SEC Historical Society
Interview with Gene Gohlke
Conducted on November 21, 2022, by Kenneth Durr

Ken Durr:

This is an interview with Gene Gohlke for the SEC Historical Society's Virtual Museum and Archive on the history of Financial Regulation. Today is November 21st, 2022. And I'm Kenneth Durr. Gene, it's good to see you today.

Gene Gohlke:

Yes, same here Ken.

Ken Durr:

Looking forward to our talk. I want to go back and talk about your education, which is real interesting. It looked like you got several advanced degrees. I want to talk about them.

Gene Gohlke:

Okay. Well, I started my undergraduate in 1960, the fall of 1960 at the University of Wisconsin in the Milwaukee campus "UWM." I majored in accounting in those four years. I was also in the Reserve Officer Training Corps program, which might be relevant later on. Graduated with high honors in 1964 with a BBA degree, bachelor business administration with a major in accounting and minors in economics and finance.

At the time, it seemed appropriate to go on to grad school and get an MBA. During my senior year at UWM, I applied to the MBA program at the University of Wisconsin, the main campus in Madison, Wisconsin, and was accepted. I started the MBA program in the fall of 1964 and finished... I think I finished the MBA program. I took some summer courses in 1965, so I finished in August or so of 1965. Just as a aside, I took the CPA exam in May 1965, and later that summer I found out I got the second-highest grade in the nation on the CPA exam. So I got the Elijah Watts Sells Silver Medal from the AICPA for that.

I was a teaching assistant during that year in grad school. So I got to work with a lot of the professors in the business school at UW, and talking to them and with some encouragement from them, they said, "Well, Gene, you ought to really continue on and get a doctorate and stay in academia."

So that's what I did. I applied for the doctoral program at UW and I spent the next three years working on the PhD. I was a research assistant in the second year of grad school. I worked in the business development part of UW. And then in the third year, I actually got a Ford Foundation Fellowship, so I didn't have to teach or do research. I could just work on my studies. And then in 1968, the last year, I had a doctoral fellowship from the Arthur Anderson Foundation back then. So that helped pay for all the expenses. And I didn't have any student loans whatsoever. Of course, college was a lot less expensive then than it is now.

Ken Durr:

Yes. So how did you end up getting into the Army?

Gene Gohlke:

Well, as I mentioned, in my undergraduate years I took the ROTC program. So when I graduated in June 1964, I was also commissioned as a Second Lieutenant in the Army. And then I asked for deferments.

You could do that at the time and I guess you can still do that to go to grad school. And so I had four years of deferment, but that was the max. So I had some pressure to finish all the grad school work in four years.

So when I graduated with the PhD in June 1968, I got orders from the Army calling me to active duty in February 1969, so I had some free months. I applied and was hired as an assistant professor and taught in the graduate program at UWM for a semester. I reported for active duty at the Army's finance School as I was in the Finance Corps in February 1969. After completing several courses at the Finance School I left for Vietnam in May 1969. In Vietnam I worked as an adviser to the Vietnamese Military Training Command for two years. Toward the end of that 2-year period, I gave a talk at the Vietnamese command and staff college. Because of my background, they thought it would be useful to have somebody with some financial background give a speech to officers in the Vietnamese military. And it just so happened that somebody from the Agency for International Development attended that session, heard me talk, and came up later and said, "Gene, we'd like to bring you on board."

I agreed, and when I finished my military tour, I worked for AID in Vietnam. What I did for AID was actually teaching staff from the various Vietnamese companies such as the electric company, the airline, the waterworks about basic accounting and financial management. I was somewhat in academia for those four years that I worked for AID in Vietnam.

I was in Vietnam until April of '75 and that's when the Viet Cong marched into Saigon. So I left about ten days before there was that transition.

Ken Durr:

Wow. So you evacuated.

Gene Gohlke:

I had to evacuate. I took a flight out. So anyway, that was the Army experience and the AID experience. And then I came back to the US in... I think it was May 1975. I took some time off on my way back to the States travelling to places such as Guam, Saipan, Truk Islands, some of the places where World War II was fought. That was very interesting.

When I got back to the US, I said, "Well, do I want to continue working for AID?" And I said, "Well, let's see what else is available." So I interviewed at the Federal Reserve Board and at the Securities and Exchange Commission. I was interested in securities in addition to accounting from my early days at the university. I think I opened my first brokerage account when I was 20 and I have been investing ever since. So I've got about sixty years of experience.

Ken Durr:

Okay. Tell me about that. Tell me about that interview with the SEC. Who did you talk to?

Gene Gohlke:

Yes. Okay. So I called the personnel department at the SEC and said, "I'd like to come in for an interview." I guess given my background, the Division of Investment Management was looking for somebody with my background. So I interviewed with, at the time it was Alan Mostoff, the Director of the Division, Syd Mendelson, an Assistant Director, and Dennis Gurtz, who managed the inspections program for investment companies and advisors at the SEC. They liked my background and they liked my interest in securities.

And I thought, "Well, gee, this would be a good place to work." So I filed the necessary paperwork. In due time it came through and so I was hired and started at the SEC in October of 1975 in the Division of Investment Management. Division staff thought that, given my background, it would be best if I worked with the inspection program for investment companies and investment advisers. So that's how I got into the SEC, got into Investment Management, and had my first association with the inspection program way back in the fall of 1975.

Ken Durr:

What was the program like at that point? Was it just cyclical exams and that sort of thing?

