

Securities Regulators Respond Effectively to Terrorist Attacks

THE HORRIFIC terrorist attacks of September 11, 2001, struck at the heart of Wall Street. The financial community lost thousands of people in the World Trade Center tragedy. The loss of life is staggering and the industry's grief overwhelming.

Beyond the human tragedy, many key Wall Street businesses were destroyed or displaced. The magnitude of the dislocation is arresting: the floor of the New York Stock Exchange was shut down for four days; 31 main offices and 30 branch offices of securities firms located in the World Trade Center were decimated, with another 350 companies with offices in the vicinity affected; commodity trading floors were among the rubble; and several securities regulators also lost their offices.¹ While trying to cope with the devastating physical, emotional and psychological effects of the attacks, the financial services industry also faced the difficult task of relocating operations, rebuilding systems and reopening markets. The member firm community exhibited a sense of unity, compassion and purpose never before seen in the competitive world of Wall Street and should be applauded. Securities regulators also have played a key role in this effort. In this time of crisis, the securities industry's regulatory agencies provided strong leadership in assisting the industry in its own labors to restore financial markets.

This article highlights the most significant (and in many cases coordinated) efforts undertaken by the Securities and Exchange Commission, the self-regulatory organizations (SROs) and the state securities commissions to respond to the attacks on New York's financial center and to help resume trading.

Reopening Securities Markets

When should the markets reopen? This was the most complex question facing the industry and securities regulators in the immediate aftermath of the attacks. Regulators quickly came under political pressure to open the markets for trading as soon as possible to assuage investor fears. At the same time, securities firms were concerned about the safety of their employees, interference with rescue efforts and the capabilities of heavily damaged operations. These problems were compounded by logistical issues as a result of the destruction or displacement of a number of Wall Street's offices and technical concerns, which mostly related to whether trading systems could be reconnected and function without glitches. Two key regulatory figures emerged during this crucial time: new SEC Chairman Harvey Pitt and NYSE Chairman Richard Grasso.²

Mr. Pitt was one of the first administration officials to come to New York, arriving by train on Sept. 12.³ Over the next several days, Mr. Pitt and the commission staff quickly began coordinating emergency meetings among regulators, New York State and City agencies, the major investment banks and other market participants to discuss all of the issues confronting the industry. During these hectic days, Mr. Pitt kept the media and the public informed about the actions taken by regulators and the industry.⁴ While leaving the decision on the timing of the resumption of trading to the industry, Mr. Pitt was instrumental in facilitating a careful and considered resolution to the difficult problem of market reopenings.⁵ At the end of the debate, the industry determined that trading would resume in two stages: the fixed income and futures markets were slated to reopen on Sept. 13 and trading in the equities and options markets would begin again on Sept. 17.⁶ Although trading was heavy and the market dropped steeply on Sept. 17, the reopenings were generally hailed as successful.

Deciding the timing of reopening was a significant step; ensuring that the markets functioned properly in light of the destruction to offices, systems and communications was per-



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haps an even more difficult issue. Mr. Grasso led the complicated and intensive effort to restore a central U.S. market — the NYSE trading floor. Although the Exchange floor was not damaged, reconnecting its trading and communications systems proved to be a round-the-clock task.⁷ Working tirelessly over several days (even reportedly grabbing a few hours of sleep on his office couch), Mr. Grasso orchestrated the rebuilding of the NYSE's operations to ready the market for the resumption of trading.⁸

With the financial community pulling together and the effective stewardship of Mr. Pitt, Mr. Grasso and their staffs, the industry was able to strike the appropriate balance among the competing concerns tugging at the markets and to effect a smooth restoration of trading.

Easing Trading and Margin Restrictions and Facilitating Access to the Capital Markets. The SEC took several actions in its efforts to assure that, once reopened, the markets operated efficiently and in a fair and orderly manner. As one example, using its emergency powers for the first time in its history, the commission issued exemptive orders eliminating certain timing and volume requirements for issuer repurchases under SEC Rule 10b-18 to provide liquidity to the market.⁹ Mr. Pitt reported to Congress that on the heels of the commission's action, major public companies announced significant buy-back programs.¹⁰ Additionally, during the period covered by the commission's actions, the SEC exempted any purchases by a §16 insider from the short swing profits recovery rule with respect to any sale in the preceding six months.¹¹ Finally, the commission eased restrictions on mutual fund lending and borrowing.¹²

