence be completely restored so quickly. Corporate America, Wall Street, and their professional stewards—lawyers, accountants, corporate and financial managers, and financial regulators—still have a lot of work to do.

If confirmed, I will vigorously enforce Sarbanes-Oxley and the rules and regulations already put forth by the SEC. I will demand accountability from all responsible parties. I will aggressively enforce civil penalties and work cooperatively with State and Federal law enforcement agencies and the President's Corporate Fraud Task Force to bring those who break the law to justice.

While Sarbanes-Oxley has laid the foundation for best practices, legislation, and vigorous regulation can accomplish only so much. In my view, there must be a conscious decision to make honesty, integrity, and regard for the good of shareholders the motivation for all business decisions. If confirmed, I will call on corporate America and on Wall Street to restore these principles to their proper place.

The SEC has been through a trying time as well. The SEC staff, in my view, is superb, with knowledge and commitment that are unsurpassed. The recent scandals have depleted their morale and taxed their resources like never before. If confirmed, I will work

closely with the agency staff to enhance their sense of dedication and pride and restore the stature of this agency.

I have great respect for the critical role of the Congress and of this Committee in particular. I hope to work closely with each of you. If you choose to affirm my nomination, I pledge to take on the task ahead with every ounce of experience, judgment, and energy that I have.

Thank you, Mr. Chairman. I would be glad to take any questions.

Chairman SHELBY. Thank you.

Mr. Donaldson, you are named in a class-action lawsuit against Aetna. The plaintiffs allege that you ignored operational problems that led to an understatement of Aetna's medical expenses, reserves, and therefore, an understatement of losses that occurred to the company. What can you tell us about the allegations made in this lawsuit? I realize it is litigation pending and I do not know how free you are to talk about it.

Mr. DONALDSON. Thank you, Mr. Chairman.

I took some strong measures when I was the CEO of Aetna to strengthen and to improve Aetna's performance. Aetna sold its financial services and international businesses to ING for some $7.7 billion. We created a new Aetna, with a new management team that focused exclusively——

Chairman SHELBY. Did they sell when you were Chairman?

Mr. DONALDSON. Chairman?

Chairman SHELBY. Did they sell to AIG?

Mr. DONALDSON. I was Chairman and CEO then, and we sold the divisions to ING.

Chairman SHELBY. Okay, ING.

Mr. DONALDSON. We created a new Aetna with a new management team that I helped to recruit to focus exclusively on improving customer satisfaction and on ensuring the long-term success of the health care business. In total, the value of Aetna has almost doubled, including cash and stock, from the day that I joined the company.

Now as far as the litigation goes, during the course of turning the company around, we had a hiccup, a hiccup that we did not expect. We addressed that hiccup. We informed our shareholders as soon as we knew about it. And as I say, over the years since then, with a management team that I helped to hire, the record of the company has been outstanding.

Chairman SHELBY. Some have criticized Aetna's use of poison pills and other anti-takeover devices during your tenure. Such devices are often viewed as benefiting management at the expense of shareholders. It has been alleged that minority shareholders had no voice in Aetna's strategic planning or operations. How would you address these criticisms?

Mr. DONALDSON. Well, when I became Chairman, and I should say that the Aetna Board of Directors asked me to become CEO and to put new management into the company, the Board decided, with my concurrence, that we would institute a shareholder protection device because we felt that we could turn this company around for our own shareholders, that we wanted to protect our shareholders from somebody coming in, swooping in, in the process of

turning the company around and taking it over for some other group of shareholders.

So when we put the shareholder device, a so-called poison pill, in, we also pledged that we would take it out within 2 years. And I am glad to report that the company has done just that. It no longer has a poison pill.

Chairman SHELBY. Okay. Mr. Donaldson, you were a co-founder of DLJ—Donaldson, Lufkin & Jenrette—a firm that has been referred to as "the house that research built."

We have all been shocked by the revelations over the past year regarding analyst reports that literally were prepared to order in to capture investment banking business.

Given your roots in qualitative research, your background, I would be highly interested in your views regarding the recent revelations concerning analysts' conflicts of interest. Do you believe that the SEC needs to invest greater resources to its compliance program in this regard? And what could the SEC do to improve its ability to detect systemic problems like the ones that came to light this past year?

Mr. DONALDSON. Mr. Chairman, you bring up a couple of issues there. Number one——

Chairman SHELBY. My time is limited up here, even as the Chairman.

[Laughter.]

Mr. DONALDSON. —is the simple issue of the quality of research itself.

If I might say, when we formed our business many years ago, we intended to do real research. We intended to do analysis of companies that would be much closer to what a management consulting firm would do to evaluate directions, management, et cetera, and the issue of earnings per share the next quarter was insignificant to us.

I deplore the denigration of research that has gone on, particularly during the boom time of the 1990's, where earnings per share and quarterly growth——

Chairman SHELBY. It became a sham in a lot of ways, didn't it?

Mr. DONALDSON. I beg your pardon?

Chairman SHELBY. It became a sham, rather than real qualitative research.

Mr. DONALDSON. Exactly. And as an aside, I might say that the imperative that that was put on managements to attempt to run their companies on a quarter-to-quarter basis has caused, in my view, a very disturbing short-term orientation.

Nothing grows like that—human beings, plants, whatever. We grow in stages. Companies grow in stages, or they should. They should make the investments do that.

In terms of the other part of your question, the conflict of interest inherent in analysts becoming hand-maidens for the investment banking side of the business, clearly, this is wrong. Compensation for doing that is highly suspect. Clearly, the SEC needs to assure that there is no linkage between the investment banking side of the business and the research side of the business. And there are a number of things that I think can be done in that line.

Chairman SHELBY. Will you pledge to continue to this Committee here, assuming you are confirmed, which I predict you will be, as the Chairman, that the SEC will push enforcement efforts in this area? And that culpable individuals who are involved in this controversy regarding research analysts are sanctioned? Because I think we can afford to do no less.

Mr. DONALDSON. Right. I think there are two issues there.

First is the separation, the iron curtain, the bamboo wall, whatever you want to call it, between research and the investment part of the business. There is a second thing there, which is the analyst's having a different view, an inside view and an outside view. Absolutely unacceptable, as far as I am concerned.

Chairman SHELBY. Thank you.

Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Mr. Donaldson, in the first round, I want to focus on the SEC itself as an institution and your role, potentially, as its Chairman. There are lots of other areas that will be covered in the course of the hearing and, presumably, we will come back to a second round, if Members deem it necessary.

I am prompted to do this because I recognize that if we have the SEC really functioning at top level, it just makes an enormous difference. As you indicated, there are people of tremendous ability and quality at the SEC and its reputation traditionally has been as the outstanding independent regulatory agency of the Federal Government.

Speaking about the SEC, an observer recently was quoted as saying: "Morale is at its lowest point. This place is a shambles of what it was 10 or 12 years ago."

I would like to put some very specific questions to you.

We indicated earlier the increase in the budget. Part of the motivation for that is to provide parity of employee benefits. The other financial regulators have the authority to raise salaries in order to retain able people, and hopefully, keep them from going into the private sector, although they can make far more money in the private sector. But it is an effort to give the employees a little more breathing room.

The SEC has not implemented full pay parity, and I am interested in your view about it. Parity of benefits, as well as parity of pay. And also, whether you calculate the parity with reference to all Federal bank regulators and not just those paying at the lower compensation levels.

At the moment, other Federal financial regulators can pay their people more than the SEC. So the SEC is losing people not only to the private sector, but they are losing them to other public sector agencies as well.

Mr. DONALDSON. Right.

Senator SARBANES. What is your view on this pay parity issue?

Mr. DONALDSON. Let me begin by saying that I am terribly concerned about the morale situation at the SEC. This is a group of professionals that have been working very, very hard with inadequate resources and, in many cases, inadequate compensation.

As far as pay parity, I have not been inside the SEC. But, just as soon as I get there, you can be sure that I will pay attention

to the issue of pay parity and pay attention to the issue of not only the reason that many of the people are there, which is the work they are doing, but also the compensation for that work.

I am not familiar yet with what is being done in other agencies. However, I assure you I will get into that issue just as soon as I get there.

Senator SARBANES. So, you see pay parity as embracing parity of benefits, as well as salary pay?

Mr. DONALDSON. Well, there is a whole package. I think pay is not the only issue. I think it is the whole package of benefits. But, as I say, I really want to get in and understand what is being done now and what is being done in other comparable Government organizations.

Senator SARBANES. The Congress, in voting higher levels, was very clear that one purpose of those higher levels of money was to achieve pay parity, and I think it is very important for the morale of the agency.

The GAO, in a report, "SEC Operations—Increased Workload Creates Challenges," in March of last year, recommended, and I quote, "That the Chairman of the SEC identify ways to involve human capital leaders in decisionmaking and establish a practice that requires management to continually ensure the effectiveness of SEC's human capital approaches in addressing employees' needs, including working with the national Treasury employees union."

Now, we have been informed that there is a strained relationship with the employee union at the SEC. What is your view of this?

Mr. DONALDSON. If there is a strained relationship, that is something that I would like to address. I am very concerned with the management of the agency. I am very concerned with the efficiency and effectiveness of that management. If I am approved by your Committee and by the Senate, I see a danger of the massive hiring that we have to do, of a large chunk of money coming into the agency.

I want to make sure that we are not just spending the money to hire the best people we can find, but that we are managing the place in an efficient way. And I pledge that that again will be high on my agenda.

Senator SARBANES. To draw a close on this, the SEC has a long and important tradition of allowing its Enforcement Division to pursue its investigations wherever they may lead. In other words, the Commissioners have not interfered with the judgments of the Enforcement Division. Are you committed to ensuring that the Enforcement Division can continue to conduct its investigations free of political considerations or other improper concerns or interference?

Mr. DONALDSON. Absolutely. I believe the Enforcement Division is at the core of what the SEC does; and they will go, as I think they always have, where they should go.

Senator SARBANES. All right. Traditionally, the SEC Chairmen were careful not to meet with persons under investigation, in part, because such meetings suggest the possibility of interfering with or improperly influencing the investigation. Will you follow this tradition and decline to meet with persons under investigation?

Mr. DONALDSON. I will abide by the letter of the law in terms of doing that. I will do everything in my power to not meet with anyone under investigation and to follow the general guidance of the General Counsel of the SEC in terms of people that I do meet with.

Senator SARBANES. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Dole.

Senator DOLE. Mr. Donaldson, as we work to restore confidence in our markets, I think we may need to do more to restore investor confidence in financial statements.

I would like to visit with you a moment on something that I feel still needs to be focused on, and that is the fact that auditors face a real conflict of interest because they are paid by the company that they are going to be auditing. And so, in a sense, then, they are beholden to that company which is paying the bills.

I am intrigued by an idea that Professor Joshua Ronen, Stern School of Business, New York University, put forward just a few months ago.

He would require that there be Financial Statement Insurance. In other words, that companies would buy insurance on the quality of their audit reports. And the liability for false or misleading statements in those reports would then run with the insurance company rather than with the Board of Directors. This would provide independence because the insurance company would then hire the auditors rather than the company.

This idea I find to be very interesting because I think just switching incentives could make a real difference here. This would mean, in Professor Ronen's view, that the SEC would require that this Financial Statement Insurance be provided. And then the SEC would require that the results be made public. In other words, in the quarterly reports, in the annual statement, financial report, the companies would report the amount of insurance and what the premiums are.

This would enable investors then to compare between companies and would I think do a lot to restore confidence, to obviously take care of the incentive issue, and to provide a comparison which could be very useful, and to give more protection to employees and to stockholders.

So my question to you is, would you be willing as Chairman of the SEC to take a look at this idea and to determine the feasibility and the possible effectiveness of such an idea?

Mr. DONALDSON. Senator Dole, I would be absolutely willing to do that. I hope that you will encourage Professor Williams to send his paper in.

Senator DOLE. Professor Ronen.

Mr. DONALDSON. And let us take a look at it. I might just say, parenthetically, that the concept of having some new ideas, ways of approaching some of the problems, is very appealing to me. I would welcome having us discuss that.

Senator DOLE. Right. Well, it seems that the insurance company, by hiring the auditor, as the incentives are changed, then the loyalty is to accuracy rather than to the company that is hiring the auditor.

I would also like to ask you for your views on how much you feel eliminating the double taxation of dividends will help the economy?

Mr. DONALDSON. I think the elimination of double taxation of dividends is part of a total package that the President has put forward. I think it is a very important part of that package. I think that it could have far-ranging effects in a number of ways on corporate governance itself.

Clearly, there is an advantage of getting away from the double taxation of dividends themselves. That goes without saying. But beyond that, I think that it could change, perhaps gradually, the way companies are structured, the use of excessive debt, the whole investor attitude toward real earnings and real dividends as opposed to futures.

So, I think this puts a new burden on corporate governance and management in terms of determining how they get a return to shareholders. Not all use of futures. The idea that they cannot just build up a piggybank there, that they have to share that with the shareholders.

I believe that it is a very positive suggestion by the President.

Senator DOLE. Good.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Schumer.

Senator SCHUMER. Thank you, Mr. Chairman. I have a few questions. Are we going to have a second round, Mr. Chairman?

Chairman SHELBY. Sure. Go ahead.

Senator SCHUMER. Great. Thanks.

Mr. Donaldson, one of the issues that has been of great concern to me and many others has been the movement of U.S. corporations to off-shore tax havens.

Often, these businesses maintain the bulk of their operations, as you know, in the United States, but set up largely a shell operation in a low- or no-tax country. I think this is a short-sighted view on the part of those business managements because they are failing to support the very economy that is sustaining their business.

What I propose, is to introduce legislation that would set standards for U.S. corporations to get shareholder approval before they can relocate off-shore.

My view is they say they are doing this for the company, but the owners of the company, the shareholders, would not really be for it because they are patriotic Americans.

Would you support this type of legislation? And can you comment on the practice of corporations moving off-shore?

Mr. DONALDSON. I have a similar concern to your's in terms of the abusive, or perhaps abusive, use of off-shore havens by corporate America. I think each individual case requires an examination, according to the law.

In terms of putting that up to the shareholders, I think that that is something that we should examine within the context of what other things should be brought up for shareholder vote. In other words, there are a number of issues where shareholders now are not allowed to vote, and I would consider this area one that——

Senator SCHUMER. Would your initial reaction be favorable? I am not asking for a commitment. Obviously, you have to study the bill. But to the general concept.

Mr. DONALDSON. Yes. Again, it is one of those things that is out there, and my initial reaction is that we should take a look at that.

Senator SCHUMER. Would your initial reaction be favorable?

[Laughter.]

Mr. DONALDSON. Well, I do not mean to waffle, Senator. I really do not.

Senator SCHUMER. I just said that you were a straight-shooter!

[Laughter.]

Mr. DONALDSON. I really want to——

Chairman SHELBY. He gave you a good introduction earlier.

[Laughter.]

Senator SCHUMER. Exactly.

Chairman SHELBY. That doesn't mean you should join, though.

[Laughter.]

Mr. DONALDSON. I am a great believer in listening to both sides of an argument.

Senator SCHUMER. Thank you. Next question. As you know, U.S. policies in securities laws reflected in the 1933, 1934 Acts, the 1975 amendments to those Acts, and many Federal laws relating to investment and market participants, promotes a national, uniform system of regulation for nationally-traded securities and national broker-dealers, and it has served to safeguard both consumers and develop capital markets that set the world standard.

You know that better than anybody else.

Recently, however, the SEC has been much less visible in its role of setting Federal securities policies, and States have stepped in to fill the void.

Rather than discuss what happened in the past, I would like to discuss what will be in the future. I have related questions which I will ask you and then you can answer them all at once.

Do you currently see a risk to our national system, and consequently, a risk to national competitiveness, from a balkanization of securities markets? Meaning many different regulations, each by the different States, rather than one national regulation.

How do you propose to work with State prosecutors currently pursuing reform of the securities industry as it operates within their respective States?

How can the SEC reestablish the Federal nature of securities law?

Should the SEC request additional legislative authority to achieve truly national regulation of markets?

And how will you assure that the SEC has a place, and a prominent place, in future discussions of industry practices?

Mr. DONALDSON. A series of very good questions, Senator.

Let me begin by saying that I think that one of the great strengths of our market system is that it is a national market system and has not been balkanized, and we see the effects in other countries of systems that are not firmly regulated at a Federal level.

Having said that, some of the instances in recent weeks and months where local or State-level regulators and/or attorneys general and so forth, have stepped in on a fraud basis, I believe have been constructive, up to a point. And that is that they have been constructive in terms of bringing all the resources we can bring at a time when perhaps the SEC has been short of resources. But up to a point.

The point is where the solution comes. I believe that the solution should come from the Federal regulators.

So, I hope that, if you do confirm me, I will be able to speak with State attorneys general and State regulators and talk this out with them and make sure that they are stopping where they should stop and put the responsibility back to where it should be.

If that doesn't work, and if I receive no response there, then I think we have to turn to you all to help redefine regulatory authority because the balkanization you talk about is a terrible threat if it should happen.

Senator SCHUMER. The next question. The press has reported that you are opposed to something your predecessor once removed supported very strongly, the regulation of fair disclosure, which was intended to safeguard investors against selective disclosure of business and financial information. You stated at one point that it was, "a terrible rule." What is your current view on Regulation FD? Is it adequate? Does it need to be strengthened? Should it, in fact, be reconsidered?

Mr. DONALDSON. Thank you. I have seen the quote in the press. I have to say up front, it was a quote taken out of context. I was a private citizen having a private meeting and was asked, what did I think of FD?