Gene Gohlke:

Well, yes, it was a cyclical exam program then and continued to be throughout the time I was at the SEC. We never had enough staff in the inspection program, although we asked for it in the various budgets that were submitted during the years. Somehow never enough money flowed down to hire enough people so that we could do exams of everyone out there every year. I'm not sure that would've been useful anyway. So, it was cyclical exams of most firms with the occasional cause exam if a company has a significant issue that came to our attention. In the late 1970's there were maybe four or five, maybe six of us in the Division of Investment Management that were overseeing and managing the inspection program.

Most of the inspections then and throughout the time I was there, were done by staff in the SEC's regional offices. There were examination staff in each of the offices, and they were responsible for doing cyclical exams of the investment companies and investment advisers in the area that office was responsible for. So inspection staff in the Division managed the program, coordinated it, set goals, did whatever else was needed in order to keep the program up and running in finding problems if there were any out there to be found.

Ken Durr:

Now the broker-dealer program went back quite a ways. My sense is that the investment adviser program was had been developing more recently. Was that the case?

Gene Gohlke:

The Investment Management division was responsible for investment companies and investment advisers, as well as insurance companies that issued variable annuities. And then at the time, I think it was, the Division of Trading and Markets was responsible for the broker-dealer inspection program. But there was a big difference, because for investment companies and advisers, there weren't any self-regulatory organizations, so the SEC staff was the primary entity that did inspections of those firms.

On the broker-dealer side, back then it was NASD, now it's FINRA, Financial Industry Regulatory Authority, that was responsible for doing the routine cyclical examinations of broker-dealers and the SEC inspection staff in Trading and Markets oversaw those inspections. For example, NASD examiners would go in to broker-dealer A, conduct an exam, write a report. The report was available to the SEC staff. After a month, couple months, or whatever time period, the SEC staff might go back to that broker-dealer and conduct an exam as well. And then compare results with what the NASD examiners found, with the idea of making sure that the NASD staff was doing an appropriate, adequate job of inspecting.

So the programs were different in that respect in that the broker-dealer program was more oversight. And the IM program was actually doing the cyclical inspections and nobody else was examining those investment companies and advisers.

Ken Durr:

Right. Right. There was an Office of Investment Adviser Regulation set up in IM in '78, three years, or a little over two years after you came in. Did that involve the inspection or the examination program?

Gene Gohlke:

Well, not really. Because in Investment Management back in 1975 even, there was an Office of Disclosure and that staff reviewed the filings, the reports, filed by the mutual funds. There was also an Office of Insurance Products, which dealt with all the issues regarding insurance company variable annuity products. Variable annuity, variable life. There was a Chief Counsel's office, there was a rule-making office. So as the investment adviser population grew, during the latter part of the seventies and during the eighties, it was thought, "Well, why not have a specialized office that focused on adviser issues," hence the development of that Office of Investment Adviser Regulation.

So it was just adding another office to, or within, the Division of Investment Management because prior to that, the rule-making office, the Chief Counsel's office would deal with investment advisers' issues as well. It was another office in the Division whose staff would specialize in investment adviser issues.

Ken Durr:

Okay.

Gene Gohlke:

Of course, that would help the examination program too, because we had staff in the division that were very knowledgeable about adviser issues. So if issues came up during an inspection, we could go to that office and say, "Well, here's an issue. What do you think?" How do we handle it?

Ken Durr:

Okay.

Gene Gohlke:

As we would do with disclosure or investment company issues, we would go to the office within investment management that dealt with those issues to get their view and get input on how to deal with the issue. So that is really the way it worked. It wasn't sort of new, it was just putting in one place staff that handled investment adviser issues.

Ken Durr:

Okay. Gene, you are cutting out a lot. So I may have you go back and retrace a few things. We definitely have signal problems.

Gene Gohlke:

For the first two years or so after I joined the Division staff, there was another person that was responsible for overseeing the Office of Inspections. But that person left. And so I assumed the responsibility for managing the inspection program. But also because of my background in finance and in accounting, it became well-known in the division that I was willing to help out anyone else that might be dealing with a new rule, interpretation of an existing rule, or an exemptive application filed by some entity, a fund, or an adviser that had financial related issues. So I sort of became a financial consultant to everyone else in the division, which was fine because I enjoyed doing that. That relationship also helped the inspection process because I could see issues that were coming up and then if they seemed to have an impact on inspections, I could deal with that and let the inspection staff know in the regional offices that, "Hey, here's an issue. Why don't we approach it this way during inspections?"

So after a while, I don't know a year or two in that mode, the leadership of Investment Management decided that... Well, they used to have an office of a Chief Financial Analyst, but the person left, I think sometime in the early seventies and it had never been filled. So what they did is they recreated that office, and I applied for the position to manage that office, and became the Chief Financial Analyst of the Division. And so I had a few staff that were focused on financial analysis as well as the inspection staff.

So I had those two programs. And I think that was really very useful, because as Chief Financial Analyst, I was involved in almost every rule-making, whether it was an advisory rule-making or an investment company rule-making that the Division undertook during the seventies, eighties, as well as issues that might come up in exemptive applications where a fund or an adviser wanted to do something that was otherwise prohibited by the regulation, but which seemed to make sense. And no action letters. So as those issues came up, I was involved and could work closely with the legal staff that were dealing with it and could identify issues, problems, and then feed that back to the exam staff saying, "Here's what this fund is doing," or this rule is going to require funds or advisers to do this or that. So here are suggestions on how we should be approaching that during our inspections.