In the corporate finance area, the SEC announced several administrative actions to assist the airline and insurance industries in accessing the capital markets quickly. These steps included providing telephone and e-mail hotlines to these industries to allow issuers and their advisers to obtain prompt staff guidance on financing and disclosure issues and developing expedited protocols for airline and insurance securities offerings.¹³

Acting in a coordinated fashion, the industry's SROs and the SEC provided extensive regulatory relief to brokerage firms. The list of SRO rules that were modified runs the gamut from the mundane (permitting firms to temporarily share office space without prior regulatory approval so that trading desks could reopen and extending the time individuals had to pass securities examinations and complete continuing education requirements) to the significant (changing the way in which firms were required to calculate net capital and extending the time within which to file financial reports with regulators).¹⁴ The commission issued three exemptive letters extending the deadlines for certain new regulatory requirements. The exemptions relate to SEC rules requiring market centers to provide reports relating to trade executions and obligating brokerage firms to report on their order routing practices.¹⁵ The SEC, however, did not take action on all of the suggestions for relief made to the agency. Of particular note, despite calls for prohibiting short selling, the commission did not implement such a ban.¹⁶

In light of the substantial disruptions and dislocations caused to firms by the attacks, securities regulators also exhibited flexibility in handling once routine activities. NASD Regulation declared an across-the-board extension for member responses to regulatory inquiries, permitting firms to respond to pending requests that required submission of information on or after Sept. 11 until Oct. 1.¹⁷ In a similar show of flexibility, Joseph Borg, the newly elected President of the North American Securities Administrators Association (the umbrella group for state securities commissions) announced that he would urge "state regulators to make all reasonable

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The relief and flexibility regulators afforded to member firms was welcomed by Wall Street as a helpful step at a time when many in the industry were beset by the traumatic and damaging events of Sept. 11.

In addition to the extraordinary actions described above, securities regulators also provided significant aid and assistance to those firms directly affected by the attacks on the World Trade Center. The NASD family of companies announced a donation of \$1 million to aid victims of the terrorist attacks and their families and a program to match employees' donations.¹⁹ For its part, the New York Stock Exchange Fallen Heroes Fund (created in 1999 to honor police and fire department employees killed in the line of duty) collected contributions from Exchange members for the families of those officers lost in the tragedy.²⁰

The SEC and NASD Regulation developed Web-site pages specifically devoted to providing information to brokerage firms concerning the fast-changing regulatory initiatives.²¹ As an example, on its Web site, NASD Regulation posted a list reflecting specific persons within the SRO who could be contacted concerning regulatory reporting issues (e.g., FOCUS, Reg T, etc.) and created a bulletin board to facilitate companies listing office space that was either needed or available.²² In a grim but vital effort, NASD Regulation provided its data base containing fingerprint cards for securities employees to member firms, law enforcement and rescue and recovery agencies to assist in the identification of victims.²³

Investigating Potential Wrongdoing and Rebuilding Enforcement Programs. In the days after the attacks, securities regulators around the world began intensive investigations to attempt to determine whether individuals or entities used advance information to trade in securities prior to Sept. 11. Various federal agencies (including the SEC, FBI and the Department of Treasury) and the industry's SROs have each been actively engaged in these investigations. According to numerous press reports, investigations are under way into possible improper trading activities in dozens of stocks and options.²⁴ In fact, some on Wall Street have expressed con-

cern that they have been overwhelmed with requests for trading records; some of the requests have reportedly been duplicative of each other. The regulators have apparently agreed to coordinate their efforts in collecting information.²⁵

Two departures from longstanding investigatory protocols are worth noting. First, in addition to making specific requests to brokerage firms for trading data relating to pre-Sept. 11 transactions, the SEC asked financial institutions to voluntarily review their records for any information concerning the accounts or transactions of 27 individuals and organizations whose assets were blocked by President Bush.²⁶ Firms were asked to contact the SEC when they located such information. Second, notwithstanding the commission's longstanding refusal to acknowledge the existence of any investigation, in light of the importance of its inquiry into potential securities violations, Stephen Cutler, the commission's Acting Director of Enforcement, issued a statement announcing that the SEC was "vigorously pursuing all credible leads" concerning those who may have sought to profit from the terrorist activities.²⁷ To date, no U.S. regulator has announced that it has found any evidence of wrongdoing in the securities markets.