My initial reaction was I thought it was crazy because, at that time, I was Chairman of a major U.S. corporation that was trying to deal with the implementation of it. I was in the throes of, at that time, thinking that there were some unintended consequences. I am totally for the intention of the law. But at that time, there were some unintended consequences of having just the reverse effect—shutting down information flow.

My present attitude toward it is that it is working better. From all I can see, FD is working better. And my attitude, as Chairman of the SEC, if I become Chairman, would be to constantly monitor the implementation of FD and to make sure that we are not having unintended consequences. But the concept of FD is right.

Senator SCHUMER. So, your initial reaction would not be to propose any changes one way or the other.

Mr. DONALDSON. Absolutely not.

Senator SCHUMER. But rather, look at it.

Chairman SHELBY. Your time is up.

Senator SCHUMER. I have some more, but I will wait for a second round.

Chairman SHELBY. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

It seems to me that the effective working of the SEC depends on how successfully everybody works together. And it seems to have been recognized in your opening statement that morale was low within the SEC.

So, I am curious, with everything that you have learned in the Marines and your career, what is your basic philosophy for motivating employees? Could you be as specific as possible?

Mr. DONALDSON. Your question is what is my philosophy on motivating people?

Senator CHAFEE. Yes.

Mr. DONALDSON. I believe very strongly that the motivation of people comes from the quality of the assignments they are given, from the freedom to pursue ideas, to have an openness within the organization, to have not a command and control structure, but, rather, to have a flatter structure that allows for individuals to say what they think.

I think that there is nothing more motivating than to have an ability to say what you think within an organization without fear of retribution. I think that is at the core of the esprit de corps of an organization.

To me, probably a bad analogy, but the SEC has been the Marine Corps of the regulatory agencies. I say that with great admiration for the Marine Corps. I have served in the Marine Corps, and I really hope that we can bring some of that spirit to the SEC in terms of the motivation.

Senator CHAFEE. I am referring back to what Senator Sarbanes said about some of the problems of the bargaining unit employees as well. This general philosophy I am sure extends to the professionals and to everybody within the organization.

Mr. DONALDSON. Yes. Clearly, the SEC is a very professional organization, with a very high percentage of employees that are professionally trained, lawyers and accountants and so forth, who have professional ethics.

I believe that the pride in the profession, if you will, is a kind of strong motivating force, as well as being paid adequately and rewarded adequately for what you are doing.

Senator CHAFEE. Well, thank you, and good luck.

Chairman SHELBY. Senator Corzine.

Senator CORZINE. Thank you, Mr. Chairman. We are going to have two rounds, so I have a whole series of smaller, more specific questions.

But there are issues with regard to investor confidence, how we rebuild that, and the independence of the SEC, which I believe are broad subject matters. As it relates to investor confidence, I cannot personally believe that there is anything more important than the SEC demonstrating this independence that a number of my colleagues have spoken about on both sides of the aisle.

And with respect to that issue, I cannot think that there is a more important place to demonstrate that than the implementation of the Public Company Accounting Oversight Board, making sure that a transparent, independent process of selecting the membership and the implementation of Sarbanes-Oxley and auditing of auditors, if you will, to short-form it.

Have you considered the process that you intend to take since there was unfortunate, I think, and damaging elements to the credibility of the SEC and to potentially even the Oversight Board itself, given that it got off to such a rocky start? Have you thought about how you reestablish that integrity and independence of that process?

Mr. DONALDSON. Well, I have read the GAO report, which examines the process. I think the report speaks for itself in terms of finding an imperfect process that resulted in an imperfect answer.

I believe that the selection of the leadership, of a Chairman for the independent board, is the number-one priority that I have going into office, should I go into office.

We are behind the eight ball given the fact that a Chairman has not been seated.

The day I get to the SEC, I will examine whatever process has been put in place since the time of the report, I would hope that a process has been put in place.

I will take a look at that process. I would intend to modify it if it needs modification. Then I would hope to, through an organized process, spread as big a net as we possibly can in terms of persons who might be qualified to run this agency.

In my view, there have to be people out there who are eminently qualified to do this job. I would hope to narrow that universe just as quickly as we can and get to the point of selection.

I will, in the final analysis, consult with everyone I can. I will consult, as required by law, I believe, with the Secretary of the Treasury and with the Chairman of the Federal Reserve. I also will consult with anybody and everybody who wants to throw a name into the hat. But in the final analysis, the decision will be up to my fellow Commissioners.

Senator CORZINE. I can only suggest that I think both markets, those of us responsible for oversight, and ultimately, the investors, will look to this kind of decision as one of those foundation points for restoring investor confidence.

On another subject with regard to investor confidence, I think it is very difficult for small investors to understand how they are fairly represented in the marketplace, particularly when they feel that they have been wronged—this whole arbitration process, which a number of my colleagues talked about earlier.

Have you considered whether you think, from your own experiences and knowledge, that the issue of securities arbitration where representatives from the exchanges and generally lawyers that are close to the industry, are basically the arbiters, where the proceedings are secret, whether there is the kind of fair review of individual investor's response, arbitration, a good process, keeping it out of the courts, potentially.

But have you reviewed whether you think we have a satisfactory arbitration process that protects the interests of small investors as they face off with large firms like ones that you and I are quite familiar with and work their way through a process that is basically established in conjunction with the industry?

Mr. DONALDSON. Well, I am intimately familiar with the arbitration process at the New York Stock Exchange when I was there. And I believe that it was working pretty well. I have not been intimately involved in the changes in the arbitration process, both at the Exchange and at the Nasdaq, since I left. I have been away from it for 8 or 9 years.

I think it is a very legitimate question to examine the arbitration practice, as it is being practiced today, and I would do that. I would do just that.

I have no idea whether there has been examination within the SEC. So the first thing I would do——

Senator CORZINE. I would make just one point. The global settlements with regard to a number of the research functions go through the arbitration process. And one statistic that I wasn't aware of when I was in another seat in another point in time.

According to the General Accounting Office, 64 percent of arbitration awards go unpaid. So even the execution of the process, whether it is a fair judicial or review process is one question. Whether it actually works is another.

Mr. DONALDSON. That is an interesting statistic. I am reminded of similar statistics in other areas where legal payments are due the Government that aren't being made.

I think bill collection, if you will, is an important issue, and it certainly would be one for me—if that statistic is correct.

Senator CORZINE. For investor confidence, I believe that this is another area where, particularly so-called investor class or small investors, need to get a fair shake, an observation here.

Mr. DONALDSON. If I understand you correctly, judgments that have been made by an arbitration panel should be paid. And if they are not, we should know why.

Chairman SHELBY. Senator Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you, Mr. Chairman.

Mr. Donaldson, first of all, I want to congratulate you on your willingness to step forward and provide public service in this capacity. And I am confident, as is the Chairman, that your nomination will be confirmed by the Senate.

I just want to cover a couple of issues if I have time with you today. The first one is derivatives transactions. As you know, last year, we had some proposals in the Senate to change the way in which over-the-counter derivatives transactions are regulated. Namely, by requiring that they be on-exchange or that they be done through an exchange rather than an off-exchange transaction.

I strongly opposed that and frankly, last year, we received letters from the Department of the Treasury, from Alan Greenspan of the Federal Reserve, from the Chairman of the U.S. Commodities Futures Trading Commission, and from Harvey Pitt, the Chairman of the SEC, indicating that they all unanimously felt that we should not change the manner in which we regulate the over-the-counter derivatives transactions and that, in fact, I think Alan Greenspan said several times that it was the flexibility that these instruments provide to us that gave us some significant strength in the economy when we saw some of the softening occurring in the last years.

The obvious question I have for you is, I expect that we will be dealing with this issue again. I would like to know what your feeling is about the issue? Do you agree with your predecessor and with others in the financial community, or do you have a position at this point on whether we should maintain our current regulatory posture with derivatives?

Mr. DONALDSON. Yes. Derivatives are extremely complex, as you know better than I. I believe that they cross, in terms of responsibility, between the Federal Reserve, the Treasury Department, the SEC, and certain of the other exchanges that deal in marketable derivatives.

First, I hope to understand what work has been done in the SEC.

Second, I would hope, through the working group with the Chairman of the Fed and the Secretary of the Treasury, that we would get together and talk about this issue.

I believe that there is the potential for risk out there somewhere. Risk gets passed via derivatives, and somewhere out there there is risk. Somebody's holding the bag. And I think we have to make every effort to find out where that is.

Chairman SHELBY. It is passing on the risk, in a way. You are passing the risk on.

Mr. DONALDSON. Exactly. It is a little bit like a hot potato, and somebody is holding that potato. And we have to find out who is holding it and whether we are adequately anticipating what might eventuate from that.

Senator CRAPO. As I understand it, one of the ways that was explained in one of our hearings by one of the experts—it may have been Alan Greenspan—was that the derivatives are actually utilized in our market to allocate risk better to those areas or those entities that can handle it, and it is a very strong, stabilizing influence in the markets. Do you agree with that?

Mr. DONALDSON. I think a very good case can be made for that. I think that is one of their positives. There is a negative case that could be made, as we have seen in a couple of the blow-ups where derivatives were being used and unexpected things happened.

So, I think, as a positive tool, putting your risk in the hands of people who are willing to accept it and must be paid for it, is not a bad idea. It is just that we have to make sure the way it is being done is appropriate and that we know that there is not something hidden out there that is going to hit us when we do not expect it.

Senator CRAPO. In that context, I think that I probably would agree with you. Some of the discussions we have had focused more on reporting and make sure that adequate information was available, as opposed to requiring that the transactions be handled through an exchange.

Mr. DONALDSON. Right. I think disclosure, transparency is the first line of regulation. And I do not disagree with that.

Senator CRAPO. Thank you. How am I on time? Out?

Chairman SHELBY. You are in summing-up time now.

Senator CRAPO. All right. I have some other questions for you, but more lengthy than that. And so what I will probably do is just discuss them with you privately.

Mr. DONALDSON. Thank you.

Chairman SHELBY. Mr. Donaldson, just to pick up on Senator Crapo's question on derivatives.

Sooner or later, somebody's holding the bag on a derivatives. Derivatives are very complex instruments and they manifest themselves in many, many ways. We have talked about this before the Banking Committee on many occasions. But if you are getting into derivatives, you are getting into some complex financial transactions that it would be hard for the layman to understand. Is that correct? Is that fair?

Mr. DONALDSON. Absolutely. I think many of them are hard for the professionals to really understand.

Chairman SHELBY. Absolutely. They are used in just about every financial—not every financial transaction—but they are used in financial markets every day now, everywhere in the world. Wouldn't you think?

Mr. DONALDSON. Yes, they are. They are being increasingly used.

Chairman SHELBY. Now, I was intrigued with your statement, and I tend to agree with that. I do not know how we can regulate, or should regulate, derivatives. But there is no substitute for transparency, for openness and who might ultimately hold this risk, the ultimate risk. And are they financially able to cope with that risk?

Mr. DONALDSON. Right.

Chairman SHELBY. Because if the risk is passed on, and that is the idea, isn't it, one of the ideas of a derivative is that it is passed on to someone else. Ultimately, it might be interesting to know if whoever is holding that risk at the end of the day is capable of holding it very long, financially. I do not know the answer to that. But we know that that is a complex world that you will be dealing with, and we should not ignore it. So openness is probably the first step, isn't it?

Mr. DONALDSON. Absolutely. It is a fertile area to investigate, in my view.

Chairman SHELBY. It is. Mr. Donaldson, what are the biggest challenges that you would face in maintaining the preeminence of the SEC as the regulator of our national markets in an increasingly global marketplace, because that has to be a challenge there, too. You have the London Exchange. You have all the others around the world. You know them all.

Mr. DONALDSON. Right.

Chairman SHELBY. What is your biggest challenge to maintain our preeminence in that area?

Mr. DONALDSON. Well, what we have now, in my view, is an increasing interest by American investors in markets outside the United States.

The figure I would quote, and do not hold me to it, is something like two-thirds of the world's earning power is coming from outside the United States, with only a third coming from the United States.

So investor attention is being directed toward purchasing shares in companies that are not resident in the United States.

That percentage of portfolios in foreign securities is growing rapidly from a very small percentage to 5 percent to 10 percent and so forth. Theoretically, it could some day get up to two-thirds if it matched where earnings were coming from.

I think we have to be terribly concerned with how American investors are treated in terms of making purchases in foreign markets, if I am addressing your question. And I think the way foreign markets operate is of importance to us. But even more important, I believe, is making sure that our markets can be competitive in trading foreign securities and give investors the protections that we have in our market, as opposed to forcing them to go and do their buying in less regulated markets.

Chairman SHELBY. This just begs the question. How do we harmonize the international accounting standards? Because if we are

going to invest in their markets, we need to know what is going on there.

Mr. DONALDSON. Right.

Chairman SHELBY. The Europeans have basically principal-based accounting as opposed to rule-based accounting. So that is a challenge in itself, is it not?

Mr. DONALDSON. Absolutely.

Chairman SHELBY. But it goes right to the heart of what you are talking about. For an investor to invest wisely, they have to know what they are investing in. Correct?

Mr. DONALDSON. Right.

Chairman SHELBY. And if you do not have basic standard accounting terms and some rules for the market, how do you do it? It is a big risk, is it not?

Mr. DONALDSON. Yes. I think that one of the great benefits of the Sarbanes-Oxley legislation and the formation of the Accounting Oversight Board is the focus and attention that will come from that sort of a regulatory umbrella still passing through the SEC, but able to focus on just the issues that you are talking about.

I believe that for the long-haul and, hopefully, shorter than long-haul, we have to get at a reconciliation or harmonization between principal-based accounting and rule-based accounting.

I suspect that the best thing is going to be a combination of both. I do not think it is going to be one or the other. I think we are behind the times in resolving that. It has been an agenda item too long. It has been debated year after year after year. So, we have to get to it.

Chairman SHELBY. I believe that one of the most important things that you will be involved in after you are confirmed, and I assume you will be confirmed soon, is the Chairman of the Accounting Oversight Board.

I have no candidates, or wouldn't have any. But I think you realize how important that position is, not only for investor confidence, but also for the working of the Board itself.

Mr. DONALDSON. I could not agree with you more. If you have a candidate, or anybody has a candidate, we would like to hear about it. We will have a process to——

Chairman SHELBY. I do not have a candidate. But I hope you are going to have one or two and you are going to select one with the wisdom and experience that you bring to this table.

Mr. DONALDSON. Top priority, Senator.

Chairman SHELBY. Last, I continue to believe always that you cannot legislate or by regulation impose ethics. You cannot do this.

But, clearly, the problems that our markets face are beyond isolated incidents of outright fraud and malfeasance. I would like to think that they were not, but they keep coming up from time to time.

I think we are suffering from a broad cultural crisis of professionalism and values there. So how would you as the Chairman of the SEC demand the highest standards of ethical conduct in dealing with our capital markets, our accounting profession, to try to restore investor confidence in our capital markets?

Mr. DONALDSON. Well, that is an excellent question. That is one I have thought a lot about.

I believe that, number one, we must have laws and we must strictly enforce them. But in the final analysis, moving up to just conformity with a redline law is not going to get the job done.

So as Chairman of the SEC, I would see as a major part of my job speaking to the corporate community and talking to anybody that will listen to me and from any forum that will allow me to speak about the responsibilities of the corporate manager, about the responsibility of the corporate board of directors, about instilling in their organizations in any way they choose a code of ethics, esprit de corps, a way of doing business that is understood up and down the ranks.

There will be different approaches to that. But what I hope that we can do by talking a lot about it, and urging action on it, and actually, commending those that are actually doing a good job and showing different ways of doing that, is that we can recreate an environment where simple conformity to the law is not enough.

Chairman SHELBY. Although you come out of Wall Street, you have been very successful there, and this I think adds to your credibility for the job that you have been nominated for.

I think that now is the time to put some fear into people. You mentioned earlier the Marine Corps. You were a Marine officer. And there is always a little fear there, fear of not doing something right. Fear of not being on time. Fear that I believe that some people that have cheated and stolen and committed fraud, and might do it in the future, that they need to fear you as the Chairman of the SEC, that although you come out of Wall Street, you are not one of them right now.

You will be the Chairman of the SEC looking over what they do or what they fail to do.

Mr. DONALDSON. Right. Well, I surely understand the concept of the independence of this agency. I also understand the independence of my role as Chairman, no matter where I have come from. I think my past history——

Chairman SHELBY. I think it is good that you are coming off the street, as we say, because you know the system. You have experienced the system. You have unique qualifications. But your role is different, or will be different when you become the SEC Chairman. No one knows that better than you. You then will have the obligation to the American people, period. Won't you?

Mr. DONALDSON. I think that I understand that, Mr. Chairman. Thank you.

Chairman SHELBY. Thank you.

Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Before I turn to the questions that I have reserved for my second round, there are some questions I want to put on the basis of the first round.

First of all, I want to join Senator Corzine and Senator Shelby in underscoring the importance of the decision you will have to make in fairly short order to put in place a Chairman of the Public Oversight Board.

Newspapers that have been following this issue very closely—*The New York Times, The Washington Post, The Los Angeles Times, The*

Wall Street Journal, USA Today, The Financial Times, and others, *Business Week*—have all underscored the importance of this.

The Financial Times had an article just a day ago: "New Chief Must Show Recruiting Skills At SEC." It talks about the appointment of the new head of the accountancy regulator. The Public Company Accounting Oversight Board is the cornerstone of legislative efforts to restore integrity to corporate America and replace the accountancy profession's failed system of self-regulation.

A creditable replacement and clean selection process should see Mr. Donaldson off to a good start.

Also in another article it said: "The first test of Donaldson's skills will come when he helps decide who should replace Webster as head of the Accounting Oversight Board." And then references the GAO report, which found just this breakdown in the process at the SEC on this very question. In fact, it was that breakdown in large part that brings you to the witness table today in terms of the Chairmanship opening up.