So having that close relationship with the rule-making office was, I think, a big plus. And I think the same thing would be would have been true in the Trading and Markets Division, where the broker-dealer exam staff could talk with the attorneys, working on rule-making, or other issues involving broker dealers, and then feed that back into both the SEC's exam program, but also, NASD exam program.

Ken Durr:

Mm-hmm. Let's talk about some of the rulemaking that you were involved in. Money market funds were getting hot in this period.

Gene Gohlke:

Yes, Yes. It started off as an exemptive application, I believe. Some fund group wanted to create a money market fund, and it had unique issues, in that they did not want to mark the funds portfolio of securities to market, as funds were required to do by the Investment Company Act that set requested funds to value all of their securities and calculate the net asset value of the fund and net asset value per share on a daily basis because that's what the fund shares would be sold for. Because a money market fund would invest in very short-term securities, the argument was, well, we really don't need to mark the portfolio to market every day, the value doesn't change that much so we wanted to use just what the fund paid for the security as "cost." If a security was purchased at a price other than its maturity value, the fund would use amortized cost.

If you buy, let's say, a treasury bill above what it's going to mature at, you got to amortize that difference, the premium, over the remaining life. So they wanted to use amortized cost, and after some analysis, it seemed to be a sensible approach with some safeguards. The fund also wanted to use a $1 net asset value. Use of a $1 NAV means that the $1 is a lot less sensitive to market changes than, let's say, a net asset value of $10, $20, or $30.

So there were a lot of financial issues involved with working on that exemptive application, and I was heavily involved with dealing with those issues. I remember doing a couple papers trying to explain why using a $1 NAV, given that they were in short-term securities, made some sense. And so, that application was granted, but then other fund groups wanted to do the same thing, so I guess, the Commission decided, "Well, let's do a rulemaking. Let's do a rule that would lay out the same requirements that the exemptive application did for this first fund group."

And then, any fund group out there, if they wanted to have a money market fund, could follow the rule. The rule added a couple other bells and whistles, like some fund group said, "Well, we want to mark to market our securities, but we want to round to the nearest penny," so penny rounding was a part of the money market fund rule as well. And there were limitations on the average weighted portfolio maturity that the fund could have because that would dampen down the impact of market changes on the value of the portfolio, so it was a big effort to come up with that rulemaking. And of course, at the same time, we had to come up with additional things that the exam staff would have to do when they did an exam of a fund group that had a money market fund. They'd have to oversee some of the requirements of the rule to make sure that the funds were adequately complying with all of those conditions.

Ken Durr:

Would you train people to be specialists in things like money market funds, for example, on the exam side?

Gene Gohlke:

No, we never did that, because there weren't enough staff to do that, so the staff were pretty much generalists. They had an inspection manual, which laid out a lot of background information on the various rules, regulations, exam steps, and they also had an inspection outline or checklist that helped guide them during the exam. And there were addendums to the checklist for money market funds that would guide the staff to look at the use of penny rounding if that's what the fund was doing, and then the average maturity, how was that being calculated?

There was also an issue about the quality of the securities that the fund could hold. Did the fund have adequate controls in place to make sure its securities purchased were within the bounds of quality, standards? So, we tried to lay all that out for the inspection staff, and during periodic training programs that we had for the inspection staff, where we would gather pretty much the entire staff, what, a hundred people, 200 people, whatever it was at the time, together, and for maybe two, three, maybe four days, and go through some of these requirements. So, we tried to keep the entire staff apprised of what they ought to be doing for these various types of funds through the training programs, as well as the various materials that were provided, the manual, the outline, and so on.

Ken Durr:

Okay. Was this a matter of bringing people from the regions into Washington for a period of time?

Gene Gohlke:

Yes, sometimes in Washington. Sometimes we would have these training programs in one of the cities where a regional office was located. It depended on the money available for travel, and Washington wasn't the cheap place for people to stay for any length of time, so it might be cheaper to have it, for example, in Fort Worth, or maybe Denver.

And in addition to these periodic all-examiner training programs, at least in the early years of Investment Management, and I think, throughout the time we were Investment Management, we would have either semi-annual or annual exam program manager meetings where just the managers would get together in one of the regional offices, and this would be from... Managers throughout the program would all come to, let's say, Chicago, and Chicago staff would host the managers for probably two days. And we would go over a lot of the issues that had come up since the last meeting, new rules, exemptive applications, new exam techniques from findings, enforcement referrals. And typically, the director of Investment Management would attend those meetings and talk about policy issues, things that the exam staff managers would need to know about. That was an additional type of training that we were doing.

When we first started back in the '70s, I'm not even sure we had laptop computers. I don't think laptops were around yet. I don't think IBM came out with their ThinkPad at that point. So, we had maybe conference calls with the exam staff, but later on we would do training programs. We could do it online. People could access some internal site that the IT staff at the SEC would set up, and we could do some training online as well.

Another big issue for the exam program came up when laptops became generally available. We tried to get a laptop for every examiner, and then a lot of the guidance for the exam staff was made available online. The laptops were also used to record work done and issues identified during exams. The exam staff also started getting what we called downloads of portfolio information from the fund groups, and from advisers as well. Having those downloads, examiners could analyze portfolio holdings to see whether the investments, one or more of the funds in the groups were making, were consistent with their investment objectives, with the information they were telling investors, and the prospectus, and things like that. So introducing laptops to the exam program was a big issue for a while after they first became widely available.

Ken Durr:

You're talking about working with the exam staff, but you're working down to the regions. Was Jim Clarkson involved in this? He had his finger on the regions.