Thankfully, all employees of the industry's securities regulators were reported safe after the attacks in New York. Several agencies, however, maintained offices in the World Trade Center, and the SEC's Northeast Regional Office, the CFTC's New York office and the NYSE's Division of Enforcement premises were completely destroyed. In addition, NASD Regulation's New York offices were displaced. In time, the regulators located new offices, with the SEC set to move into new downtown space in the Woolworth Building and the NYSE attorneys and investigators landing at 20 Broad St., and NASD Regulation has returned to 33 Whitehall St.

Each of these regulators has also begun the painstaking process of attempting to rebuild their enforcement and regulatory programs. In doing so, regulators have been adamant that no significant investigation will be affected by the destruction caused to their offices. As SEC Chairman Pitt told Congress, "no-one whom we have sued or whose conduct we have been investigating should for a single moment doubt

our resolve to continue our pursuit of justice in every such matter."²⁸

In remarks delivered to the Senate concerning the commission's open lines of communication with firms seeking relief from various regulatory requirements, Mr. Pitt noted that the SEC "assured industry participants that if they came to us with their problems, we would work with them to find solutions, without after-the-fact recriminations, except in cases of venal conduct."²⁹ In a subsequent interview, Mr. Pitt went further, indicating that where securities firms disclose internal problems to the commission and convince the SEC that they have remedied any deficiencies and repaid investors, enforcement action would not be instituted. Of course, Mr. Pitt said that cases of deliberate violations and fraud would be treated harshly.³⁰ To some in the defense bar, these comments engendered optimism that the SEC staff was signaling a new attitude toward how the commission would treat firms who self-reported violations.

Shortly after the terrorist attacks, regulators were concerned that scam artists would try to take advantage of the tragedy by soliciting fraudulent donations for relief efforts. While such acts are difficult to imagine, SROs and state regulators tried to alert the public to these kinds of schemes. NASD Regulation issued an Investor Alert warning brokerage firms and investors about potential fraudulent schemes that may be designed to take advantage of the public's desire to contribute to relief efforts.³¹ Similarly, NASAA cautioned investors to be wary of possible investment scams purportedly connected to disaster assistance programs.³²

An examination of the tremendous efforts undertaken by securities regulators in the wake of the Sept. 11 attacks reveals that these agencies acted promptly and effectively. Through thoughtful and considered actions, the regulators also fulfilled their traditional role of protecting investor interests and ensuring the integrity of the market. Perhaps NASD President and CEO Robert Glauber put it best when he said, "Countless markets and firms — ordinarily the fiercest of competitors — have cooperated like the closest of friends."³³

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(1) For statistics concerning the massive displacement caused by the attacks, see Testimony of NASD President and CEO Robert R. Glauber before the U.S. Senate Committee on Banking, Housing and Urban Affairs, Sept. 20, 2001, at http://www.nasdr.com/news/sp/pp11_25.html ("Glauber Testimony").

(2) For articles describing the key roles played by Mr. Pitt and Mr. Grasso, see Vanessa Blum, "How SEC Chief Helped Avert Market Meltdown," *LegalTimes*, Oct. 8, 2001; Stephen Labaton, "After the Attacks: The Regulator, In the Eye of the Storm, A Voice of Calm From Washington," *N.Y. Times*, Sept. 14, 2001; and Jeff D. Opydyke and Charles Gasparino, "Rebuilding Wall Street: Wall Street Rivals Become Allies," *Wall St. J.*, Sept. 24, 2001. Not to be overlooked were the efforts and leadership of Nasdaq's Chairman and CEO Hardwick Simmons. While the Nasdaq market does not operate a central trading floor, the market making capabilities of firms was obviously disrupted by the destruction in New York. Nasdaq worked diligently with the industry and its regulators to reconnect firms to allow the resumption of trading.

(3) See Blum, *supra*.

(4) Testimony of Harvey L. Pitt before the U.S. House of Representatives Committee on Financial Services, Sept. 26, 2001, at sec.gov/news/testimony/092601tshlp.html ("Sept. 26, 2001 Pitt Testimony").

(5) See articles cited at endnote 2, *supra*.

(6) See Testimony of Harvey L. Pitt before the U.S. Senate Committee on Banking, Housing and Urban Affairs, Sept. 20, 2001 ("Sept. 20, 2001 Pitt Testimony"), at <http://www.sec.gov/news/testimony/092001tshlp.html>.