So, I do not have a question. I just want to underscore the importance of this decision and the absolute necessity of putting into place someone whose very naming must command confidence and send a strong message that we really mean business about cleaning up these practices.

I think it is of critical importance and I just want to leave that with you.

I want to clear up a couple of things on the SEC. There have been all these references to your Marine Corps experience, and I commend that. I have enormous respect for the Marines. But I do hope that in running the agency, you will recognize the place of the employees union and the necessity as the Chairman to consult with them in a respectful and reasonable fashion. Can you give us some assurance on that point?

Mr. DONALDSON. I will give you absolute assurance on that point, Senator.

I have no experience with whatever the problems or the alleged problems are. But I assure you that that will be, again, one of the first things that I will want to take a look at.

Senator SARBANES. The other thing that I want to get assurance about is that you have to fight for the SEC budget. We have been through this process. Senator Corzine has taken a very keen interest in it and now, if we can bring it to success in the two budget decisions about to be made for this year and then for the next year, we will have a significant increase in the SEC resources, approximating almost doubling. But it took a lot of effort to bring that about. And the SEC needs a Chairman who will fight for its budget within the Administration and with the Congress.

You have to really be prepared, I think, to put yourself on the line to try to get the resources that your agency needs in order to do the job. That is going to have to require a lot of skillful in-fighting and almost a fierce determination on your part. Do you have such a commitment to assuring your agency its resources?

Mr. DONALDSON. Indeed, I do. I believe that the President's budget for 2004—I have one ally there to begin with. Clearly, I will do everything in my power to help convince the appropriate committees that that is a needed budget.

I also am aware of the timeliness now of resolving the interim appropriations for the year we are in right now.

We have a lot of promises out there. But right now, the SEC doesn't have much money and we really do not have much money as we are loaning money to the Oversight Board.

So, we need to get this through. And again, if I can be of help—I guess it is in conference right now. But if I can help in any way of convincing people that it should be done quickly, I will do so.

Senator SARBANES. I want to ask a couple of questions about some of your past performance.

An article in *The Washington Post* only a few days ago states that when you served as Chairman of the New York Stock Exchange when senior officials there looked the other way while four brokers reaped millions of dollars in illegal stock trades.

And *Business Week* reported that the SEC censured the big board for failing to catch illegal trading by floor traders in part during your watch.

Of course, that leads to the question, were you aware of these activities? Some have alleged that, as the Chairman of the Stock Exchange, you simply passed it over. What was the situation?

Mr. DONALDSON. Let me, if I can, elaborate on that. I am glad that you asked that question because there has been a lot of misunderstanding and misquotation in the press from a number of very prominent organizations who basically have not done a very good job of reporting.

First of all, during my tenure at the Stock Exchange, enforcement and protection of investors was always my top priority.

The New York Stock Exchange's first line of defense . . . We went back in and looked at the numbers. Enforcement actions increased by 80 percent during the years that I was Chairman of the Stock Exchange because I had put a lot of emphasis on that, 80 percent over the prior 3 or 4 years.

One of the issues that arose was an issue associated with a practice called flipping. Flipping is kind of a day trading operation carried on by floor brokers where profits accrue to their customers.

The practice while I was there raised some very important questions—is this good for the overall market, and is it being done in accordance with the rules and regulations? And if it is being done in accordance with the rules and regulations of the Stock Exchange, should those be changed?

So in the early years of my tenure, there were a couple of committees that were put together, a couple of standing committees that looked at the process, examined it, and came away saying that they thought that the Exchange should re-remind the practitioners of the rules and regulations and take a good, hard look at infractions that may be going on because people did not realize the rule.

Having done that, I was not satisfied with the conclusion of those two committees. And therefore, I caused a third committee to be formed, made up of directors of the Stock Exchange, representatives of the directors of the Stock Exchange, and others who were not intimately involved with the practice, and charged them with another look at this whole situation. And they did just that. They came up with some recommendations for changes. Those changes

were submitted to the SEC and approved by the SEC. That was during the period, let's say 1992, and I left the Exchange in 1995.

Later on, and all I know now is what I read in the press, the New York Stock Exchange, in conjunction with the U.S. Attorney in New York, opened up an unrelated investigation. And that investigation was caused by the allegation of criminal actions, not flipping actions, but criminal actions—false accounts, false time stamps, devious ways of sharing in the profits, et cetera, backdating orders, and so forth.

This was addressed by the Exchange. It was addressed by the U.S. Attorney. And this had to do with a criminal investigation that was undertaken.

If I can go one step further, the allegations that these criminal activities were going on during my tenure. . . . The allegations are something that is being promoted by lawyers defending a particular individual, and the very misleading statements have been released to the press and just picked up and used.

Senator SARBANES. Mr. Chairman, I am way over the time.

Chairman SHELBY. As former Chairman, I was indulging you. You used to indulge me. Thank you so much.

Senator SARBANES. Well, I appreciate the indulgence.

Chairman SHELBY. Senator Corzine.

Senator CORZINE. Thank you.

Let me go quickly through a series of things. First, the oversight and scope of view of derivatives. And I would like to talk about kissing cousin users of derivatives. Hedge funds are an area that I do not know whether you have verbalized to the public how you feel about being involved in oversight by the SEC. But many of us are concerned about both the connection between derivatives and hedge funds and whether there is some need for supervision there. I would like to hear your view on that.

If I could go ahead and just tick off these issues, I would like to get them on the record.

The harmonization of global accounting issues which you spoke to raises an issue which we have had a lot of conversation here in the Congress about, one that I hope we do not regulate, or one, we do not write rules on, but it is important to be addressed. And that is the expensing of options.

As you know, the International Accounting Standards Board has already recommended that that be the case. We could get into a harmonization problem pretty quickly if they take one approach, and we do not others. And certainly you have some element of relationship to FASB.

I would love to hear a little bit of your philosophy with regard to enforcement. Being on the other side of the fear quotient that the Chairman talked about, I just think that firm enforcement is a good idea.

I wonder if you have a philosophy that you bring with regard to enforcement considerations. You know, a number of the fall-out questions of the scandals that we have seen in the last several years raise this issue, WorldCom probably being the most extensive. But you can say that on Enron and other places. When does a corporate action dictate how you think about that? I would love to hear.

And if there were time, I would love to hear some impressions about the oligopoly of credit agencies and the economy.

Mr. DONALDSON. Let me see if I can hit those.

First of all, on hedge funds, I believe that there is a tremendous growth in hedge funds, pretty much totally unregulated. A lot of money. There is a distressing move toward what I would call the REITization of hedge funds, making them available to smaller and smaller investors and aggregating their money. It is of serious concern to me. Not the hedge fund concept itself, but the possibility of, A, less sophisticated investors not realizing the risks inherent in the vehicle and——

Senator CORZINE. My question wasn't formulated under the view that hedge funds necessarily are bad. They can greatly positive.

Mr. DONALDSON. Absolutely. And the allegations that concern me is what are possible manipulative aspects to hedge fund management. So, I am not against hedge funds per se. I think we need to know more about how they are operating. I believe that the SEC has already started to look into this and I would encourage that investigation.

In terms of expensing of options, I believe in oversimplified terms that there is an expense associated with options, and that that expense should be reflected in the operating statements of a company. The devil is in the details as to how you do it. We are about to get a report from FASB which I look forward to, if I am Chairman of the SEC, in terms of their approach to the details of how you do it.

And we, I hope, will be looking at anybody else's ideas with the end result desired that we have a common, an acceptable approximation of the best way to reflect the costs and it becomes a standard within the industry.

As far as enforcement is concerned, again, if I understand the thrust of your statement, as I said earlier, I believe that enforcement is at the core of the SEC.

I think that there may be some issues out there where people are impatient with the pace of enforcement. And I would simply say that I think we have to be very careful that we do not violate the ethics of review and process and so forth when we go to make very serious charges.

We cannot afford to make mistakes. So it is a slow, deliberate process. I am not saying that we cannot do it faster. But we cannot do it so fast that we harm the justice system that is so meaningful to all of us.

Senator CORZINE. Mr. Donaldson, the thrust of my question was not face. It is trying to get a sense of your balancing of the weight of individuals versus the corporate entity.

Mr. DONALDSON. Yes, the individual versus the corporate.

Senator CORZINE. It is a tough call. I am not trying to say that there is a How-You-Do-It book here. But there are certainly needs sometimes when the entity has so been infected with what the violation is, that it needs to be recognized as a choice that I think enforcement agencies and officials need to take a look at.

Mr. DONALDSON. I think that, clearly, individuals in many cases have broken the rules within their organization and are guilty and should get the penalties due that.

If there is such a pervasive atmosphere within an organization itself, that it is not an isolated individual breaking of the rules, but it is breaking of the rules throughout the whole organization and the organization is, "corrupt," then I think, if I am addressing your question, the organization becomes guilty.

That is a tough call. And it is quite dangerous, I think, to condemn a whole organization for the sins of outliers within that organization. But it is a tough call.

You also asked about what I think of the oligopoly of the rating agencies, of which there are three, or perhaps four, prominent ones. There is an oligopoly, and we depend so much on these agencies for the ratings that they give. There are a number of issues there as far as I am concerned.

One is that the rating agencies are paid by the very entities that they rate to give those ratings. That is an interesting fact and it has gone on for years. It is very tough to become a rating agency now, given the laws and the practice we have.

So, I think the area of rating agencies, the way they go about their business, the conflicts they face, how we bring more competition into that business, as well as allegations of delinquency and uncovering ratings that should have changed, that should have been quite obvious, but weren't quite obvious to the agencies. All of this, I think, justifies a hard look at the rating agencies.

Chairman SHELBY. Senator Schumer.

Senator SCHUMER. Thank you, Mr. Chairman.

And thank you for being here for a while, Mr. Donaldson. These are very important issues, and this is our first chance publicly to ask you these questions. We all appreciate it.

My next question is not about the transparency between investment bankers and research analysts. There has already been a lot of talk about that transparency. However, more and more firms are offering an array of products under the same roof to their corporate clients, particularly since the Financial Services Reform Act.

I would ask you to comment on another side of transparency, the relationship between loans to a corporation that may or may not be subsidized by the promise of future additional investment banking business.

I believe this practice has the potential to alter credit markets, and it certainly disguises the true cost of credit—can disguise. Let's not say it does.

It may also price out many firms that cannot subsidize below-market loans through fees from other businesses. It also, frankly, has the potential to hurt many banks. I think we have seen in the last year, that banks find themselves drawn into loans that they otherwise wouldn't make to maintain corporate relationships.

Now this is a question we have all debated on this Committee for a long time. But since the Financial Services Act of 1999—Gramm-Leach-Bliley—we have seen a lot of new changes, and we have seen a lot of write-downs of loans that may well have been made, or certainly were made alongside investment banking relationships, and there may have been a relationship among those.

I am thinking specifically of recent experiences of firms who have lost more in loan value from recent large-scale bankruptcies than they ever made in investment banking fees.

What is your experience as an executive with this practice? As head of the SEC, would you push for disclosure of any of these agreements? And can you give us a general view of how you feel about it.

Mr. DONALDSON. Well, if you go way back in history and the enactment of the Glass-Steagall Act, the reason for that Act was basically to separate banking and brokerage or underwriting, and there was a purpose for that given the problems that existed back then.

Obviously, the Financial Services Act has basically abrogated Glass-Steagall and set in motion a conglomeratization in the financial services business that already has changed the face of Wall Street. All the acquisitions by banks of investment banking firms and, conversely, investment banking firms acquiring banks, has changed the whole face of Wall Street dramatically in the last decade, and even more dramatically in the last 5 years. And within that context, there are whole new sets, as you bring up, of conflicts of interest existing in a one-stop-shopping concept.

The banks that have acquired investment banks have been after the generally higher profit margin business associated with investment banking. And clearly, the issue of whether making soft loans in order to get the more profitable business is an issue that, in my view, rivals in importance the use of research to be a handmaiden to investment banking and the securities industry.

Senator SCHUMER. So that is something that you would examine as Chairman of the SEC.

Mr. DONALDSON. Absolutely.

Senator SCHUMER. Good. My next question is about WorldCom.

This has been characterized as the biggest corporate fraud in American history. As you know, billions of dollars of wealth were wiped out. Confidence of business management was substantially undermined, to the detriment, not only of the shareholders and employees of WorldCom, but also to all U.S. businesses.

I still get complaints from other businesses whose phone service is all tangled up in this mess.

What do you see as the role of the SEC in prosecuting the individuals responsible for this fraud? As you know, as of now, there have been no official actions by the SEC.

Mr. DONALDSON. Well, if you confirm me as the Chairman of the SEC, I certainly will look into whatever work is going on inside the SEC in terms of this problem you cite.

Senator SCHUMER. Anything else?

Mr. DONALDSON. I would go on to say that if there have been violations of law, they should be punished, and that punishment should come as quickly as we can, doing it fairly.

Senator SCHUMER. Do you have any thoughts of how good a job the SEC has been doing in this regard in this case up to now?

Mr. DONALDSON. I do not, Senator. I wouldn't comment on that.

Senator SCHUMER. Okay. Thank you. Final question, do I have time for one or should I wait?

Chairman SHELBY. Go ahead, finish it.

Senator SCHUMER. Thank you. Is there a clock?

Chairman SHELBY. We have been very generous with——

Senator SCHUMER. You have.

Chairman SHELBY. —Senator Sarbanes' time.

[Laughter.]

Senator SCHUMER. Paul, if you would like to go, I can wait. I have one more question.

Senator SARBANES. For the sake of friendly relations, I urge you to go ahead with your next question.

[Laughter.]

Senator SCHUMER. Paul, we will always be friendly, as far as I am concerned.

Senator SARBANES. Would the Reporter please note that for the record.

[Laughter.]

Chairman SHELBY. Strike that.

[Laughter.]

Senator SCHUMER. Okay. All of us in the Senate, in this Committee in particular, are very concerned about the current state of the economy. As you know, the stock market has lost almost $5 trillion in the last 2 years, a mind-boggling sum. Last year, it showed its worst performance since 1974. And I am told that the stock market is down more in the last 2 years, the first 2 years of President Bush's Administration, than any modern President, including Herbert Hoover. What is your assessment of the current market? How much do you see the threat of war weighing on stock prices and investor confidence? What is your view of the relationship between deficits and interest rates? And in turn, interest rates and stock prices?

Mr. DONALDSON. Well, let me——

Senator SCHUMER. I can go over each one of them separately.

Mr. DONALDSON. Let me talk a little bit about the market itself.

Clearly, the economy has been in a recession. It is coming out of a recession, I believe. I believe that the pace of recovery has taken a little side tick here. It appeared that it was on a much more sustained track and that now there is evidence that perhaps that is moderating a bit.

To me, it is amazing that it hasn't moderated sooner, given the events that are worrying investors, to wit, that the earnings of corporations have been a little disappointing, that recovery earnings have been a little disappointing.

The escalation of the possibility of war is overhanging the entire situation. And of course, the constant daily reminder of the malfeasance that has gone on in the securities markets and corporations and so forth, the undermining of the confidence, just general confidence, is there and has not been dissipated.

I would hope that the SEC could have some influence on the confidence factor.

I think that until the international situation is resolved, at least the immediate possibility of action in Iraq, it is going to be a very nervous market. And of course, we have other worries that may be triggered by that action, terrorist worries, North Korea, and so forth.

Frankly, that is beginning to reflect itself in consumer confidence and that again flows back into earnings estimates, business not being as good as people expected it to be. So, we are in a very uncertain period.

I do believe that the President's program, as proposed, is a good program. I am sure it will be argued about. But I think, essentially, as to the deficit implications of that, my own personal view is that nobody likes deficits. Deficits do count. But also, we have to take remedial action. We have to have an insurance policy. We have to take steps that we might not take in normal times to make sure that we do not go over the cliff. And in that sense, the risk of larger deficits is justified, I believe, in terms of even greater risk that the economy rolls over.

As far as the long-term impact of deficits on the economy, clearly, borrowing does have an effect. Deficits do affect the economy.

The hope is that the best way of addressing those deficits and meeting our other obligations is that the tax policy will get the economy going again and the tax revenues will come in and that we will help to pay down that deficit by these actions.

Senator SCHUMER. I had asked you also about the relationship between deficits and interest rates and interest rates and stock prices.

Mr. DONALDSON. Well, there is a definite relationship between interest rates and stock prices. As a matter of fact, the take-off for pricing of stocks, of price earnings multiples, is a simple measure, and definitely has something to do with the rates of return available in other forms of investments.

If interest rates were at 10 or 15 or 20 percent, or ever where they were years ago, that becomes a pretty attractive investment relative to the stock market and vice versa. So there is a definite correlation, not over a short period of time, but over a long period of time.

In terms of the effect of deficits on interest rates, again, there is a lot of debate on this. There is the theory, as you know better than I, of a crowding out, the financing of the deficit by the Government crowding out the private borrowers. I do not see that as an immediate problem here. I do not believe that the cost of capital right now, which is very low, is what is impeding industrial investment. I believe it is confidence that is impeding. If I am running a company and I am facing some of the things that we were just talking about a minute ago, war, et cetera, and somebody comes in and says, let's build a new plant, I am going to say, why don't we wait? Why don't we wait for a couple of months?

Senator SCHUMER. Right.

Mr. DONALDSON. So the dissipation of that is what the problem is right now.

Senator SCHUMER. And regardless of one's overall views in terms of your earlier comments——

Mr. DONALDSON. I should preface this—excuse me—by saying I am not an economist. These are my own personal——

Senator SCHUMER. We understand that. But you have a lot of experience, practical, good experience.