Gene Gohlke:

He was sort of the SEC's coordinator for regional office staff, head of regional office operations, I guess. And so, he too, whenever we had these meetings with the exam staff, Jim would also attend and have time to talk about the broader SEC issues that were beyond just investment management-related issues. So yes, Jim was a very good person to have around to help us get stuff for the exam program through the executive director's office. And in enforcement cases that the regions might want to bring, he could advocate for the regions on enforcement matters to the division of enforcement, so yes we worked closely with Jim Clarkson.

Ken Durr:

Okay, so we talked about interfacing with the regions, and I mean, the regions were your staff, but how about interfacing with the states? There was an initiative in the 1980s where the SEC is working with states in a joint program.

Gene Gohlke:

Right. We recognized that many states had investment adviser registration requirements; some requirements similar to those of the federal statute, sometimes a little different. And some of the states were doing examinations of investment advisers located in their state, looking at the adviser's compliance with state requirements. So, we thought, well, wouldn't it make sense to coordinate with states that had these exam programs? So, to the extent we were doing exams in the state of advisers... to go in together with the state, and they could look at state-related issues, and we would look at the federal aspects of the adviser's operations. That would reduce the burden on advisers, but it would also provide, oh, some training for the state examiners, and also, just give our examination staff a broader view of what that adviser is doing, because the states would be perhaps looking at things that weren't part of our examination process.

So, we had a lot of discussions with the state. There was, I think it was NASSA, North American Securities Administrators Association. We had a variety of meetings and discussions with NASSA staff in order to coordinate this joint examination program. And then, once the examinations were done, the states would give us a copy of their exam report and we would give the state a copy of our exam report so that we could all be informed of what was found, what the issues were, if there were deficiencies, how they were being corrected. And so, we tried to work with the states in order to both increase our knowledge and ability to understand what advisers are doing as well as to reduce burdens on the industry.

And we did the same with some of the foreign regulators in whose country some SEC registered advisers were located. Some SEC registered advisers had offices in London, in Hong Kong, Sydney, not so many in Germany generally, and not so many in France. So, we thought, well, it makes sense if the US adviser is located in the UK. It might be a subsidiary of the adviser, it might just be an office. We already needed to take a look at what was going on in that foreign country by that adviser, since many of the clients were US clients, and so it made sense to work with the securities regulators in those countries, because many of those countries required the adviser to register with the securities regulator in that country.

So, to do a joint exam with the Hong Kong securities commission staff, with the UK commission staff, and to a lesser extent, with the Australian securities commission, SEC examiners would travel to that country and conduct a joint exam. We could watch how the foreign regulators conducted their exams. They could watch what we did. So it was, in part, a learning experience, but it was a good way to oversee what these advisers with foreign affiliates or foreign offices, foreign from us anyway, were doing. After these exams were completed, we would share the reports of exam findings.

So anyway, we tried to have as many angles as possible for insight into our large population of registrars. And given the size of our staff, we were not able to visit, particularly advisers, maybe once, what was it, every ten years or so. So, to have some assistance from the foreign regulators, because they would get reports from these advisers, and hopefully, they would share with us if there were some particular significant issue, that we could learn about it as well through their interaction with the advisers, and likewise, with the states.

Ken Durr:

Was there a point where you took over the exam side exclusively, or were you still working as a financial analyst through the '80s into the '90s?

Gene Gohlke:

The entire time I was in Investment Management I did both financial analysis and the inspection program because I supervised both financial analysts and examiners. When I moved into this chief financial analyst position, I selected a person to run the exam program on a day-to-day basis and in close coordination with myself. And likewise, in the financial analysis area, there was a person that was day-to-day responsible for financial analysis, and I was managing both programs, but I became very much a hands-on manager. I enjoyed doing the work and getting involved with the issues.

Ken Durr:

Okay. Speaking of management, you were acting director for a little while, right? Tell me about that experience.

Gene Gohlke:

Okay, Yes. Kathy McGrath was the division director, and she left to go into private practice. Richard Breeden was chairman at the time, and before he appointed somebody as a permanent division director of Investment Management, I was probably the senior person in Investment Management. And just as an aside, over the years, quite a few Investment Management staff came to view me as the best non-lawyer lawyer that they ever knew because I was very familiar with the regulations and could speak legalese, and while I was in grad school, I minored in law, so I had some background in the legal area.

And I guess, putting that together with my experience in the division, it made sense that I would be acting director. That was a lot of work because as I was working as acting director I was still a financial analyst. I had the inspection program. I had to manage the financial analysis staff. And I think by then, somehow, I had acquired the insurance products office, so I had those three offices to manage directly, and then overall, the entire division, so it was a busy time.

Ken Durr:

And did you go and sit before the Commission a good bit?

Gene Gohlke:

Yes, it was common. If there was a rulemaking or an enforcement action, sometimes exemptive applications needed direct Commission approval. The process would be where the division staff would provide the Commission with the proposal, with background information, perhaps meet individually with some of the Commissioners, but then at a Commission meeting, sit before the Commission and summarize what we wanted the Commission to do and what the situation was, answer questions from the Commissioners, and then hopefully, get their approval of whatever we wanted them to approve.

And so, the director of the division, or in my case, the acting director, was the focal point of those discussions, so fortunately, there weren't too many times while I was Acting Director. It was a relatively short period that I had to go through this. But that, too, would put added burden on myself to prepare for that and become familiar with the potential questions. But yes, it was a good time, let's put it that way. I enjoyed, very much, working in investment management.

Ken Durr:

Yes, so things started to change going into the '90s. And I want to talk big picture. I know this was an idea that Chairman Levitt had. What were some of the bigger picture things behind the creation of OCIE?

