MERGED

NASD chief Mary L. Schapiro is gearing up for the challenges posed by the consolidation with NYSE Regulation.

By Simon Butler

Photos by Brooks Kraft

When members of the Securities Industry and Financial Markets Association's Regional Firms Committee met with Mary L. Schapiro last July, they were pleased with what they heard.

"She has been very open about the merger and how to make things accretive to us as members," says Walter S. Robertson III, the committee's chairman, and president and chief executive officer of regional firm Scott & Stringfellow. "This was a meeting that we called up and said, 'Look, maybe this is a good time for us to sit down and get on [the same page],'" he says. "She was just very open and very forthcoming and made you feel like this was a self-regulatory organization. She's done a good job of listening."

In fact, it's been a little less than a year since Schapiro, 52, took the reins of the NASD. But as she moves into her role as chairman and CEO of the newly merged entity of the NASD and the regulatory arm of the New York Stock Exchange, she has fashioned a good idea of what it takes to bring the two organizations together.

As the SIFMA members discovered, one of the biggest ingredients is listening. That trait was an integral part of the tour Schapiro made to firms following the announcement of her promotion at the NASD last January.

"I spent a lot of time on the road talking to CEOs of firms," says Schapiro. "I sent about 30 of them a letter in advance, and I said, 'I want to come and talk to you one-on-one. I want to talk to you about the NASD and see the NASD from an outsider's perspective, because I've been here for 10 years and I have pretty much an insider's perspective at this point. And I want to talk about what we can do together to really raise the level of investor protection in our industry.'"

The result of her efforts, was, as Schapiro puts it, "amazing," though "a little bit exhausting." Through this initiative, she was able to visit with firms operating in all business models—including independent contractors, institutional firms and fixed-income companies. Those visits enabled her to incorporate much of the information she learned into her organization's agenda for this year.

"There's lots of positive feedback about that," says Schapiro of her organization's efforts to help firms comply with regulators.

But, along with the positive, Schapiro is also willing to face criticism. She doesn't hesitate to say that she has also received "lots of feedback about how we drive people crazy—and what could we do to drive them a little less crazy but still get our jobs done."

Much of that criticism centers around the cost of compliance. According to one report by SIFMA, securities firms spent $23.2 billion on compliance in 2004 and an estimated $25.5 billion in 2005.

Schapiro is listening to the needs of the industry but also remains steadfast in her determination to be a strong regulator.

"She is a highly disciplined executive who can be tough when she has to be without a scintilla of arrogance," says Arthur Levitt, a former chairman of the Securities and Exchange Commission. Levitt, who worked with Schapiro in the early 1990s when she was a commissioner at the agency, now serves as a senior advisor to The Carlyle Group, a global investment firm, and a director of Bloomberg. "She's an example of how to use power constructively without abuse, overreach or personal aggrandizement."

In fact, Schapiro is a veteran of government regulation, starting in the industry more than two decades ago. A political independent, she has served as a commissioner of the SEC under two presidents—Ronald Reagan and George H.W. Bush. In addition, she was named acting chairman of the SEC in 1993 by then-President Bill Clinton. Prior to joining the NASD in 1996 as president of NASD Regulation, Schapiro served as chairman of the Commodity Futures Trading Commission.

Nowadays, Schapiro's Washington, D.C. office at the NASD overlooks bustling K Street. She is accessible to not just her staff, but to member firms as well. And while this lawyer's affable and soft-spoken manner could inspire just about anyone to walk into her office for a chat, her no-nonsense approach to regulation is unmistakable.

"If you look at a chart or a diagram of the regulatory structure in the United States, what you see is really almost a spaghetti bowl of regulators," says Schapiro, citing the banking, securities and insurance industries. "We have a multilayered, multifaceted regulatory structure that—to my way of thinking—is unnecessarily complicated. And there's lots of overlap and duplication and inconsistency among all of those regulators."

The industry outcry against the redundancies was part of the driving force behind the decision to combine the NASD and NYSE Regulation into one—yet to be named—entity. (The merger is expected to go into effect this month, pending SEC approval.) "We thought it made sense, on multiple levels, to try to streamline and modernize securities regulation," Schapiro says.

That streamlining of oversight for the 200 or so firms regulated by both the NASD and the NYSE, according to Schapiro, will include moves to have a single examination team—instead of two—to scrutinize each firm's operations. The restructuring will also include an effort to combine potentially duplicative enforcement cases.

"The substance of what we do and what [the NYSE] does is very similar already," Schapiro says. "I don't expect the substance to change as much as I expect to have this layer of additional responsibility to make sure that we deliver on our financial commitments, as well as our commitments with respect to reforming regulation. And then we get the two organizations integrated and working as one entity—not two camps."

Challenges for the New SRO

The effort has many supporters and critics within the industry. "The NASD is moving in the right direction with Mary Schapiro," says Mark J. Astarita, managing member of Beam & Astarita, a Saddle Brook, N.J. law firm, which offers securities litigation services to small- and medium-sized financial services firms.

Despite the promising forward momentum, Astarita contends that there are issues—specifically the heavy-handed tactics of the SRO's staff—that must be addressed. Astarita says it's one thing for NASD executives to speak about how they're going to do right by the industry—but it's another thing for these sentiments to filter down to the staffers who actually do the exams and conduct the investigations. Too often, he says, examiners take incorrect posi-

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—SCHAPIRO

tions and then become unreasonable about them, demanding overly severe fines or sanctions.