Wouldn't it make more sense if we were using the deficit to prime the pump a little bit, or using deficit spending, to do a good deal of it this year and next year, rather than in 2006, 2007, 2008, and 2009?

As you know, the President's plan does a very small percentage in this fiscal year and a rather small amount in the next fiscal

year. It really comes hitting later on. Maybe if and when you become Chairman of the SEC, you will have done such a good job, that by then the economy will be going on all cylinders.

But one of the things I think that makes people scratch their heads a little bit is how backloaded the President's so-called stimulus plan is. Some even say it is not even a stimulus plan, but rather, tax reform, whether you are for it or against it.

Would you care to comment? Would it be better in terms of getting the economy going, getting the markets going, to do a little more in this first and second year to prime the pump?

Mr. DONALDSON. This business of confidence, confidence is a very evasive concept. It is my own personal belief that one-shot tax reform is not nearly as effective in gaining confidence as is a long-term program that you can count on.

And having a few dollars in hand or a depreciation deduction that goes on 1 year, off another year, that is a lot less confidence-building than surety that, over the long haul, things are going to kick in on a programmatic basis.

I think we have so many expenditures now that we need to make in connection with all of the things that we are trying to do—Medicare, domestic spending, military spending, et cetera—that I do not think we have to go out and build new roads or stimulate the economy in any other way than just addressing some of the real problems we have.

Senator SCHUMER. Thank you, Mr. Chairman. I appreciate Senator Sarbanes letting me ask that last question.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Mr. Donaldson, *The Washington Post,* in an article when you were first named, said, and I am quoting them now: "As New York Stock Exchange Chairman, he argued that foreign companies should be allowed to sell stock to U.S. investors with financial disclosure rules weaker than those required of U.S. companies."

"The SEC Chairman at the time, Richard Breeden, who was appointed by Bush's father, refused to allow that despite Donaldson's lobbying of the White House and Congress."

I am interested in this issue of listing standards for non-U.S. companies. Actually, we tried to address it to some extent in the legislation. And I would like to know your view on this question. Particularly as you move from being head of the New York Stock Exchange toward the prospect of being Chairman of the SEC.

Mr. DONALDSON. Right. As I touched on before, the issue back then, 1990 through 1995 or so, was the amount of money that was going overseas, going through many intermediaries, and being invested by individual investors overseas, in markets where there were not the regulatory safeguards that we have in our market.

At that time I felt very strongly that somehow we should give—and at that time I was wearing a partisan hat of the New York Stock Exchange—investors the protection of the New York Stock Exchange's rules and regulations by somehow getting these foreign companies to list on the New York Stock Exchange.

The main inhibition for that was the absolute insistence of conformity to U.S. accounting GAAP standards that we attempted to force on foreign companies. And I can remember talking to a num-

ber of foreign companies—as an example, in Germany, where no German company had ever listed on the New York Stock Exchange, and listening to their arguments about why their accounting was better than ours.

I obviously disagreed with that, but it became very apparent to me in subsequent events that there was an element of truth to that, that our accounting did not look so good in hindsight. And perhaps some of their accounting looked a little better.

So what I was calling for was not a diminution of accounting standards, but, rather, a harmonization of somehow getting the best of both with a view toward transparency and disclosure, but gotten at in a different way.

The fact of the matter is that, during that period of time, gradually, the SEC's posture changed a bit under Chairman Breeden and finally, when Daimler-Benz wanted to list on the Stock Exchange, the rules were changed. We let Daimler-Benz list without making them report their earnings back over 3 years, which they could not do. So, in fact, the rules were modified to allow the largest German company to list on the Stock Exchange.

Senator SARBANES. Well, now, if we achieve harmonization between FASB and the International Accounting Standards Board, so that there is a uniform set of accounting principles, we wouldn't have this issue, then, would we?

Mr. DONALDSON. Correct.

Senator SARBANES. It is important, though, it seems to me to achieve harmonization at the highest level, not at the lowest level. In other words, that we take the best out of both systems in the course of doing that and FASB and the IASB are in discussions about doing this, as I understand it right now.

Until that is achieved, though, I think it is important that we not relax the standards for listing in the United States of foreign companies in such a way that we are not protecting our investors or creating a nonlevel playing field for American companies. Would you agree with that?

Mr. DONALDSON. I would agree with that. I believe that there should not be, in areas other than pure accounting, things that foreign companies can do that a U.S. company cannot do. However, there are certain things having to do with foreign companies where our current laws, are impossible for them to conform to.

And again, I am referring now to the dual boards and directors by their laws who must be termed to come from the company and be insiders and who cannot be outsiders on their audit committee.

It is a matter of law, and I think that the interpretation, as I understand it, of the Sarbanes-Oxley law, the rules that are coming out now, are taking that into consideration. I think that that is probably an unintended consequence.

Senator SARBANES. Now the SEC has made some accommodations, which, upon review, seem to be fairly reasonable. For instance, the German, the Swedish companies have, given the way they are structured corporately, they have employee representatives on the Board who also usually have an employee representative on the audit committee.

It is arguable that they do not constitute an independent director. The SEC has made an accommodation for that purpose. But it

seems to me that we still have to be pretty rigorous in ensuring that the companies being listed meet our standards. The only penalty for not doing so is they do not get listed. And of course, we are anxious to protect our capital markets and to assure investors that they can rely on the disclosures and the corporate governance that lies behind it.

So, I would be very concerned about some effort that said, we are getting this argument from abroad that we are trying to do extraterritoriality by imposing our standards on foreign companies.

It is only if they seek to become listed on our exchanges that these standards apply.

Mr. DONALDSON. Right.

Senator SARBANES. If they do not seek listing on our exchanges, they can govern themselves any way they want. But it is once they want to get that entry into the American exchanges that we then have to be concerned about providing assurances to investors in terms of the information that has been flowed to them.

Mr. DONALDSON. Well, several responses. One, I basically agree with you. I think that the transparency of our accounting cannot be fiddled with, if you will, in terms of foreign listings. The individual investor has to have the protection of our accounting system as we try to harmonize it.

I also think that there is an element here of U.S. competitiveness that we cannot disregard. To wit, if we have such a high fence around our markets and we force foreign companies not to trade here, not to be listed on our exchanges, the market will move from the United States to other countries.

Senator SARBANES. The way to deal with that high fence is to achieve this harmonization between FASB and the International Accounting Standards Board.

Mr. DONALDSON. I agree with you, Senator.

Senator SARBANES. Then the problem becomes moot. Assuming that the harmonization is achieved at a high level and not down at some low level.

But if we have learned any lesson out of what we have been through, it is the necessity to sustain the integrity of our markets in a way that people can repose confidence in them.

In that regard, I was encouraged to hear your response to Senator Schumer about examining the WorldCom situation. They overstated their earnings by $10 billion. By $10 billion. And it seems to me that it is worth looking into. I don't know that they should simply take a bankruptcy bath and everything is forgotten and forgiven. I think of all the companies, their impact in terms of lost employment, the hits to pension funds, to retirement plans, is by far the greatest.

Let me ask you, do you regard State securities regulators and State attorney generals as prospective partners for the SEC in enforcement of the securities laws?

Mr. DONALDSON. Absolutely. I absolutely believe that, and I also believe that the President's Corporate Fraud Task Force with the Justice Department is another partner. I think that the law enforcement agencies, whether they be Federal or local or State, should be partners in pursuing securities crime.

Having said that, I think there has to be a primacy in terms of the solutions to these things that rests with the Securities and Exchange Commission.

Senator SARBANES. I think Attorney General Spitzer was pretty sensitive to that, actually. I think he moved into a vacuum that was not being filled by the SEC and they called for some action. And he has been very clear himself in the necessity to have national standards with respect to the securities markets.

I think it is very important for the SEC to see the State securities regulators and the State attorneys general as partners in their effort to sustain the integrity of these markets.

Even the increase in resources that you are getting, you have nowhere near enough to do what has to be done and, in many instances, they have contributed to it.

A couple more questions, if the Chairman will indulge me.

Chairman SHELBY. You go right ahead.

Senator SARBANES. There have been a number of newspaper articles about your compensation package at Aetna. I am sure you have seen those. They talk about your share options and your own direct pay package and so forth. Your bonus on top of your salary. I would like to hear your response to that. But I would also like to couple it with another question.

The Council of Institutional Investors has said that it is time for the SEC to review the current rules and to consider updating and improving the disclosure requirements. This is on executive compensation. And I would like to know your view on this suggestion from the Council of Institutional Investors that we need to have improvements in the disclosure requirements of executive compensation.

Mr. DONALDSON. Yes. Let me address the first question first, which is my compensation for my role as the CEO of Aetna.

I believe that my compensation was strongly aligned with shareholder interest. I received substantial compensation from Aetna. However, the majority of that package was contingent upon my achievement of six stated goals. When I became CEO of Aetna, the independent compensation committee hired an outside consultant and they developed a compensation package with six goals. And the equity portion of that was staggered. In other words, it wasn't all granted at the existing price. There were ever-increasing prices which would make the options worth something only if the stock price went up.

By the way, the value created since the day I took over Aetna as CEO until today, for the shareholders, was, according to my calculations, $4.3 billion of new value that was created for Aetna shareholders.

My compensation package was tied to the six goals and it was tied to what the rest of the shareholders were going to get.

And this relates to the second part of your question. It was fully disclosed in all of our proxy materials; they spelled out exactly the compensation I received, the procedure as to how it was awarded, the fact that it was independent directors who determined it, the fact that they use outside independent consultants to verify their judgments. So, I feel that that was the way it should work.

Now at the time I took on the job, and this has to do with the duration of my employment, part of my arrangement with the directors of Aetna was that I was there to achieve certain goals. Those goals were to restrategize the company, to sell off properties, to bring in new management, and so forth. I had no idea, nor did the directors, how long that was going to take.

Frankly, we got it done in a lot shorter period of time than might have been expected. And when, in my view, it was done, I resigned my position, turned the whole thing over to the current CEO. By the way, they are doing a terrific job right now, if I might say that.

Senator SARBANES. Let me put one final question to you.

The SEC has just approved a final rule requiring mutual funds to make public how they vote the proxies of the companies they invest in. This regulation responded to investor complaints that mutual funds were voting against investor interests on issues like Bermuda reincorporation, board independence, the whole list of things. Do you support the implementation of this rule?

Mr. DONALDSON. Yes, I do. I believe that there are lots of arguments pro and con. But I think that this is a good start in terms of transparency. And inducing large shareholders, in this case, mutual funds, to exercise their rights of ownership, and obligations of ownership. So, I do support the bill.

Senator SARBANES. Mr. Chairman, I want to thank you for holding this hearing promptly. After all, Mr. Donaldson's papers only arrived last week. And I know of your own commitment to try to move the nomination forward, which I share.

I intend to support this nomination. We have had a Chairman of the SEC who resigned the first week in November. It is now the first week in February and he is still on the job.

We do not have a Chairman of the Public Oversight Board. We need to get moving. And I have the hope and the expectation that Mr. Donaldson will prove to be the kind of committed Chairman of the SEC who will bring about these changes that are so essential.

You face a tremendous challenge, and a tremendous opportunity. This Committee obviously will be watching closely. I know the Chairman has indicated his own intention to have a very active oversight agenda.

There is a chance here now to raise in a very significant, substantial and hopefully, a lasting way the whole level of corporate governance, corporate behavior, accounting standards, the accountability of the accountants. But it very much depends on the new Chairman of the SEC providing that kind of leadership. We look forward to working with you on that and we wish you the very best as you undertake these very significant responsibilities.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you, Senator Sarbanes.

I just want to add, Mr. Donaldson, I believe that you bring more than the requisite experience, your educational background, your commitment to this country. That you could, and I hope you will, be one of the outstanding Chairmen of the SEC. Otherwise, I do not believe you would have taken the job.

I want to work with you. And of course, I intend to support your nomination. I told you that earlier.

There are some Senators who have submitted some questions for the record. I would hope that you would answer those questions expeditiously. And Senator Sarbanes and I will get together and try to have a Committee hearing as soon as possible, if you get those questions in and report your nomination to the floor, and ultimately, the Senate will vote on it.

Thank you for your appearance. I wish you well.

Mr. DONALDSON. Thank you very much, Mr. Chairman.

Chairman SHELBY. The hearing is adjourned.

[Whereupon, at 12:50 p.m., the Committee was adjourned.]

[Prepared statements, biographical sketch of the nominee, and response to written questions follow:]

PREPARED STATEMENT OF SENATOR TIM JOHNSON

Mr. Chairman and Ranking Member Sarbanes, thank you for convening today's hearing to consider the nomination of Mr. William Donaldson to become Chairman of the Securities and Exchange Commission. I would like to take a moment to welcome the new Members of the Senate Banking Committee. I look forward to working with Senators Chafee, Dole, and Sununu on so many issues of importance to this country.

Mr. Chairman, our Nation continues to confront a crisis of confidence in the markets that was precipitated by outrageous fraud in companies and their auditors, from WorldCom to Enron to Arthur Andersen. It is my hope that new leadership at the SEC will help to move America forward. Ever since Mr. Pitt announced his resignation on election night, we have been waiting for President Bush to show leadership in this area. I know I join my colleagues in welcoming a strong new head of the SEC, and we look forward to hearing Mr. Donaldson's thoughts on his vision for this critical position.

I would like to note to this panel the importance of setting the tone for the future of the SEC. As I am sure most recognize now, it is clear that Mr. Pitt made a grave error in the tone he set at the start of his tenure by declaring his intention to create a "kinder and gentler" SEC. As we have all learned since, most of us the hard way through a steep decline in the value of our retirement savings, we must work to create a formidable SEC, a trustworthy SEC, and most important, an SEC that places the interests of investors above all else.

If the SEC is to become kinder and gentler, I believe it should be toward investors, who are now negotiating the difficult maze of arbitration to seek justice over the outrageous fraud that has gutted their life savings. I look forward to hearing Mr. Donaldson's views about the arbitration process, and how we might take steps to protect the rights of investors in this area.

Companies must understand that in the long-term, an SEC that is trusted by investors will work to their ultimate benefit. Until we restore confidence in investors, we cannot get our economy back on track. Investors have not pulled out of the market because they want to avoid paying tax on their dividends. They have pulled out because they do not trust corporate leadership, and they do not trust the SEC.

Now, I would like to note for the record that the SEC under Harvey Pitt has taken some important steps toward implementing the Sarbanes-Oxley Act, and I would especially like to acknowledge the extraordinary leadership of Senator Sarbanes, along with Senators Dodd and Corzine on this effort. We need to keep the pressure on implementation of this law, and I look forward to working with Chairman Shelby and this Committee to conduct strong oversight.

PREPARED STATEMENT OF SENATOR MICHAEL B. ENZI

It is nice to be back at the Committee after the recess, and I look forward to working with the Committee on issues affecting the financial services sector.

I want to welcome Bill Donaldson to the Committee. I certainly appreciate his willingness to take on this role and to help restore investor confidence in our capital markets.

This is not an easy time to become the head of the SEC. The markets have recently gone through more turmoil than since the 1930's. Corporate fraud and the bursting of the internet bubble has cost investors large portions of their personal savings and retirements. In my opinion, the job of the next SEC Chairman will be to restore this confidence and to renew Americans' willingness to participate in our capital formation process. This will be an incredible challenge for the new Chairman.

I believe part of accomplishing this includes penalizing the wrongdoers to the fullest extent possible. The purveyors of corporate fraud must be punished swiftly and severely. The only way to punish these criminals is to deliver real sentences and harsh monetary penalties. The victims of these crimes demand justice and they deserve to receive it. Class-action lawsuits that allow the trial lawyers to reap millions of dollars while the investors receive pennies will not bring justice to the victims. To accomplish this, I am glad that during last year's passage of Sarbanes-Oxley we significantly strengthened white collar crime penalties. I know that Congress did this with the expectation that the law enforcement community would utilize the authority.

I also want the new Chairman to closely examine and follow Congressional intent during the Commission's rulemakings. For instance, I do not believe that anyone who was involved in the development of Sarbanes-Oxley believed that the Financial

Accounting Standards Board should not be the accounting standard-setting body described in Section 108. However, the SEC has yet to officially notify the FASB they are that body.

It was my understanding that while naming this standard-setting body that we would be giving FASB more independence.

By giving them an independent funding source and statutory authority, they would have a better ability to make independent decisions on accounting matters. This Section was not intended to give the Commission significantly more authority over accounting standard setting. The Commission does not have the expertise to set accounting standards.

This lack of acknowledgment by the Commission has left the FASB in a funding crisis. Private companies are no longer supplying funds to the FASB because they were intended to have the mandatory funding mechanism outlined in Sarbanes-Oxley. The Commission should immediately name the FASB as the standard-setting body in Section 108.

This point brings us to, I think, a bigger issue. Throughout the recent rulemakings, the SEC has gone beyond the statutory requirements of last year's legislation. Whether it is the auditor independence rule, the Section 307 lawyer provision, or the naming of the FASB which I mentioned, the Commission seems determined to go beyond the statutory requirements. Some of these issues, in particular the nonaudit services provision, went well beyond the statute.

A large part of Sarbanes-Oxley was the construction of a new Public Company Accounting and Oversight Board or PCAOB. This Board is designed to be the frontline regulator of the accounting industry, including the establishment of nonaudit service prohibitions. It was unnecessary for the Commission to go as far as the proposed rule did when we are a few months from the PCAOB operational. They, not the Commission, will be in the best position to make the determination regarding what is, and is not, a conflict.