Gene Gohlke:

I think the main driving force was the idea that, hey, we got these two separate inspection programs in Trading and Markets and Investment Management, and there were an increasing number of broker dealers that were forming investment advisers, that managed mutual fund groups, so wouldn't it make a lot of sense to bring the oversight of those entities together in one office, provide greater coordination among the staff, to just have just a better approach to oversight? So, I think that was the main reason Chairman Levitt decided to make that change. Although it was a wrenching change, at least for headquarters staff. For the regions, that didn't make too much difference because I don't think the reorganization applied to them as such. But for us in the headquarters office, that meant leaving the divisions of Investment Management and Trading and Markets, or maybe by then was called Market Regulation, and setting up this new office, OCIE.

But Lori Richards, who was the first and longtime director of OCIE, was a very, very good person to work with. She understood the stresses that we were going through, both myself and my counterpart in Trading and Markets in leaving the divisions and setting up in this new office. But I think it improved the coordination between the broker dealer staff and the investment management staff.

Although most of the examinations werebeing done by the regions, they were all under one regional office head anyway, so they could have coordinated whenever it seemed appropriate without too much to do. But it made sense, I think, bringing the headquarters staff into one office as well. Although I enjoyed being Investment Management. I had that direct contact with the legal staff doing the rule making the exemptive applications, as did Mary Ann Gadziala in Market Reg. But even though I was organizationally separated from the Division, I tried to maintain a good level of coordination and interaction with Division staff. It because it was probably the rare day when I wasn't on the floor that Investment Management staff occupied, talking to people, just walking around, just being there so people could reach out and say, "Hey, Gene, I've got this issue. What do you think?" And so I tried to maintain that close contact with investment management staff because I thought it was very useful to do that.

Ken Durr:

How did you do that? Because OCIE's got, you've got this whole new structure now. You've got this entire office over here. Did you set up systems or did you keep it kind of informal, talking back and forth with Investment Management?

Gene Gohlke:

Informal, informal. As I said, I tried to, daily, or at least every other day, just walk through the floor that Investment Management occupied. I knew a lot of the people there because I'd worked with them for a long time. So even if I didn't have an issue to discuss, I could stop in the offices of Division managers, like Bob Plaze, Doug Scheidt, Tom Harmon, Mary Podesta, Tom Lemke, all those folks that were office heads in Investment Management. If there was an inspection issue that might have regulatory implications, I could casually just stop in their office and say, “Hey, this issue came up in the inspection program. What do you think?” I might also ask, “Are you working on something that has inspection-related or financial-related implications? Can I help? Is there something I can do?”

So yes, it was just informal. And I think Lori was very much in favor of that. I did that as well with the Office of Economic Analysis. I got to know a number of the economists very well. In fact, two of them and myself had a weekly coffee. We would stop at Starbucks in Union Station. Getting off the Metro, you’d walk right past the Starbucks. And one of us would get three coffees and we would sit before office hours and talk about issues that were coming up. So I had that informal relationship with the economists as well.

Ken Durr:

Talk a little bit about building up OCIE. I’ve heard stories about having a whole floor out of yourself and it was empty, and you got to put people in here. Did you hire from within? You get a lot of people from outside? How did that work?

Gene Gohlke:

Let me see.

I don’t recall getting a lot of people from outside in OCIE. It was pretty much taking the existing inspection staff that I had supervised in Investment Management, and they all moved to OCIE. By then there were seven or eight people and then myself. And then I think the same on the broker-dealer side. The broker-dealer examiners that were in Market Reg moved, just moved over to OCIE. There were more of them than there were of us in the Investment Management side.

And to the extent we could get additional money in the budgets, we hired additional people. As the OCIE exam staff grew in size, we separated the staff into two branches.

And then we, I think, divided up responsibilities for the regions among those two offices, say Los Angeles, San Francisco, Seattle, when it was still in existence, probably Denver. Maybe Fort Worth were under one branch, and then the Chicago, New York, Boston, Miami, Atlanta offices were under the other branch. So that helped streamline things a little bit, and they could pay more attention to the regional offices they were associated with, because one of the things that OCIE staff did was to review all of the inspection reports that were done by the regional offices to make sure that they seem to have covered all the areas that were important for that type of firm, and that they appropriately handled deficiencies they found.

Ken Durr:

Right. Right. You talk about the staff issue, and clearly staffing and staffing shortage is something you’re living with. And you mentioned earlier that figure that you could get to every investment adviser once every ten years, something like that.

Gene Gohlke:

Yes, something like that.

Ken Durr:

Yes. And I assume that one of the goals of OCIE was to step that up, was to do more inspections. What things did you put in place?

Gene Gohlke:

Well, that would be hard to do because, as I said, most inspections are done by regional office staff, not by Washington, DC staff. And we would have to have grown the regional office staff, which we did bit by bit over time, but there wasn't all of a sudden, a whole bunch of new exams when OCIE was formed because of staffing limitations. And initially in the first year or two, there weren't any additional staff. It was just staff from the existing offices that were combined into the one office in OCIE.

Ken Durr:

Okay.

Gene Gohlke:

And also, most of the new exam staff went to the regions because that's where the examination work was done. And with the increase in numbers of investment companies, investment advisers, as well as the size of existing groups, the exam cycle didn't change significantly. For example, if you're doing a fund group that has, let's say a billion dollars of assets under management, and one that has a hundred billion dollars of assets under management, it's going to take longer to do the latter than the former. So as the size of the industry grew in terms of numbers of entities, as well as the assets under management, the time needed to conduct exams sort of increased, increased, increased.