In addition, Astarita says, is the practice that enforcement examiners rely on "a rule, regulation or interpretation that the NASD knows they can get a firm on." That approach needs to be tackled, especially with issues such as anti-money laundering violations, which frequently come up in supervision-related cases he has done, Astarita says.

"There's a sense—at least from the firms' perspective—that examiners will do what they need to do to find a violation," says Astarita. Most of these violations are inadvertent or a function of a firm not being able to have the staffing or the resources to be compliant, he says. "Enforcement needs to stop viewing firms as the enemy."

But Schapiro says that the regulators do indeed recognize how these rules and regulations affect small firms. She and her staff realize that "the ability of small firms to comply with our rules is sometimes really tested," she says.

One way to alleviate this burden is through the installation of a more customized rulemaking process.

"Our goal is to get down to that single rulebook, and I think we will have fewer rules at the end of the day," says Schapiro. "What we might have that's really different though, is the opportunity to make sure we don't have one-size-fits-all rules."

But Schapiro also believes that her new self-regulatory organization will need to find ways to accommodate small firms—without compromising investor protection. She adds that regulators also have to "make sure that we are sensitive to those areas where we could have exemptions or different ways to implement rules or different approaches that make it easier for [firms] to be in compliance."

A Better Deal for Small Firms

Still, some small firms have voiced concerns about the benefits of the merger, especially when it comes to representation. In January, NASD members voted in favor of the bylaw changes that would set the merger in motion, despite the efforts of a dissident group to block the move. According to the NASD, nearly 83% of the 5,058 firms eligible to vote, cast a ballot during the election period—with 64% voicing support for the merger.

Schapiro believes small firms will, with the advent of the single SRO, be even better represented than before. "There are some really important things about the new governance structure that serve small firms extremely well," she says. "Instead of having one seat on the NASD board, they will now have three guaranteed seats, and they will select the firms that sit in those seats. Big firms won't select them; intermediate firms won't select them—[small firms] will select them. So they have very direct governance."

In addition, says Schapiro, the small firm advisory board will be 50% elected instead of solely appointed by the NASD. "The small firm advisory board is a very important deliberative body for the NASD," she says. "No rules go to the NASD board for approval that haven't gone through the small firm advisory board. And the input they give us about operational impacts, costs and benefits of rules, the impact on business models, are invaluable and more often than not, result in our changing a rule that we have proposed for their consideration."

But there's another potential benefit that's flying under the radar: clearing. Many small firms clear through New York Stock Exchange members. "Those small firms have no voice in the New York Stock Exchange's regulatory programs, even though they're very fundamentally affected by it," Schapiro says. "Because we're consolidating all of this into the new SRO, they will have a very direct voice now in rules that impact clearing firms with whom they do business."

Schapiro's predecessor at the NASD, Robert R. Glauber, agrees. "In the new structure, [small firms] have specifically more representation than they do in the old," says Glauber, now a visiting professor at Harvard Law School. "I believe they will discover that as time goes on."

The Coming Cuts

Other changes are more tangible in nature. According to Schapiro, there will be a single budget for the new organization. "Over time, it will become less than the combined budgets of the two entities, and that's part of the efficiencies we expect to achieve," she says.

There will also be some cuts. "A large amount of savings we expect to come from the consolidation of the technology platforms," she says. "And then we expect the organization will ultimately right-size through attrition of personnel." The merger will combine about 2,500 NASD staffers with approximately 450 NYSE staffers.

ADDING VALUE

NASD staffers	*About 2,500*
NYSE Regulation staffers	*About 450*
Expected total in new entity	*About 3,000*

The NASD's budget for 2006 was $698.7 million, according to a spokeswoman for the SRO. A spokesman for NYSE Regulation declined to divulge his unit's budget.

As Schapiro puts it: "The challenge is—particularly in this time and place of increased competition, increased sensitivity to regulatory costs and burdens—is going to be to get the balance right."

Glauber says Schapiro may have "to make regulation scalable so the cost and burden of regulation is proportional to the size of the firm."

But investor needs can't be ignored either. And Schapiro is aware that part of that challenge will include monitoring the sale of certain products that warrant particular scrutiny due to suitability and marketing issues. These investments, according to Schapiro, include offerings that have traditionally been available only in the institutional channel—such as hedge funds—and are now available to retail investors.

Products geared to senior citizens will also be in focus for the newly merged SRO. To help combat infractions in this area, the organization is putting together a task force to help develop guidance and best practices for firms in working with seniors, Schapiro says. Of particular concern are tactics such as scams disseminated through junk mail, as well as free-lunch seminars that attempt to convince these elderly investors to buy certain products.

All that may help assuage investors worried that the SRO consolidation will mean less protection for them. "We've heard some concern about, 'Oh, there's one less cop on the beat.' " Schapiro says. "The fact is, to the extent that any issues used to fall between the cracks between multiple regulators—that should not be an issue anymore."

She also recognizes the benefits of both principles-based regulation (which puts the responsibility on firms) and prescriptive rules. She says that firms need to include "in their culture the belief that doing right by your customer is the way to prosper and thrive in your business. But you also need some rules around certain things, because people want some level of certainty. It's another balancing act—getting right the balance between principles and prescriptive requirements. The fact is that you need a combination of things."

The best investor protection of all is firms wanting to do the right thing, Schapiro says. "That's part of being a successful regulator. It's not just pounding the table. It's not just writing a rule and bringing an enforcement case, although those are things we do. It's helping people understand why these things matter." ■