Also, I know that the salary levels of the Members of the PCAOB has received a lot of attention, particularly from Members of the Commission. This Board was constructed to be private and not a Government agency. Part of this was to ensure it could attract and retain qualified Members of the Board by offering competitive salaries. I think we need to ensure that the Board is able to continue to attract these people.

I know that I have put a lot on your plate, Mr. Donaldson. I want you to know that I have complete faith in your abilities and the direction which you will lead the Commission and our securities markets. If, at any time, you feel you need more authority or resources to help weed out corporate wrongdoers, I hope that you will feel comfortable calling on this Committee before we encounter these types of problems again.

Mr. Chairman, I thank you for your efforts on this matter. I look forward to working with you, the Members of the Committee, and the Commission in the future.

PREPARED STATEMENT OF SENATOR JON S. CORZINE

Thank you, Mr. Chairman, for holding this hearing. I want to welcome Mr. Donaldson before the Committee and congratulate him on his nomination.

Mr. Chairman, though Mr. Donaldson was kind enough to pay me a courtesy visit last week, I did not need that meeting to become convinced of his vast knowledge of our Nation's financial markets. I have known Mr. Donaldson for quite some time, and he has always been an innovator and a leading thinker within the securities community.

Those characteristics and the skills acquired from years spent at the company he co-founded—Donaldson, Lufkin & Jenrette—his tenure at the New York Stock Exchange and his time as a public company CEO give Mr. Donaldson a wide array of experiences from which to tap into should he move forward to become the next Chairman of the Securities and Exchange Commission.

If confirmed, Mr. Donaldson would take the helm of an embattled agency. His first task will be to restore investor confidence after a year plagued by corporate fraud and accounting scandals. The efforts he will immediately undertake at the agency will go a long way toward determining his success or failure at restoring that confidence.

Those include finding a strong, credible individual to lead the new Public Company Accounting Oversight Board and overseeing the rulemaking process for implementation of the Sarbanes-Oxley Act. Mr. Donaldson will also need to devote considerable attention to restoring the morale amongst SEC employees and fighting

to make sure that the agency receives the funding it has been promised by President Bush in his fiscal year 2004 budget and by the Congress.

Over the long run, I look forward to seeing how Mr. Donaldson seeks to turn his vision of a new SEC into a reality. That vision will play a significant role toward ensuring whether America's capital markets—in the face of growing global competition—remain the heart of global capital formation.

Mr. Chairman, the U.S. capital markets have, in many ways, provided the fuel for the expansion of the global marketplace. Domestically and abroad, they have driven the economic growth that has been at the heart of technological, economic and cultural change throughout the world. In doing so, our capital markets have grown stronger, more liquid, and more adaptable to ever-changing and dynamic global economic conditions.

To remain strong U.S. markets must pursue innovative thinking and risk-taking which, coupled with transparency and effective regulation, will ensure the integrity of a system that investors will continue to view as a fair and reliable place to do business.

To be certain, the challenges facing the SEC are enormous. Fortunately, Mr. Donaldson will be equipped with considerably more human and technological resources than those before him have had. The Sarbanes-Oxley legislation provides a statutory framework that should enable his success, as will new funding for the agency. The rest, as they say, will be up to him.

Mr. Chairman, I look forward to Mr. Donaldson's testimony before the Committee, and should he be confirmed, to assisting him in any way I can. And Mr. Donaldson, I again congratulate you.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF SENATOR ELIZABETH DOLE

Thank you, Mr. Chairman. I look forward to working with you and the other Members of the Senate Banking, Housing, and Urban Affairs Committee, and I join you this morning in welcoming William H. Donaldson, who has been nominated by the President to serve as the next Chairman of the U.S. Securities and Exchange Commission.

Economic growth and job creation, the very health of the American economy, all depend on the honesty of American business, the integrity of our securities markets, and the faith of the American people in our financial institutions. Over the past year, this faith has been badly shaken—a fact that is further compounded by the global uncertainty surrounding the war on terror and the unpredictability of Saddam Hussein.

The vast majority of American businessmen and women obey the laws and uphold the rules. However, those that refuse to play by the rules, and threaten to undermine the integrity of our financial markets in the process, deserve tough penalties.

Last July, President Bush signed the Sarbanes-Oxley Act, which adopts tough new provisions to deter and punish corporate and accounting fraud and corruption. It ensures justice for wrongdoers, and protects the interests of workers and shareholders. There are a lot of very good things in this new law—like requiring companies to disclose more information and then having CEO's and CFO's personally vouch for the truth and fairness of their company's disclosures.

This law takes much needed steps to help expose and punish corporate corruption, improve disclosure, and increase protections for those that invest, including pension funds. Now, we need to focus on strengthening the SEC's structure and ensure the ability of the agency to fight fraud *and by fully implementing the Sarbanes-Oxley legislation.*

And there is more we can do to restore investor confidence.

Auditors currently face a real conflict of interest—as *The Wall Street Journal* recently pointed out, they are paid by the people they are asked to police. And there is no doubt that at least some of the scandals we have seen over the past year occurred because auditors were hoodwinked by management.

So it comes down to a matter of incentives. What incentive does an auditor have to report something displeasing to those who foot the bill? *Wouldn't it be in their best interest to make the client happy,* thereby guaranteeing more work from that client in the future?

I like an idea put forward by New York University Stern School of Business Accounting Professor Joshua Ronen, to change the incentive structure for auditing companies. The proposal would require that companies buy Financial Statement Insurance in much the same way they now buy officers and directors insurance,

offering a solution to help improve the integrity of audited financial statements at publicly-traded companies.

I believe Professor Ronen has hit the nail on the head. Again, according to the *Journal,* his idea "not only attacks the incentive problem, but along the way it brings market discipline into corporate accounting via stock prices, offers better protection to shareholders in the case of fraud than does directors-and-officers insurance, and avoids more Government regulation."

It is a matter of changing the incentives.

Let's look quickly at the problem: *Auditors face a real conflict of interest.* Right now, an auditor is hired by the corporation, and therefore is, to some extent, beholden to the corporation that is paying the bill. But if corporations are required to buy Financial Statement Insurance, and the insurer hires the auditor, it changes the incentive.

The insurance company has every incentive to hire the most competent auditor, and the auditor has every reason to ensure an accurate audit. Under such a system, the loyalty is to accuracy, not to the corporation being audited.

Financial Statement Insurance attacks the incentive problem, brings market discipline into corporate accounting and offers better protection to employees and shareholders. But making the leap to Financial Statement Insurance is unknown, thus less comfortable and businesses are unlikely to make the jump unless pushed. That is where the Federal Government comes in. By requiring this by the SEC, the natural reluctance to change, even for the better, can be overcome. And requiring companies to have Financial Statement Insurance enables investors to accurately judge the quality of financial statements and make sound choices with their money.

It just makes good sense—it will not cost the companies much more, and if their audits are very reliable, maybe even less. It will not cost the Government much since it is only adding some additional lines to already required quarterly and annual statements. And since it does not create a new cause of action, it will not create new lawsuits and the insurance companies already know the risks.

Mr. Donaldson, I look forward to working with you on this issue and others to ensure that investors have fair and accurate information to make sound investment decisions. I appreciate your commitment to service, and I am confident that you will work hard to vigorously enforce our Nation's laws against corporate corruption and help bring confidence back to our markets.

Thank you.

PREPARED STATEMENT OF SENATOR DEBBIE STABENOW

Thank you, Mr. Chairman. Let me take a moment—since I have not yet had the chance—to congratulate you publicly on taking over the Chairmanship of our Committee. I am looking forward to working with you on important legislation in the 108th Congress and I think there are a number of important issues where we will find a great deal of common ground.

Today, we are going to be hearing from Mr. William Donaldson, the President's choice to replace Harvey Pitt as head of the Securities and Exchange Commission.

I believe it is absolutely essential that we have a strong and effective leader running the SEC.

I was the first Member of this Committee to call for Mr. Pitt to step down from his role at the SEC. With the ever-intensifying concerns from many about his decisions and priorities and with the profound problems in the markets and with investor confidence, it was clear to me that we needed new leadership.

The sooner we have a strong leader in place at the SEC, the sooner we can assure consumers that the Sarbanes-Oxley Act will be implemented effectively.

I look forward to hearing more from Mr. Donaldson about how he intends to make sure the law is fully implemented as intended by Congress. I also look forward to learning more about his plans to restore investor confidence. I know that people remain scared of the markets. Many people lost huge portions of their life savings over the last 3 years and are holding back on future investments. In addition, I do not believe that we can guarantee to the public that all of our accounting concerns have been allayed. The work of the Public Accounting Oversight Board, after all, is just getting underway.

Mr. Donaldson came by my office yesterday and we had a chance to talk briefly about a number of issues of concern to me. In particular, I indicated to him that it is extremely important to me that the corporate whistle-blower amendment that I offered to the accounting reform bill is effectively implemented. I want to make sure that employees can confidentially and anonymously report concerns about ac-

counting wrongdoing directly to their company's audit committees. In this way, I believe we can stop some of these corporate implosions early on—rather than after millions of dollars invested in these companies are lost and thousands of jobs are gone forever.

I will remain actively engaged on this issue of corporate whistle-blowing, and I want to work with the SEC to make sure the new whistle-blower mechanism is working well.

It is also important to me that the public understand the new law. I have encouraged Mr. Donaldson, upon confirmation, to update the SEC's website and to engage in a public relations campaign to make sure that the employees of publicly-traded companies understand that they have a means of reporting questionable accounting procedures to those that have a responsibility to do something about it.

Mr. Donaldson and I also had the chance to talk about the challenges the SEC has faced in remaining an independent regulator. Too often, political influences have tried to alter sound policy decisions. Sometime it has been Members of Congress. Sometimes it has been an Administration. Sometimes it has been various industry groups. I want a strong independent SEC that will work in the best interests of investors. I have told Mr. Donaldson that, to the extent that I can help insulate the SEC from political interference that affects sound decisionmaking, I will be an active and supportive ally.

This is especially critical now, as the SEC gets ready for one of the most significant budget and staffing increases in quite some time. It is so important that the SEC get sufficient funding in the fiscal year 2004 funding cycle and beyond.

We tend to forget about Enron and WorldCom and the other companies since they are not in the news everyday. But the SEC, as I am sure Mr. Donaldson would agree, cannot ignore the wrongdoing that occurred in those various companies and its investigations must continue and those guilty of crimes will need to be punished.

Thank you, Chairman Shelby. I appreciate the chance to share some of my thoughts today and I look forward to learning more about Mr. Donaldson, his vision for the SEC, and how he will help restore investor confidence in America's markets.

PREPARED STATEMENT OF SENATOR WAYNE ALLARD

Mr. Chairman, I would like to thank you for holding this hearing to consider the nomination of Bill Donaldson to head the SEC. I especially appreciate that you scheduled it so promptly after the Committee received his paperwork. This is a critical position in our Government, and I look forward to working with you and the rest of the Committee to get Mr. Donaldson confirmed.

As we all know, the SEC has been the subject of many headlines over the last year. With the revelations of corporate scandals and passage of Sarbanes-Oxley, the agency has received a mandate for change. As the nominee to lead the SEC through this transition, Bill Donaldson has a daunting challenge before him.

Mr. Donaldson, as I do for all nominees before this Committee I would like to take this opportunity to bring to your attention the Government Performance and Results Act. The Results Act requires Government agencies to focus on results and outcomes rather than processes. I would urge you to carefully study the Results Act and apply it to your decisionmaking at the SEC.

Finally, I would also urge you to communicate regularly with Congress and keep us informed of your work. We all have a common goal of wanting to provide effective and efficient service for American taxpayers and investors, and good communication will help us both.

Again, Mr. Chairman, thank you for convening this hearing. I look forward to hearing from Mr. Donaldson.

PREPARED STATEMENT OF SENATOR RICK SANTORUM

Mr. Chairman, as you may know, the Finance Committee, of which I am a new Member, is marking up a key legislative priority for the Administration at the same time as this confirmation hearing for Mr. Donaldson. In addition, I am the lead Republican sponsor of the legislation, the Charity Aid, Recovery, and Empowerment (CARE) Act. I regret that I will have to leave shortly.

Mr. Donaldson, you are being considered to take leadership responsibility at a challenging time for the Securities and Exchange Commission, investors and Wall Street. The drop of the stock market and various financial scandals, some of which involve criminal wrongdoing, have taken their toll on the U.S. financial sector, in-

vestor confidence, and the economy at-large. In response to the scandals, Congress last year passed the Sarbanes-Oxley Act, the most sweeping securities legislation in a generation.

Yet at the same time, it is important to remember that the U.S. financial markets are the most fair and efficient in the world and play a key role in the economic strength of our Nation and the standard of living Americans enjoy. The preeminence of U.S. financial markets, however, is not automatic and there are competitors around the world who would eagerly replace the position of the United States in world financial markets.

Innovation, competition, and the trustworthiness of our processes and our people have produced all the positive characteristics found in our financial markets today. Yet events of recent years prove that there are still standards to tighten, and unfortunately, crooks to punish. The Commission must therefore regulate with the utmost care while balancing competing needs to provide for necessary safeguards, particularly for average investors, as well as maintaining our competitiveness. If done well, the safeguards of a sensibly regulated national market system can be an asset to U.S. financial markets that will allow Americans to continue to benefit from favorable capital inflows from around the world to U.S. markets.

Your experience in various roles in the financial world will bring an important perspective as you lead the Commission in the coming years in evaluating complicated issues and making significant decisions for which there will be no absence of critics or scrutiny. I look forward to working with you as this Committee continues its work to ensure that the SEC has the necessary resources and legislative authority from Congress to perform its mission with excellence and to reinvigorate confidence on the part of all investors in U.S. financial markets.

PREPARED STATEMENT OF SENATOR JIM BUNNING

Mr. Chairman, I would like to thank you for holding this very important hearing and congratulate you on becoming the newest Chairman of the Senate Committee on Banking, Housing, and Urban Affairs. I look forward to working with you in your new capacity.

This is obviously a very important nomination. Mr. Donaldson has a long and impressive résumé. He has extensive experience both on Wall Street and in academia. He is going to need it. Everyone knows the Securities Exchange Commission (SEC) faces extensive challenges as we recover from the corporate scandals that have plagued our country. Mr. Donaldson has a very tough job in front of him. I hope he is up to it.

We do not have to recap what has happened to our markets over the past few years. It has not just affected the rich, but almost everyone from seniors on a fixed pension, to union members, to ordinary workers with 401(k)'s, to employee stockholders, to Wall Street investors to Government employees. We have seen over the past few years how many people the capital markets really affect.

Last year's Sarbanes-Oxley bill, which I proudly supported, was a big step in restoring trust in the markets. But as hard as it was to pass that bill, and let me reiterate my admiration for everyone on this Committee who worked so hard on that bill, the implementation of Sarbanes-Oxley may be even tougher. And believe me, this Committee will be watching the implementation of Sarbanes-Oxley very closely.

However, as everyone here knows, there are many other issues facing the SEC. The former Chairman started hearings on market structure. There are applications before the SEC that have been there for over 2 years, and there are countless other proposals that the SEC needs to study. I am not taking a side in any of the business before the SEC, I am just pointing out that many of the noncorporate responsibility issues have been put on the back burner. That is not a criticism of the SEC. The SEC has limited resources, we are trying to correct that, and corporate responsibility had to be its first priority. But it is time to start looking at the other issues before the Commission.

Once again, Mr. Chairman, I thank you for holding this hearing and congratulate you on your ascension to the Chairmanship.

PREPARED STATEMENT OF WILLIAM H. DONALDSON

MEMBER-DESIGNATE OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

FEBRUARY 5, 2003

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, it is my distinct honor to come before you today as President Bush's nominee to be Chairman of the Securities and Exchange Commission, and I thank you for this opportunity. I want to especially thank Senators Schumer and Clinton for their warm introductions.

The U.S. capital markets have long been the most intelligently regulated, efficiently functioning, and widely admired markets in the world. Because of this strength, America's financial system has become synonymous with an entrepreneurial spirit and free flow of capital that is unparalleled throughout the world.

Over the past year and a half, our Nation and its financial systems have been faced with extraordinary new challenges. The evil of global terrorism attacked a great symbol of our financial strength. Soon thereafter, we witnessed revelations of corporate and financial corruption that accompanied the market's retreat from the boom of the nineties.

Many Americans' individual savings, accrued over a lifetime, were devastated. This loss was more than simply monetary—it was the loss of their hopes, their dreams, their futures, and their security. The reports of fraud and manipulation only fanned the flames of their distrust and outrage with corporate America and Wall Street. Their loss was profound, and, in many cases, the violation of trust was great. Such circumstances required a response just as serious.

The groundbreaking Sarbanes-Oxley legislation, passed by Congress and signed by President Bush responded with the most sweeping reforms of American business since the New Deal. But just as the war on terrorism cannot be won overnight, neither can investor confidence be completely restored so quickly. Corporate America, Wall Street, and their professional stewards—lawyers, accountants, corporate and financial managers, and financial regulators—still have much work to do.

If confirmed, I will vigorously enforce Sarbanes-Oxley and the rules and regulations already put forth by the SEC. I will demand accountability from all responsible parties. I will aggressively enforce civil penalties and work cooperatively with State and Federal law enforcement agencies and the President's Corporate Fraud Task Force to bring those who break the law to justice.

While Sarbanes-Oxley has laid the foundation for best practices, legislation and vigorous regulation can accomplish only so much. There must be a conscious decision to make honesty, integrity, and regard for the good of shareholders the motivation for all business decisions. If confirmed, I will call on corporate America and Wall Street to restore these principles to their proper place.

The SEC has been through a trying time as well. The SEC staff is superb, with knowledge and commitment that are unsurpassed. The recent scandals have depleted their morale and taxed their resources like never before. If confirmed I will work closely with the agency staff to enhance their sense of dedication and pride and restore the stature of the agency.