Ken Durr:

One of the things you did do, there were some high-profile sweeps, sweep exams, that were undertaken shortly after OCIE was created.

Gene Gohlke:

Yes. And we did sweep exams in investment management as well. I think after the money market fund rule was in effect for a while, we did a sweep of money market funds. So we just focused on those funds to see how they were complying with the rule. And I think there were several instances, and I don't remember if it was in OCIE or in Investment Management where there were dislocations in the interest rate market, let's say short term rates shot up in a very short period of time, which would impact the value of assets held by the funds. So, if something like that occurred, we might very well decide to do a sweep.

We would tell the regional offices, "Okay, for the next two months or so, we're going to focus on money market funds," or, "We're going to focus on this type of fund or that type of fund," and so that means the routine exams of other funds would get pushed back because of the sweep. But conducting the sweeps was a way to quickly get information both for the exam staff, and also for the regulatory staff in IM and in Market Reg as to how entities were complying with new rules, new policy issues, things like that.

So, the sweeps had a variety of purposes, certainly, first of all to determine whether the entity was complying with whatever the new issue was, but also to provide feedback to the regulatory divisions as to possible glitches in a rule, or there's some open questions here that need to be addressed.

Ken Durr:

Okay.

Gene Gohlke:

And we continued to do sweeps as OCIE was formed, because those same issues would come up. Suppose the insurance products office put in a new rule for variable annuities. Well, we might do exams focused on insurance company variable annuity products in order to provide feedback to the regulatory staff about how things were going.

So, we did sweeps in IM, we did sweeps in OCIE, and it was usually tied to some new development, but it might also have been tied to some broader issue in the market. After I think such as after Long Term Capital Management imploded and interest rates went wild, we probably did some sort of a sweep of money market funds and maybe some other types of debt- related funds just to see how they were handling this huge dislocation in the market. Were they appropriately pricing their securities, their assets as part of their net asset value calculations, which was very important because that's what investors paid to get in and the amount they got when they left the fund. So net asset value was always a big part of examinations because that directly impacted investors. So our sweeps were regulatory related, but also market development related.

Ken Durr:

Okay. I noticed that for a while, a lot of these, they were published. They were big formal reports, and they were published and disseminated to the public.

Gene Gohlke:

Yes. Well, it was a way of telling the industry, "Okay, here's a development, here's how it was handled," or, "Here's a new regulatory requirement. Here's how it's being handled." And we thought that would be useful feedback for the industry. Not all of the results of sweeps were made public. I think the soft dollar sweep, the 12B1 sweep may not have been made public. I don't remember. I didn't take anything with me. I didn't want a Trump Mar-a-Lago issue, so I don't have any paperwork.

Ken Durr:

Yes, that's probably a good thing.

Gene Gohlke:

Yes, Yes.

Ken Durr:

So let's just talk generally. You've been over and over discussing the growth of this investment company/investment adviser market. What was going on to drive that growth?

Gene Gohlke:

Oh, I think there were several things. 401k plans, 403B plans came into effect at some point in the eighties. The government's thrift savings plan, which invested in investment companies, came into being. All of that funneled retirement money into the investment management industry. Plus there were very high interest rates in the early eighties. So that attracted a lot of money to money market funds, as well as other types of debt funds. So, it was a variety of things. Just the increase in the size of the US economy, people were told to be saving for retirement, Social Security isn't going to be enough. So, a lot of money just poured into mutual funds, as well as accounts managed by investment advisers.

And then, I don't remember the year, but exchange traded funds were created. Prior to exchange traded funds, ETFs, as they're called, investment companies were primarily mutual funds. And with mutual funds you submit an order, and you get the price at the end of the day, the net asset value of the fund. So, you couldn't purchase a fund using a limit order. Well, ETFs, the exchange traded funds, were traded on the exchange. So, you could buy and sell an ETF throughout the day, and you could place a limit order. So if you wanted to purchase a S&P 500 ETF at $2 less than the current market price, you could put that into a broker's system, and if the price got there, you would get your shares. If it didn't get there, you wouldn't. It was just like a regular stock.

So I think that also led to many more people investing in investment companies. Also ETFs avoid the capital gains surprises that that can come with investments in mutual funds because the way ETFs work for mutual funds. Come the end of the year, they're required to pay out most of their capital gains. And so investors can get hit with a huge capital gain distribution, which is fine, but it also has tax implications. This doesn't happen with ETFs, so there were a lot of reasons why I think ETFs have really taken off. There's trillions of dollars in ETFs now.

Ken Durr:

So moving through the nineties and into the early two thousands then, when I look at the records, I get a sense that late trading and market timing, there was all this hullabaloo about the SEC kind of missing it. And shortly after that comes this OCIE effort to sort of formalize a risk based examination program. Did those two things, was that a cause and effect in any way?

Gene Gohlke:

Well, yes. It certainly had an impact on the focus on risk during examinations. While conducting a typical cyclical exam of a fund, to identify if there may have been abusive market timing taking place, the exam staff would have to look at the sales and redemptions of funds in a group. And in order to determine whether that seems unusual, know information about a lot of other similar types of funds. So, the staff could determine if this fund's purchase and redemption of its securities stand out in some way from similar funds. So, identifying market timing in a fund during a regular exam can be difficult unless you happen to run across an email or somebody coming up to you at a water cooler and saying, "Hey, you ought to look at this."