(7) Resuming, Reshaping, Restoring Confidence, The Exchange, at <http://www.nyse.com/content/articles/NT0005A9A6.html>.

(8) "Deals and Dealmakers: Bids and Offers," *Wall St. J.*, Sept. 21, 2001.

(9) Exchange Act Release Nos. 34-44791 (Sept. 14, 2001) and 34-44827 (Sept. 21, 2001). The emergency relief for SEC Rule 10b-18 purchases included in these orders lasted for 10 business days, ending on Sept. 28, 2001. On that date, the relief was extended under the commission's general exemptive powers until Oct. 12, 2001. See Exchange Act Release No. 34-44874 (Sept. 28, 2001).

(10) See Sept. 26, 2001 Pitt Testimony.

(11) Exchange Act Release Nos. 34-44791 and 34-44827, *supra*. This relief was in effect from Sept. 17 until Sept. 28, 2001.

(12) Investment Company Act Release No. 40-25156 (Sept. 14, 2001). This exemption lasted from Sept. 17 through Sept. 21, 2001.

(13) SEC Announces Assistance to the Airline and Insurance Industries in Reaching the Capital Markets, Sept. 28, 2001, at sec.gov/news/headlines/airline-insurance.html.

(14) Emergency Office Space — Sharing Arrangements; Filing a Form RE-3, at <http://www.nyse.com/content/memos/NT0005A62E.html>, and Net Capital, Financial, and Operational Issues and Web CRD and Registration Issues, at http://www.nasdr.com/special_netcap.html, and http://www.nasdr.com/special_crd.html.

(15) See Sept. 26, 2001 Pitt Testimony; Request for Temporary Exemption from Rule 11Ac1-5 for Nasdaq Securities, at sec.gov/rules/exorders/nasdaq092101.html; Request for Temporary Exemption from Rule 11Ac1-6, at sec.gov/rules/exorders/sia092101.html; and Request for Exemption from Rule 11Ac1-6, at sec.gov/rules/exorders/smfirm092101.html.

(16) See Sept. 20, 2001 Pitt Testimony.

(17) Extension for Member Responses to Regulatory Inquiries, at http://www.nasdr.com/special_extension.html.

(18) State Securities Regulators Pledge to Help Securities Firms in Recovery Effort, Sept. 20, 2001, at <http://www.nasaa.org>.

(19) NASD Companies Donate \$1 million to Aid Victims of Sept. 11 Attacks, at nasdr.com/news/pr2001.

(20) NYSE Fallen Heroes Fund, Oct. 4, 2001, at <http://www.nyse.com/events/NT00054652.html>.

(21) See Relief Actions Taken After Sept. 11, 2001, at <http://www.sec.gov/ncr/sept11relief.html>, and the homepage of NASOR at www.nasdr.com.

(22) Regulatory Reporting, at nasdr.com/spec_reg_reporting.html, and Office Space, at nasdr.com/special_office.html.

(23) See Glauber Testimony, *supra*.

(24) See Bob Drummond, "Bank of America Among 35 Stocks in SEC's Attack Probe," *Bloomberg News*, Oct. 3, 2001.

(25) Charles Gasparino and Laurie P. Cohen, "Money Problem Puts Strains on Wall Street," *Wall St. J.*, Oct. 11, 2001.

(26) Request for Records Search by Securities-Related Entities, Including Brokers, Dealers, Investment Advisers, Investment Companies, Municipal Securities Dealers and Transfer Agents, Sept. 26, 2001, at sec.gov/news/headlines/recordsearch.

(27) Statement by Stephen Cutler, Sept. 19, 2001, at <http://www.sec.gov/news/press/2001-96.txt>.

(28) Sept. 26, 2001 Pitt Testimony, *supra*.

(29) Sept. 20, 2001 Pitt Testimony, *supra*.

(30) Michael Schroeder, "SEC Eases Procedures to Help Airlines, Insurers Raise Capital," *Wall St. J.*, Sept. 27, 2001.

(31) NASD Regulation Investor Alert, at http://www.nasdr.com/alert_092401.html and Charitable Donations Scams Surfacing, at http://www.nasdr.com/special_charity_scam.html.

(32) State Securities Regulators Warn of Opportunistic Investment Scams Following Attacks on World Trade Center, Pentagon, at <http://www.nasaa.org>.

(33) Glauber Testimony, *supra*.