I have great respect for the critical role of the Congress and of this Committee in particular. I hope to work closely with each of you. If you choose to affirm my nomination, I pledge to take on the task ahead with every ounce of experience, judgment, and energy that I have.

Thank you. I would be glad to take any questions.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: Donaldson (LAST) William (FIRST) Henry (OTHER)

Position to which nominated: Chairman, Securities & Exchange Commission Date of nomination:

Date of birth: 6/2/1931 (DAY) (MONTH) (YEAR) Place of birth: Buffalo, New York

Marital status: Married Full name of spouse: Jane Phillips Donaldson

Name and ages of children:

Kimberly E. Donaldson	35
Matthew E. Donaldson	33
Adam J.P. Donaldson	12

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Harvard University	9/1956 - 6/1958	MBA	6/1958
Yale University	9/1949 - 6/1953	BA	6/1953
Nichols School Buffalo, New York	9/1944 - 9/1949	H.S. Diploma	6/1949

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

See Attachment Number 1

Attachment Number 1

Honors and Awards: **List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other recognitions for outstanding service or achievement.**

Held a tenured chair as the William S. Beinecke Professor of Management Studies, Yale University Graduate School of Management

Received a master of business administration degree with distinction from Harvard Graduate School of Business Administration

Designated a Chartered Financial Analyst (CFA) by the Association for Investment Management and Research

Honorary Master of Arts degree, Yale University

Honorary Doctor of Laws degree, Webster University

Honorary Doctor of Philosophy degree, St. Lawrence University

Honorary Doctor of Humane Letters degree, Alfred University

The President's Distinguished Service Award, State University of New York (Buffalo)

Recipient of the Freedom of the Human Spirit Award, International Center for the Disabled

Distinguished Leadership Award, Girls Club of New York

Good Scout Award, Greater New York Councils, Boy Scouts of America

Semper Fidelis Award, U.S. Marine Corps Scholarship Foundation (Los Angeles)

Major General John H. Russell Leadership Award, U.S. Marine Corps University Foundation

Legend of Leadership Award, CEO Leadership Summit

Attachment Number 1 (continued)

Honors and Awards: **List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other recognitions for outstanding service or achievement.**

Economic Education Leadership Award, New Jersey Council on Economic Education

American Heritage Award, Anti-Defamation League

The Haskins Award, New York University Stern School of Business

The Entrepreneurial Spirit Award, National Foundation for Teaching Entrepreneurship

The Colonel I. Robert Kriendler Memorial Award, Marine Corp Scholarship Foundation (New York)

Vision Award, The Eye-Bank for Sight Restoration

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
See Attachment		
Number 2		

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

See Attachment

Number 3

Attachment Number 2

Memberships: **List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.**

Note: The information below is to the best of my knowledge and information at this time, but I am seeking additional information. I will supplement my responses as soon as that additional information is obtained.

PRESENT:

Trustee, the U.S. Marine Corps University Foundation
April 1991 – Present

Trustee, New York City Police Foundation
March 1996 – Present

Trustee, The Aspen Institute
April 1999 – Present

Chairman, Yale School of Management Advisory Board
1996 – Present

Chairman, Silvercrest Asset Management Advisory Board
June 2002 – Present

Chairman, Carnegie Endowment for International Peace
May 1999 – Present

Governor, Foreign Policy Association
March 1984 – Present

Member, Council on Foreign Relations
1974 – Present

Member, Steering Committee, Financial Services Volunteer Corps
1990 – Present

Director, Lincoln Center for the Performing Arts
June 1984 – Present

Attachment Number 2 (continued)

Memberships: **List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.**

PRESENT:

Director, Bright Horizons Family Solutions
January 1998 - Present

Member of the Advisory Council of the Weissman Center for International Business at Baruch College
1995 – Present

Association for Investment Management and Research
September 1967 – Present

Trustee, Committee for Economic Development
May 1991 – May 1995; November 2001 – Present

Board of Selectors, American Institute for Public Service
January 1994 – Present

Steering Committee, Future of Accounting Profession, The American Assembly, Columbia University, October 2001 – Present

Coral Beach & Tennis Club
1963 - Present

The Links Club
1964 – Present

The Maidstone Club
1973 – Present

The River Club
1969 – Present

Attachment Number 2 (continued)

Memberships: **List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.**

PRESENT:

Waccabuc Country Club
1970 – 1972; 1982 - Present

The Century Association
November 1980 – Present

The Economic Club
1998- Present

The Yale Club
1957 – Present

The University Club
September 2002 – Present

Kappa Beta Phi
1968 – Present

The Pilgrims of the United States
1982 – Present

FORMER:

Director, Aetna Inc.

Chairman, President & CEO, Aetna Inc.

Director, EasyLink Services Corporation

Trustee, Council for Excellence in Government

Senior Advisor, Donaldson, Lufkin & Jenrette

Chairman & CEO, New York Stock Exchange, Inc.

Attachment Number 2 (continued)

Memberships: **List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.**

FORMER:

Member of the New York Society of Security Analysts

Director, Philip Morris

Director, Honeywell

Chairman, DLJ Merchant Banking Advisory Board

International Advisory Board Member, NEC Corporation (Japan)

Chairman and Director Aetna Foundation

Partner, New York City Partnership

Board Member, National Executive Service Corps

Director, Business Council of the State of New York

The Harvard Business School Club

Trustee and Chairman, finance committee, the Ford Foundation

Trustee, Henry Ford II Trust

Trustee, Cathedral of St. John the Divine

Chairman, finance committee and member of the corporation (Trustee), Yale University

Chairman, finance committee and trustee, the German Marshall Fund

Trustee, Wesleyan University

Trustee, St. Lawrence University

Trustee, Nichols School

Attachment Number 2 (continued)

Memberships: **List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.**

FORMER:

Trustee, St. David's School

Trustee, Hudson Institute

Trustee, Museum of Modern Art

Director, Joffrey Ballet

Director, Foundation for American Dance

Director, New York Urban Coalition

Director, Beekman-Downtown Hospital

Trustee, A Better Chance

President, the Young President's Organization (New York)

Adviser, Rockefeller Family Funds

Adviser, Twentieth Century Fund

Governor, Association of Stock Exchange Firms

Charter director, Securities Industry Association

Trustee, Bowery Savings Bank

Director, H. D. Bohack & Co.,

Director, Cole National Corporation

Director, Comstock Partners Strategy Fund

Director, Continental Oil Corporation (Conoco)

Attachment Number 2 (continued)

Memberships: **List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.**

FORMER:

Director, Crane Co.

Director, Frontier Oil and Refining

Director, GK Technologies, Inc.,

Director, the London American Ventures Trust

Director, Scoville Corporation

College and Graduate School Fraternities & Honorary Societies:

Century Club (Honor Society) at Harvard Business School

St. Elmo Society at Yale University (Fraternity)

Skull and Bones at Yale University (RTA, Inc., Deer Island) Senior Society

Torch Honor Society at Yale University

Attachment Number 3

Employment Record:	**List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.**
4/2001 to Present	Self Employed, Chairman, (DBA) Donaldson Enterprises New York, NY
12/2000 to 4/2001	Chairman, Aetna Inc. Hartford, CT
2/2000 to 12/2000	President & CEO, Aetna Inc. Hartford, CT
6/1995 to 2/2000	Senior Advisor, Donaldson, Lufkin & Jenrette Inc. New York, NY
1/1991 to 6/1995	Chairman & CEO, New York Stock Exchange New York, NY
1/1981 to 12/1990	Chairman & CEO, Donaldson Enterprises Inc. New York, NY
1975 – 1980	Dean, William S. Beinecke Professor of Management Studies (Tenured), Yale Graduate School of Management New Haven, CT
1974 – 1975	Counsel to the Vice President of the United States (Nelson Rockefeller)
1973 – 1974	United States Undersecretary of State for Security Assistance, Responsible for military security assistance, oil and energy aspects of foreign policy, and the department's Bureaus of Education and Cultural Affairs, Oceans, and International Environmental and Scientific Affairs.
1959 – 1973	Co-founder & CEO, Donaldson, Lufkin & Jenrette, Inc. and The Alliance Capital Management Corporation New York, NY

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

United States Undersecretary of State (1973-74), Special White House Counsel (1974), Executive Committee, Presidents Private Sector Survey on Cost Control (The Grace Commission, 1982-84), U.S. Presidential Mission to Poland (1990), U.S. Trade Representatives' Investment and Services Policy Advisory Committee (1993-95), Senior Advisor, Governor of Puerto Rico Rafael Hernaudez Colon, Senior Advisor and Budget Director transition of Governor Hugh L. Carey, Member, Citizens Advisory Committee New York Housing Development Administration, Founding Director, NY Urban Coalition

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

See Attachment Number 4

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

None - - Was active as unannounced prospective candidate for Republican Primary Nomination for Governor of New York State. Late 1980/Early 1981

Attachment Number 4

Published Writings: **List the titles, publishers and dates of books, articles, reports or other published material you have written**

Note: The information below is to the best of my knowledge and information at this time, but I am seeking additional information. I will supplement my responses as soon as that additional information is obtained.

Published Articles / Interviews:

- Institutional Investor, October 2001
  Title: The Pioneers
- Bill Donaldson, Letter to Shareholders printed in Aetna's 1999 Annual Report
- Bill Donaldson, Letter to Shareholders printed in Aetna's 2000 Annual Report
- Bill Donaldson, Direct Mail/Mass Mailing Letter 7/12/2000 re: Aetna's plans/actions for change/improvement
- Bill Donaldson, Letter to Editor, Washington Post February, 2001 - re: response to 2/25 article re: Aetna
- Ebiz Chronicles, "We Globalized the Business World and Now It's Time to Deal With It," 2001
- Bill Donaldson, Chairman & CEO, NYSE, Press Release, Richard Grasso Promoted to Executive Vice Chairman, 8/9/1990
- Bill Donaldson, Chairman & CEO, NYSE, Press Release, Second Phase of Downsizing, Competitive Repositioning, 2/8/1991
- Bill Donaldson, Chairman & CEO, NYSE, Press Release, NYSE to Observe Moment of Silence in Honor of US Troops in the Persian Gulf, 2/25/1991
- Bill Donaldson, Chairman & CEO, NYSE, Press Release, WHD to Address Financial Writers Luncheon, 3/7/1991

Attachment Number 4 (continued)

Published Writings: **List the titles, publishers and dates of books, articles, reports or other published material you have written**

Published Articles / Interviews:

- Bill Donaldson, Chairman & CEO, NYSE, Press Release, NYSE Board of Directors Approves Extension of Trading Hours, 7/3/1991
- Bill Donaldson, Chairman & CEO, NYSE, Press Release, NYSE to Delay Implementation of Earlier Opening Pending Further Study, 7/29/1991
- Bill Donaldson, Chairman & CEO, NYSE, Press Release, NYSE Chairman Expanded Global Role For Big Board, 1/6/1992
- Bill Donaldson, Chairman & CEO, NYSE, Press Release, NYSE Chairman Says Entrepreneurial Spirit Can Change the World, from the Bottom Up, 2/7/1992
- Bill Donaldson, Chairman & CEO, NYSE, Annual Report, "The Market of the 90's Meeting a Global Challenge," 1990
- Bill Donaldson, Chairman & CEO, NYSE, Annual Report, Letter from the Chairman & President, 1991
- Bill Donaldson, Chairman & CEO, NYSE, Annual Report, Letter from the Chairman & President, 1992
- Bill Donaldson, Chairman & CEO, NYSE, Annual Report, Letter from the Chairman & President, 1993
- Bill Donaldson, Chairman & CEO, NYSE, Annual Report, Letter from the Chairman & President, 1994
- Bill Donaldson, Chairman & CEO, NYSE: The Exchange, "The Global Exchange," January, 1995
- Bill Donaldson, Chairman & CEO, NYSE: The Exchange, SEC Chairman Arthur Levitt Addresses Ethics Conference Audience at the NYSE, March, 1995

Attachment Number 4 (continued)

Published Writings: **List the titles, publishers and dates of books, articles, reports or other published material you have written**

Published Articles / Interviews:

- Bill Donaldson, Chairman & CEO, NYSE: The Exchange, "Q&A With Bill Donaldson," May, 1995

Speeches:

- Bill Donaldson, Foreign Policy Association, May 30, 2000
- Bill Donaldson, Chairman and Chief Executive Officer, Aetna Inc. Address to Connecticut State Medical Society, May 10, 2000
- Bill Donaldson, Chairman, Aetna Inc. Academic Medicine and Managed Care Forum, June 8, 2000
- Bill Donaldson, ING Press Conference, July 20, 2000
- Bill Donaldson, Chairman, Aetna Inc. St. Francis Hospital Reception, September 20, 2000
- Bill Donaldson, Chairman, Aetna Inc., The Bushnell Reception, December 5, 2000
- Bill Donaldson, Chairman, Aetna Inc. First Quarter, 2000 Earnings, Post Call Final 4/27/00, Talking Points to Investment Community, April 27, 2000
- Bill Donaldson, Aetna Inc. Shareholders Meeting, November 30, 2000
- Second Quarter, Aetna Inc._2000 Earnings, Final 8/3/00 6:00pm,
- Aetna Inc. Talking Points to Investment Community, August 4, 2000
- Aetna Inc. Third Quarter, 2000 Earnings
- Aetna Inc. Talking Points To Investment Community, November 1, 2000

Attachment Number 4 (continued)

Published Writings: **List the titles, publishers and dates of books, articles, reports or other published material you have written**

Speeches:

- Aetna 2001 Outlook Conference Call
  Hartford, Ct, December 18, 2000 9:00 A.M. Et

- Aetna Inc. 4th Quarter 2000 Earnings Conference Call
  Hartford, Ct, January 30, 2001 9:00 A.M. Et

- Final Distribution Copy, Bill Donaldson, Chairman, Aetna Inc. Annual Shareholders Meeting, April 28, 2000

- Bill Donaldson, Chairman & CEO, NYSE, Corporate Secretaries Dinner 1/13/1994

- Bill Donaldson, Chairman & CEO, NYSE, Capitalism for the 1990's, Milwaukee, Wisconsin, 11/30/1992

- Bill Donaldson, Chairman & CEO, NYSE, Symposium On Corporate Governance, May 29, 1992

- Bill Donaldson, Chairman & CEO, NYSE, Enhancing America's Position In An Age of Global Markets, National Press Club, March 4, 1991

- Bill Donaldson, Chairman & CEO, NYSE, The Market Of The 90's: Meeting The Global Challenge, Minnesota Meeting, Minneapolis, March 20, 1991

- Bill Donaldson, Chairman & CEO, NYSE, The Market Of The 90's: Building Quality And Confidence, World Affairs Council of St. Louis, March 21, 1991

- Bill Donaldson, Chairman & CEO, NYSE, The Challenges and Opportunities of the Global Marketplace, Fidelity Investments 1993 Financial Forum, Boston, September 23, 1993

Attachment Number 4 (continued)

Published Writings: **List the titles, publishers and dates of books, articles, reports or other published material you have written**

Speeches:

- Bill Donaldson, Chairman & CEO, NYSE, Strong Self-Regulation: A Key to Capital Formation, International Seminar on Current Issues for Securities Markets, Mexico City, June 3, 1992
- Bill Donaldson, Chairman & CEO, NYSE, Bicentennial Cake Ceremony, May 17, 1992
- Bill Donaldson, Chairman & CEO, NYSE, Make a Difference, Commencement Exercises, Webster University, St. Louise, Missouri, May 9, 1992
- Bill Donaldson, Chairman & CEO, NYSE, III Convention of the Mexican Securities Markets, Bolsa de Valores, Mexico, D.F., April 28, 1992
- Bill Donaldson, Chairman & CEO, NYSE, To The 1992 HBSC Annual International Dinner, New York, New York, Tuesday, April 21, 1992
- Bill Donaldson, Chairman & CEO, NYSE, Two Hundred Years and Still Growing, City Club, Cleveland, Ohio, April 3, 1992
- Bill Donaldson, Chairman & CEO, NYSE, Education and Business: Fostering the Entrepreneurial Spirit, Headmaster's Association Meeting, Princeton, New Jersey, February 7, 1992
- Constructive Coexistence: Mandate for Business and Government on the 80's, Economic Club of Detroit, 3/3/1980
- DLJ Technology Conference, Laguna Niguel, CA, March 1997
- Round-table discussion, "New Leadership in the Public Interest" 10/29/1980

ATTACHMENT NUMBER 4 (continued)

NEW YORK STOCK EXCHANGE ARCHIVES

William H. Donaldson Appearances

SEARCH: find (Title-Description ct whd/donaldson)

Record Group: 6-15. Communications Division. / VIDEOTAPES.