And there were other issues that came up -- investments in derivatives. Some funds were going into derivatives in a fairly big way. Other funds didn't go into them. And there's certain limitations. Funds have a limit on the amount of "senior securities" they can have. That is, securities that have a prior claim on the fund's assets. And just dealing with all these new things out there, it just seemed to me and to Lori, to the exam staff, that in addition to the standard inspection outline that examiners typically follow, they should really see the forest and not just look at the trees. "Okay, we're going into this fund group. What's different about this fund group? Oh, they have this fund that's heavily into derivatives. Well, do they have an investment manager that is capable of evaluating derivatives? Can they price the derivative correctly? Can they monitor it?"

So, looking for unusual aspects of a fund group or an adviser or particular activities that the fund might be engaged in as creating a higher risk. And so pay attention to those things in addition to everything else. So, you're seeing that you're looking at the individual trees in the forest, so to speak, but you're also seeing the forest and, "Oh, it opens up this whole other area." So it was something that seemed appropriate to push.

Ken Durr:

Computers are getting more powerful. Did you start to get better tools for tracking bigger movements in the markets so you could look at the forest?

Gene Gohlke:

Well, not really, because I think the best tool would've been this form N-SAR. It's a semiannual report form for investment companies that collected a lot of information for every fund, not just the fund group, but every fund, and was able to, if the database had been built, categorize that information by type of fund. So, we could look at all funds of a particular type and then identify any funds that might behave all funds, let's say all junk bond funds that had characteristics, outliers, if you will. And that would help us identify fund groups that might have a problem in that area, or might have an enforcement issue in that area, and then focus on them. Again, it's the risk-based approach.

But unfortunately, the Commission never had enough funds to build the database or to do the algorithms that go against the database to identify funds that had outlier characteristics. At one point, IT staff hired a small firm to try and do that, but they were not able to do the work. We talked with larger firms that seemed able to do the work, but we never had the budget money to pay for them.

Ken Durr:

Okay.

Gene Gohlke:

So we had all this information, but we couldn't really use it to do the risk-based approach to exams. And I firmly believe had this database been in existence, because there was a section of that form that had to do with sales and redemptions of fund securities. So had we had information across the industry on sales and redemptions by fund type across the industry, we should have been able to identify funds that stood out, that were outliers, and then we could have focused on them. But we never had that ability.

Ken Durr:

Okay.

Gene Gohlke:

That central component (the Form NSAR database and related algorithms) of the risk-based approach never got implemented.

Ken Durr:

Okay. Something that was implemented was the compliance rule. Did you have a role in that?

Gene Gohlke:

Yes, I think that was an important initiative because it required every fund group, I believe, again, I'm somewhat hazy on that, but I believe it required every fund group to have a chief compliance officer and to have appropriate measures in place to assist that chief compliance officer in monitoring the activities of funds in the group, or at least monitoring risky activities of the funds. And I think that's what I tried to do in that speech I gave regarding duties of compliance officers which focused on, "From my point of view, here's what the CCOs that you're all going to be hiring ought to be doing in order to monitor what's going on and bring to senior management issues that may not be appropriate for the fund."

So I think that was an important step toward improving the risk-based monitoring of the industry. Granted, each firm had to do it, and the CCOs, I guess could be compromised. It's not unheard of, but at least there was that requirement you have a CCO. And the exam staff then would focus on, "Okay, what are the qualifications of the CCO? What are the duties? What sort of controls are in place that this person monitors? What sort of issues have been identified? Have they identified anything that went wrong or that seems to be out of whack?" So it was an additional tool the exam staff could use in conducting risk-based exams.

Ken Durr:

So it sounds like that really changed in a pretty big way. The compliance rule changed the work that the exam staff did.

Gene Gohlke:

Well, we would still look at things, at details, still look at valuation calculations, net asset value, 12B-1 payments. But yes, we would probably... I don't recall how we told the exam staff to interact, but that would probably be something right up front in the exam is to sit down and have a discussion with the CCO asking such questions as, "Okay, what do you do? What have you found? What are the issues that you think this fund group or this adviser has?" And then use that to moderate the more detailed work that we would do during the exam.

And hopefully we would have access to compliance reports that the CCO got, assuming they got any. If they didn't get any, we would probably have an issue with that. "But what were the compliance reports you got?" And review a sample of them. Look for issues that were teed up and if there were issues, "Well, what was done with it? What have you done about this? Has it been corrected?" So yes, it was a big aid for the examination staff.

Ken Durr:

Two big things, two big landmarks that hit in 2007, 2008. You had the financial crisis, which is the first thing. Did that change the strategy as far as going out and doing examinations was concerned?

Gene Gohlke:

I don't recall it changing it, but the crisis did cause us to focus on investment in subprime loans. Were funds, debt funds, or even equity funds, were they into those things? What sort of due diligence did they do before they bought in? Was it sort of a fictional thing that they bought or was it a real thing? And how are they valuing these things in the crisis? When the market dries up, how do you value it? You go to fair value where you try and estimate what the value is. And examiners would ask, "Okay, you've fair valued these securities, you've sold some of them. How do your selling prices compare to the previous day's fair value?"

And if there's a huge gap, well, maybe your fair value procedures aren't so good. So I think we would have looked more at valuation issues because of the financial crisis and portfolio management issues. So, we probably would've focused more on those and less on fidelity bonding and things like that.

Ken Durr:

Okay. And then the Madoff thing hit, and that was a pretty big deal for OCIE for sure. I want to talk about some of the first things that you were able to do. I know that a lot of things changed long term, but what happened in that immediate aftermath?