	CNBC Market Wrap With WHD,	Box 328 IM
	CNBC With WHD,	Box 335 IM
	CNBC With WHD, 1/9/92.	Box 328 IM
	CNBC With WHD, 10/19/92.	Box 328 IM
	CNBC With WHD, 9/17/93.	Box 328 IM
	CNN Daywatch With WHD,	Box 329 IM
	Donaldson Step Down,	Box 336 IM
	Pinnacle With WHD,	Box 328 IM
	WHD Live From LA City Club,	Box 329 IM
27	Donaldson / Ortiz,	Box 310 IM
44	WHD, 5/31/91.	Box 312 IM
47	WHD Testimony, 4/14/93.	Box 312 IM
48	WHD Cleveland,	Box 312 IM
99	Donaldson Interview (NBR), 1/2/91.	Box 316 IM
100	Donaldson Interview (NBC), 1/2/91.	Box 317 IM
904	Bicentennial, Board Room exhibits, Donaldson, Grasso,	Box 201 IM
940	Albany Bicentennial reception, Donaldson, Grasso, Cuomo at Post, remarks,	Box 199 IM
941	Albany Bicentennial reception, Donaldson, Grasso and guests,	Box 199 IM
944	Bicentennial, Donaldson breakfast speech, Cleveland,	Box 199

ATTACHMENT NUMBER 4 (continued)

William H. Donaldson Appearances

NEW YORK STOCK EXCHANGE ARCHIVES

		IM
946	Bicentennial, Cleveland, East High School, William Donaldson,	Box 199 IM
950	Bicentennial, Donaldson at Case Western #2,	Box 198 IM
957	William H. Donaldson on CNN Inside Business,	Box 211 IM
959	William Donaldson, CNN Moneyline,	Box 211 IM
960	William Donaldson, Nightly Business Report,	Box 211 IM
962	BBC Bicentennial story, William Donaldson,	Box 211 IM
964	Address to Melbourne, William Donaldson,	Box 211 IM
965	Pinnacle, with William Donaldson,	Box 211 IM
1020	Bicentennial, Wall Street festival, B roll, Donaldson, Grasso, Brady,	Box 210 IM
1024	Bicentennial, CBS interviewing Donaldson,	Box 210 IM
1065	Donaldson in Los Angeles, Mark Taper Hall,	Box 204 IM
1066	Donaldson in Los Angeles, Mark Taper Hall,	Box 204 IM
1067	Donaldson in Los Angeles, Town Hall luncheon,	Box 204 IM
1068	Donaldson in Los Angeles, Town Hall luncheon / USC,	Box 204 IM
1069	Donaldson in Los Angeles, USC symposium,	Box 204 IM
1070	Donaldson in Los Angeles, dinner / awards ceremony,	Box 213 IM
1071	Donaldson in Los Angeles, dinner / awards ceremony,	Box 213 IM
1072	Donaldson in Los Angeles, dinner / awards ceremony,	Box 215

ATTACHMENT NUMBER 4 (continued)

William H. Donaldson Appearances

NEW YORK STOCK EXCHANGE ARCHIVES

		IM
1082	Donaldson and Grasso ring closing bell, 12/31/92.	Box 214 IM
2021	Donaldson addresses Clinton on economic conference,	Box 212 IM
2028	Pinnacle, interview with Donaldson,	Box 212 IM
2064	CNBC interview with Donaldson, edit master,	Box 208 IM

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

See Attachment Number 5

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

See Attachment Number 6

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

Yes

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

None

3. Has anybody made you a commitment to a job after you leave government?

No

4. Do you expect to serve the full term for which you have been appointed?

Yes - at the pleasure of the President

Attachment Number 5

Political Contributions: **Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.**

10/29/02	Gail Hilson for State Assembly	$1,000.00
10/4/01	Committee for Betsy Gotbaum	$1,000.00
7/12/01	Friends of Pataki	$1,000.00
12/21/00	Committee for Betsy Gotbaum	$500.00
9/13/00	Re-elect Nancy Johnson to Congress	$500.00
9/10/99	Friends of Reba White Williams	$1,000.00
7/13/99	PHIL-PAC	$500.00
3/30/99	Gov. George W. Bush Presidential Exploratory Comm.	$1,000.00
9/14/98	Barry Ford for Congress	$1,000.00
9/14/98	Charles Schumer for Senate	$1,000.00
10/24/97	Gov. Bush Committee	$1,000.00
2/6/97	NY Republican County Comte.	$1,000.00
9/11/96	PHIL-PAC	$500.00

Attachment Number 6

Qualifications: **State fully your qualifications to serve in the position to which you have been named.**

I have had a fifty year career involved in founding and then serving as CEO of a major investment banking firm (Donaldson, Lufkin and Jenrette) and its former subsidiary, a major investment counseling firm (Alliance Capital Management). My roles at DLJ included serving personally as a securities research analyst and investment banker, and CEO of a range of finance activities of the firm as it expanded. I served as Chairman and CEO of the New York Stock Exchange with all the responsibilities of managing a SRO, have been founder, Chairman and CEO of a private investment company (Donaldson Enterprises, Inc) and Chairman, President and CEO of the nations largest publically held multi line insurance company (Aetna Inc.). I believe the exposure to the management challenges and responsibilities of these roles give me the experience and knowledge to address responsibilities as Chairman of the SEC. I have held a range of directorships in public, private and non profit corporations and institutions and dealt with many aspects of corporate and non profit governance issues.

I was the founding Dean of Yale's Graduate School of Management and also served as a tenured professor of management and have dealt with a wide range of issues in my role as manager of this academic institution and teacher of advanced students in various management and financial disciplines.

I have served as an officer in the U.S. Marine Corps, commanded troops and served as aide to a commanding general. I have also been involved throughout my life with managing my own and my families' investment interests.

Moreover I believe my educational background would be important in discharging the duties of Chairman of the SEC. I am a graduate of Yale University (BS), received an MBA with Distinction from Harvard University Graduate School of Business Administration, and was granted a CFA (Chartered Financial Analyst) designation from the Association for Investment Management and Research.

In sum, all of this experience, along with my own personal dedication and commitment to serving my country in the role as Chairman of the SEC (if confirmed by the Senate) will, I believe, equip me to take on the challenge of the position of Chairman of the SEC.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

See Attachment Number 7

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

See Attachment Number 8

3. Describe any business relationship, dealing or financial transaction (other than tax-paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None

Attachment Number 7

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None. With respect to defined benefit pensions paid to me by the New York Stock Exchange and Aetna, Inc., I will not participate personally and substantially in any particular matter that will have a direct and predictable effect on the willingness of Aetna, Inc. or the New York Stock Exchange to continue to make these payments.

Attachment Number 8

Potential conflicts of interest:

2. List any investments, obligations, liabilities or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

None. As set forth in my Ethics Agreement with the Securities and Exchange Commission, my wife, my minor child and I have agreed to divest ourselves of all investments that could present a potential conflict of interest. As described in my response to Question 1 herein, I will not participate personally and substantially in any particular matter that will have a direct and predictable effect on the willingness of Aetna, Inc. or the New York Stock Exchange to continue to make pension payments. In addition, I will recuse myself from particular matters involving Aetna for as long as Aetna indemnifies me in connection with a lawsuit in which I, Aetna and the current Aetna CEO have been named as defendants.

I also intend to resign as trustee for two trusts for my adult children. The new trustee will have no financial interests that can be imputed to me.

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

None – except in the general role of Chairman & CEO of the New York Stock Exchange, Aetna Inc.

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

I have described above how I will resolve any potential conflicts of interest. I do not foresee any other potential conflicts of interest. Should any conflicts of interest issues arise, I will consult promptly with ethics officials at the Securities and Exchange Commission.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

CONFIDENTIAL FINANCIAL STATEMENT

NET WORTH

SEE ATTACHMENT NUMBER 9

Provide a complete, current financial net worth statement which itemizes in detail all assets (including bank accounts, real estate, securities, trusts, investments, and other financial holdings) all liabilities (including debts, mortgages, loans, and other financial obligations) of yourself, your spouse, and other immediate members of your household.

ASSETS				LIABILITIES			
Cash on hand and in banks				Notes payable to banks—secured			
U.S. Government securities—add schedule				Notes payable to banks—unsecured			
Listed securities—add schedule				Notes payable to relatives			
Unlisted securities—add schedule				Notes payable to others			
Accounts and notes receivable:				Accounts and bills due			
Due from relatives and friends				Unpaid income tax			
Due from others				Other unpaid tax and interest			
Doubtful				Real estate mortgages payable—add schedule			
Real estate owned—add schedule				Chattel mortgages and other liens payable			
Real estate mortgages receivable				Other debts—itemize:			
Autos and other personal property							
Cash value—life insurance							
Other assets—itemize:							
				Total liabilities			
				Net worth			
Total assets				Total liabilities and net worth			
CONTINGENT LIABILITIES				**GENERAL INFORMATION**			
As endorser, comaker or guarantor				Are any assets pledged? (Add schedule.)			
On leases or contracts				Are you defendant in any suits or legal actions?			
Legal Claims				Have you ever taken bankruptcy?			
Provision for Federal Income Tax							
Other special debt							

SEE ATTACHMENT NUMBER 9

SOURCES OF INCOME LAST 3 YEARS

1. List sources and amounts of all income received during the last 3 years, including all salaries, fees, dividends, interest, gifts, rents, royalties, patents, honoraria, and other items exceeding $500 or more. (If you prefer to do so, copies of U.S. income tax returns for these years may be substituted here, but their submission is not required.)

	19.....	19.....	19.....
Salary			
Fees, royalties			
Dividends			
Interest	See Attached Income	Tax Returns	
Gifts			
Rents			
Other—exceeding $500			
Total			

(Add schedule itemizing each individual source of income which exceeds $500. If you are an attorney, accountant, or other professional, attach schedule listing all clients and customers whose billings exceeded three quarters of one percent of your gross billings during each of the last 3 years.)

2. List sources, amounts and dates of all anticipated receipts from deferred income arrangements, stock options, uncompleted contracts and other future benefits which you expect to derive from previous business relationships, professional services and firm memberships or from former employers, clients, and customers.

See Attachment Number 10

Signed: William H. Jarald

Date: 21 Jan 2003

The undersigned certifies that the information contained herein is true and correct.

GPO : 1986 O - 62-040

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM WILLIAM H. DONALDSON

Q.1. As you know, there are a great deal of market issues facing the SEC. The former Chairman started hearings on market structure. There are applications before the SEC that have been there for over 2 years, and there are countless other proposals that the SEC needs to study. I am not taking a side in any of the business before the SEC, I am just pointing out that many of the noncorporate responsibility issues have been put on the back burner. That is not a criticism of the SEC. The SEC has limited resources, we are trying to correct that, and corporate responsibility had to be its first priority. Will you, if confirmed by the Senate, start to take a look at these issues that have not been a priority lately?

A.1. Over the past several years, as you recognize, advances in technology and globalization have given rise to many new challenges for our securities markets. I understand that the SEC has begun the process of addressing a number of critical issues affecting market structure and the regulation and control of exchanges. I believe it is important to continue to move expeditiously to address these issues, with a view to assuring competitive and vibrant markets that meet the needs of U.S. investors.

Q.2. Earlier this week, the SEC, Treasury, and OFHEO put out a report calling for more disclosure of Mortgage Backed Securities by Government Sponsored Enterprises (GSE's). As you may know, the Tennessee Valley Authority (TVA) has over $20 billion in publicly-traded debt and does not disclose with the SEC. Do you think that they should?

A.2. In my view, it is important to provide investors, wherever possible and appropriate, with disclosure that meets the high standards that they have rightly come to expect in our securities markets. I understand that there is the potential for tension between TVA's exempt status under Federal securities laws and the need for disclosure to investors that serves investors' interests. While TVA is an agency and authority of the United States, its debt is not backed by the full faith and credit of the United States. It is my understanding that the Commission staff has had preliminary discussions with TVA regarding potential means of meeting Commission disclosure standards, such as voluntary compliance or registration under the Exchange Act, and that TVA has expressed interest in enhanced disclosure. I expect to work with the staff in this area and to support efforts that achieve improved disclosure.

Q.3. Do you believe the Chairman of the Federal Reserve should get involved in trying to affect the capital markets when the Fed Chairman believes the markets are inflated or depressed? Or do you believe the markets should be left to sort themselves out?

A.3. The Federal Reserve has a clear mission: To conduct monetary policy and regulate certain banks and affiliated institutions. The Federal Reserve is an independent agency, and I believe that the Federal Reserve Board, under the leadership of its Chairman, should make his own judgments about how the Federal Reserve fulfills its mission. Generally, though, I believe that our markets

are strong and resilient, and market forces should determine market levels.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HAGEL FROM WILLIAM H. DONALDSON

Q.1. Do you see a problem with current disclosure rules for the Federal Home Loan Banks? I have heard from my small community banks back home that they are worried the proposed structure, where the FHLBanks must register their stock with the SEC, could potentially harm or slow-down the availability of funds to member banks. Do you think FHLBanks need to be regulated by *both* the Federal Housing Finance Board (FHFB), as they are currently, *and* the SEC?

A.1. My understanding is that the Federal Home Loan Banks, like other Government Sponsored Enterprises, publicly offer debt securities that are not backed by the full faith and credit of the United States. I support what I believe is the Commission's view and the view of the Administration that Government Sponsored Enterprises should be role models for disclosure. As such, I believe that they should comply with the "gold standard" of disclosure—the disclosure requirements of the Federal securities laws. Until further study, I am not prepared to determine the exact manner in which that compliance should be achieved.

Q.2. As you know, there are a number of market structure issues facing the SEC, and the Commission has indicated it intends to take action on some of these critical issues this year. What do you see as the key market structure issues?

A.2. The U.S. markets have long been the most efficient, well-regulated, transparent, and accessible markets in the world. Our Nation's securities markets have uniquely encouraged investment by a broad range of public investors. I consider it essential to maintain the preeminent position of our markets and to assure that all categories of U.S. investors continue to have confidence in their efficiency and integrity.

Over the past several years, as you know, advances in technology and globalization have given rise to many new challenges for our securities markets. I understand that the Commission has begun the process of addressing a number of critical issues affecting market structure and the regulation and control of exchanges. These issues include important questions about the basic obligations of regulated exchanges, access to information and trading opportunities, market linkages, the quality of investor trade execution, and incentives for innovation and competition. I believe it is important to continue to move expeditiously to address these issues, with a view to assuring competitive and vibrant markets that meet the needs of U.S. investors.

Q.3. What are your thoughts on Nasdaq's pending application to become a national securities exchange and the length of time it has taken the SEC to consider it?

A.3. Under our system of self-regulation, exchanges play a very, very important role. They ensure that their members comply with securities laws. They also help maintain markets that instill investor confidence and protection, while being free from fraud and ma-

nipulation. At the same time, it is important that the SEC's review of exchange applications not impede the entrance of additional competitors to our marketplace. Applications that are consistent with the statute and do not jeopardize the integrity of our securities market should be approved. I understand that substantial progress has been made to address the complicated, but more technical, issues related to Nasdaq's application. I am committed to working with the Nasdaq to resolve the significant outstanding issues that remain.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM WILLIAM H. DONALDSON

Q.1. Some companies seem to be using bankruptcy protections to eliminate their debt and return to the marketplace. I am not sure that I support companies who engage in fraud on a wide scale and mislead their shareholders and then are able to reemerge as competitors to companies that have been legitimate. What I see happening in these cases is that a company's stock essentially goes to zero when they declare bankruptcy. Then the company brings in new executives with large compensation packages. The company then reemerges from bankruptcy in much better financial condition than their competitors who did not engage in fraud. Do you believe that this method of utilizing the bankruptcy code has occurred and do you believe it should be allowed to continue in future cases of widespread fraud?

A.1. The bankruptcy laws, as you mention, can be used to permit failing companies to restructure their debts and return to the marketplace in a financially stronger position. In cases where large public companies file for bankruptcy under a cloud of fraud, as has occurred several times in the past few years, shareholders and competitors often have concerns regarding the appropriate use of the bankruptcy process.

It is essential, in my view, that those who commit fraud be punished for their actions. It is also necessary, in cases where a company's viability has been put at risk through fraudulent conduct, to consider whether a bankruptcy filing is the most effective way of preventing further harm to public investors and creditors, as well as to preserve jobs that are lost when businesses liquidate. In addition, Chapter 11 provides a mechanism to replace old management who operated the company when the misconduct occurred with new management that can more effectively and appropriately maximize value for those who did not participate in the wrongdoing.

Q.2. Payment for order flow seems to have reemerged as an issue affecting certain options exchanges recently. In December 2000, the SEC released a study on internalization and payment for order flow in the options industry and was very critical of the practice. Can you tell me what your opinion is of paying for orders even through broker-dealers are already supposed to send order flow to the market with the best execution?

A.2. Payment for order flow and other forms of internalization can discourage competition. These arrangements also can pose a conflict of interest for broker-dealers because of the tension between

the firms' interest in generating profits from routing orders and its fiduciary duty to customers to seek best execution. Some brokers also "internalize" retail option orders by trading as counterparties to their customer orders. Like payment for order flow, internalization can discourage markets from competing on the basis of price and pose a conflict of interest for broker-dealers.

I understand that on January 24, 2003, Chairman Pitt wrote to each of the five options exchanges to express his belief that all exchange-sponsored payment for order flow programs should be eliminated. I agree that these programs may discourage competition for orders among market makers and may encourage firms to consider their own economic interests over those of their customers. I recognize, however, that these issues are complicated and the Commission has struggled with them for many years. If confirmed, I will give them my close attention to ensure customers receive the best execution possible.

Q.3. Chairman Pitt has been very outspoken about his frustration with the State bar associations not fully disciplining attorneys the Commission refers to them. I, too, believe that attorneys have escaped much of the blame, which I believe they deserve in some of these corporate frauds. Do you believe that the Commission has the needed authority to discipline attorneys who assist in corporate fraud?

A.3. Attorneys and other professionals play a critical role in our capital markets—and I consider it important to hold them fully accountable for their actions. I understand that the Commission has extensive authority to sanction attorneys when they participate in, or assist others in carrying out, fraudulent or similar illegal activities under the securities laws. In addition, Congress recently clarified and expanded the Commission's authority to discipline attorneys in the Sarbanes-Oxley Act. I believe that the Commission should enforce that new authority vigorously. If the Commission's newly expanded authority does not prove adequate to establish an appropriate level of attorney accountability, I would actively consider whether additional authority is needed.