Gene Gohlke:

Well, it was introspection as to how could this occur. And I don't recall when the last adviser exam was done of the firm prior to all the issues becoming public. But also, what about the FINRA exams? At the time, there was a registered broker-dealer there, so FINRA should have been doing exams of the registered broker-dealer on a cyclical basis. What were the findings of their most recent exam?

Did they recognize the additional risks that may have come up by Madoff being both an adviser and a broker-dealer and having advisory clients' securities held by the broker-dealer? If an adviser is not a broker-dealer and has custody of client securities, that is, they can go to wherever the securities are held, a bank, a broker, whatever, a depository and conduct transactions in the client's account without getting prior client approval. And then the adviser has custody. And the adviser would need to get an independent audit or count of its securities, of its client's securities on an annual basis.

Well, in Madoff's case, the securities are at his broker. So, the adviser didn't have to have, if I recall correctly, one of those independent audits. So it really came back to FINRA doing the exam of the broker-dealer. And why didn't they see that the securities weren't there? All the securities that should have been there weren't there. I don't know why it was missed.

Ken Durr:

Right. So you get this asset verification push that must have complicated the exams in the aftermath.

Gene Gohlke:

Well, yes. Yes. It hugely complicated them because doing asset verification is a lot of work. For an investment adviser, that would mean the exam staff sending a confirmation request to one or more custodians that hold client securities, asking them to, as of a date, what are you holding for clients or this adviser? Getting that information back and then comparing it to the adviser's records and statements sent to clients, and maybe confirming some of the assets with clients just to make sure that they know what they think they have and comparing all that stuff. And the volume was significant. So yes, it created a lot more work for the exam staff. But it's something that I think was important to do because, and not only for investment advisers, but for broker-dealers too, to have FINRA staff and to the extent the SEC is doing an oversight exam of a broker-dealer to go to Depository Trust Company and ask DTC to confirm, "Okay, what does this broker hold in your record, on your records?" And compare that to the broker's records, compare that to statements sent to clients, and make sure that's all consistent.

So that's a huge amount of work, but it really is something that should be done, particularly where there are additional risks such as where the broker-dealer is also the adviser.

Ken Durr:

One of the things that this did free up is some resources, so I know that OCIE got the ability to hire some new people and to staff up a good bit. And I believe you were still there when that was happening. Do you remember that, that process and what the challenge was?

Gene Gohlke:

Well, I think it would probably be primarily in the regional offices where that staff went, because they do most of the exams.

Ken Durr:

Right.

Gene Gohlke:

I think most of that additional staffing went to the regions so it was regional office staff that needed to do the hiring and find the space to accommodate the additional staff. And of course, then you have the need to train all of these people. A large amount of training is done on the job. Exams are typically done by teams. It's rare that an exam is done by an individual.

So, it's a team of examiners that go into a firm. So the new staff would work with the existing examiners to learn about the exam process, to learn about what are the issues that should be looked at and how do we look at them. What constitutes deficient practices and how do we handle deficiencies? So a lot of the learning comes from on-the-job training. And so presumably after these people were hired, there would've been quite a bit of on-the-job training. And I don't remember if we had an all-examiner training program or not. I just don't recall.

Ken Durr:

Okay. Well, this has been a great talk. Is there anything else that we should talk about that we haven't so far?

Gene Gohlke:

Well, I don't know. Oh, one other thing, I think I misspoke when we talked earlier. When I had that session at Columbia University talking at the Mutual Fund Directors Forum, I think what I was talking about was what directors ought to be concerned about for funds that invest in derivatives. What they should be asking the fund manager regarding expertise in understanding the derivatives and pricing and things like that. So that speech was aimed at directors, but it had to do with derivatives, not with the CCO.

Ken Durr:

Okay. It did get a lot of play though.

Gene Gohlke:

Oh, Yes. Oh, Yes. It was written up in various industry publications. I did a fair amount of speaking both in Investment Management and at OCIE. And I visited a lot of firms too, so I had direct contact with a lot of investment advisers, so I was able to talk to them and they got to know me. So it was a good relationship because I could get out there and talk to a large group of people and discuss current issues and problems.

Ken Durr:

Well, what made you decide to retire? Was it just getting to be that time?

Gene Gohlke:

Retire?

Ken Durr:

Yes.

Gene Gohlke:

Well, in April 2011, when I retired, I'd been at the SEC almost 36 years. I was 69 years old. And the new director of OCIE, Carlo DiFlorio, in my opinion, wanted to take the approach to exams in a different direction, more process-oriented, by the numbers and less risk-based, and I didn't think I had much to add to that. So it just occurred to me that, "Hey, this is a good time to pack my bags and say goodbye." And sort of a personal thing, at the time is my wife was operating a small urban farm for many years, and I would help her out on weekends, but during the week I had to go the office, so I couldn't help her. But as you get older, you can do less lifting and bending and weeding and things like that. So by retiring, I could stay home, I could help her full time and do agricultural stuff like working outside, tilling the ground, getting my hands dirty, seeing things grow. So, I said, "I have something to go to if I retire. I can say goodbye to the SEC, but I can say hi to being farmer."

And so that personal issue was also a fig factor in my decision to retire. So all in all it was a good time to retire and say goodbye to the many people I worked with over the years. Once I left, I never looked back. I've sort of completely cut off anything with the SEC. I don't follow anything because I became a farmer and had no time to do anything else.

Ken Durr:

Right. Well, I really appreciate you taking a little bit of time to look back with me today and you can get back to your afternoon.

Gene Gohlke:

Okay. You're welcome.