Q.4. I understand that a number of exchange rule changes are pending before the SEC that would permit implementation of a pilot program for portfolio margining in the account of a customer with an account equity of at least $5 million for positions in broad-based index options, and futures. This pilot program, which was developed nearly 4 years ago, is an important first step in introducing state of the art, risk-sensitive portfolio margining for securities customers. What steps need to be taken by the SEC or others before the portfolio margining pilot can be implemented? What is the SEC doing to ensure that these steps are completed in the near future so that the portfolio margining pilot can finally be implemented? When does the SEC expect that the portfolio margining pilot will be implemented?

A.4. I understand that the Commission staff is working to resolve issues relating to the portfolio margin proposals as submitted to it by the New York Stock Exchange and the Chicago Board Options Exchange. If confirmed, I will work with the staff in coordination with the exchanges, the market participants, and other financial

regulators to resolve this and any other issues that may arise in connection with the portfolio margining pilot program.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM WILLIAM H. DONALDSON

Q.1. Do you believe that off-exchange derivatives are important tools which contribute to the economy? Is regulation of over-the-counter (OTC) derivatives adequate?

A.1. I share the views of Chairman Greenspan that derivatives have come to play a very important role in our financial system and economy. Companies have successfully employed derivatives as an important part of their risk capital allocations. If confirmed, I look forward to reviewing the existing regulatory framework involving derivatives and discussing the views of the CFTC, the FERC, and the Treasury Department on this important issue.

Q.2. Do you support additional disclosure requirements for the Government Sponsored Enterprises?

Q.3. In light of the existing exemption for FHLBanks' securities from SEC registration, do you believe the FHLBanks should register their capital stock with the Commission under the Securities Exchange Act of 1934 (1934 Act)?

Q.4. Along the same lines, do you believe the FHLBank System should register its debt to conform to the requirements of the Securities Act of 1933 (1933 Act)?

Q.5. What is the benefit of additional regulatory oversight by the SEC over the Federal Home Loan Bank System?

Q.6. I have heard from community banks back in Idaho that they are worried that registration of FHLBank's capital stock could potentially harm or slow-down the availability of funds from the Bank System. As Chairman of the SEC how can you assure me this will not be a problem?

A.2–6. In my view, it is important to provide investors, wherever possible and appropriate, with disclosure that meets the standards that they have rightly come to expect in our securities markets. My understanding is that the Federal Home Loan Banks, like other Government Sponsored Enterprises, publicly offer securities that are not backed by the full faith and credit of the United States. I support what I believe is the view of the Commission, and of the Administration that Government Sponsored Enterprises should be the role models for disclosure. As such, I believe that they should comply with the "gold standard" of disclosure—the disclosure requirements of the Federal securities laws. Until further study, I am not prepared to determine the exact manner in which that compliance is achieved.

RESPONSE TO WRITTEN QUESTION OF SENATOR MILLER FROM WILLIAM H. DONALDSON

Q.1. The Nasdaq Stock Market has an application to become an exchange that has been pending before the Commission for more than 2 years. Admittedly, the Commission has had its plate full lately with the September 11 crisis and the implementation of the Sarbanes-Oxley Act. I hope you will look into the status of the

Nasdaq application and the issues the application raises when you get to the Commission and address the application in a timely manner.

A.1. I am aware of the length of time that the Nasdaq's exchange application has been pending before the Commission, and, if confirmed, I will assure that sufficient resources are committed to allow for timely consideration of the application. There are complex issues of market structure inherent in the Nasdaq application. I understand that the Commission and Nasdaq have been working closely to resolve all outstanding matters related to the Nasdaq's operation as an independent self-regulatory organization. In this regard, it is important that the Commission and Nasdaq continue to work together with all deliberate speed to thoroughly consider and resolve the complicated issues raised by the Nasdaq's exchange application.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR STABENOW FROM WILLIAM H. DONALDSON

Q.1. Mr. Donaldson, as I mentioned in my opening remarks, I am concerned about the on-going lack of confidence among investors. Although the Enrons and WorldComs of the world are not receiving daily news coverage, these two and a lot of other companies like them need a thorough examination of what went wrong, and people who have committed crimes must be punished. This is essential to ensuring that the American people believe that the Government is protecting their interests and fighting to make sure that these sort of accounting outrages won't happen again. Would you please confirm for the Committee that, even though there is less public attention, you are committed to pursuing all of the allegations of corporate malfeasance and accounting fraud against these companies and doing everything you can, within the jurisdiction of the SEC, to ensure that those guilty of defrauding investors and running these companies into the ground are brought to justice?

A.1. Combating financial fraud has been a priority for the President's Corporate Fraud Task Force and the SEC. If confirmed, I pledge to make strong enforcement of securities laws among my chief priorities. I share your view that restoring investor confidence is essential to maintaining the vitality of our markets. Vigorous and tough enforcement actions against corporate wrongdoers must be the cornerstone of that effort.

Q.2. When a company engages in fraudulent activities that have hurt its employees and shareholders, I think the Government should not reward them with Government contracts. Recently, it was brought to my attention that the GSA and the GAO have on-going Government contracts with WorldCom even though the information that WorldCom provided to get those contracts has been questioned. Do you think, as a general rule, it is appropriate for the Government to continue to have contracts with companies that have been found to have engaged in corporate malfeasance or misrepresentation of their accounts? What do you think the SEC should do in regard to this issue and what, if anything, should it do specifically about WorldCom?

A.2. As I testified before the Committee, I believe that companies and individuals who engage in fraudulent activities that harm employees or shareholders should be punished, and I will make tough enforcement of the securities laws among my top priorities, if confirmed. In principle, I agree that the Government should not reward in any manner those found guilty of corporate wrongdoing. I do not believe it would be appropriate for me to comment on the specific circumstances of any case pending before the SEC.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM WILLIAM H. DONALDSON

Q.1. What would you do with the new Sarbanes-Oxley regulations to go beyond what Commissioner Pitt has proposed to protect investors and restore confidence in the capital markets and corporate financial statements?

A.1. If confirmed, I will continue the work that has already been done by the SEC to ensure swift and effective implementation of the Sarbanes-Oxley Act. This landmark legislation gives the SEC a broad new mandate for action, and I intend to pursue these important reforms vigorously.

In areas where the Commission has taken final action to implement new rules under Sarbanes-Oxley, I will work hard if confirmed to ensure strong enforcement of the rules, while monitoring their implementation over time. In other areas that are yet to be resolved, I will work with my fellow Commissioners to accomplish this goal expeditiously, taking into account the extensive public input that is part of the rulemaking process.

In general, I believe that improving protection for investors and restoring investor confidence requires sustained and tough action by the SEC in all areas, including rulemaking under Sarbanes-Oxley as well also tough enforcement of the laws and rules.

Q.2. Under the Sarbanes-Oxley Act of 2002, all insiders, defined as officers, directors, and 10 percent shareholders, are required to file reports with the SEC of their trades of employer stock before the end of the second business day on which the trade occurred or at such other time if the SEC determines that the 2-day period is not feasible. However, contributing to swap funds is not currently defined as trading and is therefore exempt from disclosure rules. Thus, executives who may be acting on insider information may contribute stocks to these funds in order to diversify, make a profit, or avoid a loss without having to disclose their actions to public investors. Do you think that these kinds of transactions should be disclosed to the SEC?

A.2. I strongly support requiring prompt public disclosure of transactions by insiders. I have not discussed with the SEC staff the current treatment of these transactions that you referenced. If confirmed, however, I will explore whether transactions of this type are covered by existing law and whether additional regulation or guidance on the requirements of the insider-reporting provisions is necessary.

Q.3. In light of your experience as Chairman for several companies, do you feel that the executive compensation disclosure rules are adequate and what improvements would you propose?

A.3. I believe that easy-to-understand disclosure of executive compensation is critical to improving investor confidence in the integrity of financial statements. I understand that the SEC has been reviewing the quality and quantity of executive compensation disclosure, and I look forward to discussing these issues with them. If the SEC can refine its executive compensation disclosure to improve investors' understanding of companies, I would consider that a positive development.

Q.4. What steps do you anticipate taking to clarify the specific actions public companies, auditors, and others must take to preserve and to protect data once they are informed of a possible SEC investigation?

For example, there were significant issues related to the destruction of evidence in recent Commission investigations. Do you agree that clear guidelines should be put in place to instruct companies that are the subject of an informal investigation to "throw the switch" and stop the routine deletion of electronic data and the recycling of backup tapes to keep evidence in useable form?

In addition to putting clear guidelines in place that articulate the document retention responsibilities of corporate information specialists, should "whistle-blower" protection be extended to information specialists and others that observe these procedures and resist activities that could result in the destruction of evidence?

A.4. As illustrated by the criminal conviction of Arthur Andersen for obstruction of justice, existing laws make clear that companies are not permitted to destroy documents or other evidence to avoid producing it in an SEC investigation. Continued SEC cooperation with the criminal authorities through the President's Corporate Fraud Task Force will go a long way toward impressing upon companies their obligation not to improperly destroy documents.

In addition, the Commission recently adopted new rules pursuant to the Sarbanes-Oxley Act that require auditors to retain audit workpapers and other relevant documents for 7 years. These strong new record retention rules should provide significant benefits to the SEC's investigative efforts.

My understanding is that the Sarbanes-Oxley Act provides whistle-blower protections for employees of public companies who assist in an investigation regarding any securities law violations or violation of other Federal laws relating to fraud against shareholders. While the whistle-blowers you refer to may be within the scope of this protection under certain circumstances, it is my understanding that this section of the Sarbanes-Oxley Act is being administered by the Department of Justice and the Department of Labor. Therefore, I would, of course, defer to those agencies' interpretation.

RESPONSE TO WRITTEN QUESTION OF SENATOR CORZINE FROM WILLIAM H. DONALDSON

Q.1. Mr. Donaldson, one area that I think there has been a deficiency in regarding the SEC's diligence toward enforcing rules requiring companies to report all material financial and nonfinancial information is in the area of disclosure of environmental activities, liabilities, trends, and uncertainties. SEC Regulation S–K, Item 103, requires companies to disclose any material environmentally-

related legal actions contemplated or initiated by a governmental agency. Item 101 of Regulation S–K instructs that a "description of business" includes appropriate disclosure of the material effects of compliance with Federal, State, and local environmental laws, including estimated expenditures for environmental control facilities. Also, the Management's Discussion & Analysis Rule, Regulation S–K, Item 303, requires disclosure of any known trends or uncertainties that have had or could have a material impact on business.

I have heard from several groups that environmental liabilities are regularly under-reported under these regulations. For example, in 1998 the U.S. Environmental Protection Agency completed a report that I understand indicated that 74 percent of companies facing environmentally-related legal actions initiated by a governmental agency seeking $100,000 or more, failed to adequately disclose these liabilities as required under the SEC rules that I just mentioned.

Knowing your interest in ensuring transparency in financial reports, what steps will you take as the SEC Chairman to measure and improve compliance in the area of environmental disclosure requirements? Several interest groups have suggested changes to current SEC environmental disclosure requirements. On March 8, 2002, the Social Investment Forum wrote then-SEC Chairman Pitt requesting that the SEC convene a roundtable to examine recent proposals to expand financial disclosure and auditor oversight of material environmental and social liabilities, obligations, and impairments. Additionally, the Rose Foundation for Communities and the Environment has recently filed a rulemaking petition (SEC File #4–463) recommending changes to material disclosure requirements with respect to financially significant environmental liabilities. Both bring into question the adequacy of existing standards. As Chairman will you scrutinize the adequacy of the existing environmental disclosure requirements and involve the full range of stakeholders in considering whether changes should be made to those requirements?

A.1. As you know, the Federal securities laws require fair and accurate financial disclosure of information to investors. The fact that a company may have environmental expenses triggers disclosure if regulatory compliance or remediation costs are material to its overall financial results or condition. Similarly, other types of exposure to potential expense or exposure in connection with environmental matters trigger a disclosure obligation where they are material. Therefore, not all environmental expenses or exposures require disclosure. That being said, if confirmed, I will work with the SEC's Division of Corporation Finance to consider the full range of views on such matters.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM WILLIAM H. DONALDSON

Q.1. One of the most important characteristics of quality accounting standard setting is that the standard-setting body must have the ability to make independent decisions on financial accounting and reporting matters. As you know, the Financial Accounting Standards Board (FASB) has been establishing "generally accepted accounting principles" for nearly 30 years.

The Sarbanes-Oxley Act, to further the goals of improving and providing greater independence in the accounting standard-setting process, created statutory criteria for the SEC to use to renew its recognition of the FASB. However, that recognition has yet to occur. This may be the result of the significant workload that the SEC is currently engaged in, as part of the implementation of the Sarbanes-Oxley Act.

The fact that this recognition has not yet occurred may pose very serious budgetary problems at the FASB. As you know, Section 109 of the Sarbanes-Oxley Act establishes an independent funding mechanism for the private sector standard-setting body envisioned in Section 108. The absence of formal recognition has left the FASB without the statutorily prescribed funding.

If confirmed as Chairman, will you pay immediate attention to the recognition of the FASB?

A.1. My understanding is that representatives of the FASB and its trustees, the Financial Accounting Foundation (FAF), have written to the SEC requesting that FASB be designated as the organization in the private sector for establishing standards of financial accounting and reporting. I further understand that the SEC staff has been engaged in a dialogue with representatives of the FAF and FASB concerning the designation. If confirmed, I will make this a priority and work with my fellow Commissioners and the SEC staff to make the designation contemplated by the Sarbanes-Oxley Act.

Q.2. Last week, the SEC approved a final rule which required mutual funds to make public, on their website, how they vote proxies of the companies in which they invest. What are your views on this recent SEC rulemaking?

A.2. While I support the Commission's decision to increase transparency in this area, I understand that the Commission's recent rulemaking on this issue attracted a significant amount of interest. On the one hand, many individual investors supported the proposed disclosure requirements on the grounds that the rule would enable fund shareholders to monitor their funds' involvement in the governance activities of portfolio companies and prevent possible conflicts of interest. On the other hand, I understand that members of the fund industry raised concerns that these requirements would deprive funds of the ability to vote confidentially that other investors have, would politicize the proxy voting process, and would result in significant costs to funds and their shareholders. I understand that the Commission weighed these concerns and decided to adopt the rule with certain modifications to address some of the fund industry's concerns. If confirmed, I will ask the staff to monitor the implementation of this rule to ensure that it is functioning as intended.

Q.3. The Intermarket Trading System (ITS) is generally considered to be antiquated and in need of an overhaul as soon as practicable. Could you please share with the Committee any thoughts that you may have on the issues facing the ITS, and the future of market linkages?

A.3. The Intermarket Trading System is clearly an important part of the current market structure. I understand that its operations are being looked at as part of the Commission's ongoing market

structure review. In light of technological advances and of other market developments, I believe it is critical for the Commission to continue this review. If confirmed, I will work with my fellow Commissioners and the staff to evaluate the issue of market linkages and other important market structure issues with the goal of making our markets as efficient, well-regulated, transparent, and accessible as possible.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SANTORUM FROM WILLIAM H. DONALDSON

Q.1. One of the issues this Committee often wrestles with is the desirability of the uniformity of national regulatory structures for various industries and the efficiencies and competitive advantages a single set of standards entails with the need to respect States rights and the appropriateness of States having the flexibility to address unique local problems. In the case of financial market regulation, however, there is a strong case to be made that a national market system is an important factor in keeping U.S. financial markets globally competitive. As you know, some States are quite active in addressing many of the issues currently being addressed by the SEC in conjunction with last year's Sarbanes-Oxley Act. What is your view on the appropriate role and function of securities regulators at the State and Federal levels?

A.1. State securities authorities play an essential role in the regulation of the U.S. securities industry, particularly as it relates to investor fraud. At the same time, I believe it is critical that the SEC serve as primary regulator responsible for upholding national standards and uniform enforcement related to our securities markets. The States' enforcement efforts should be complementary.

Q.2. The Biotechnology Industry Organization (BIO), whose membership includes some Pennsylvania companies, and has brought to my attention their concerns with the Commission's proposed Rule 3a–8 under the Investment Company Act of 1940. BIO is concerned that this rule, which is intended to allow research and development companies flexibility in raising and investing research capital, is not flexible enough in its current form and does not create the best framework for allowing the research-oriented companies to invest funds where they can obtain the best return. It is my understanding that the BIO has filed a petition detailing its concerns. What is your evaluation of the BIO's concerns and position on the proposed rule?

A.2. I understand that the Commission proposed this rule, which would provide relief from the Investment Company Act to research and development companies, in response, in part, to a rule petition filed by the Biotechnology Industry Organization (BIO). I understand that the comment period on the proposed rule has closed and that the staff is analyzing the comments, including comments submitted by the biotechnology industry. If confirmed, I look forward to considering those comments with a view toward a final rule that provides biotechnology firms and other research and development companies with sufficient flexibility without compromising the goals and the investor protection objectives of the Investment Company Act.

RESPONSE TO WRITTEN QUESTION OF SENATOR BENNETT FROM WILLIAM H. DONALDSON

Q.1. Mr. Donaldson there is some concern that companies that own and operate distributed generation in small onsite applications in multiple States may qualify as holding companies under PUHCA. Recognizing the obvious fact that the law was not written in 1935 to apply to such companies, which have no market power, would you support an SEC exemption from PUHCA for the DG companies?

A.1. My understanding is that the Act has an exemptive provision that deals with similar types of situations. The Commission has historically tried to respond to the changing face of the utility industry in a way that preserves the core purposes of the statute, which, as you note, dates to the 1930's. If confirmed, and working together with my fellow Commissioners, I would be open to exploring the issues raised by the development of distributed generation to determine whether an exemption would be in the public interest.