Securities and Exchange Commission Historical Society
Interview with David Silver
Conducted by Kenneth Durr, on April 21, 2006

KD: We finished up last time with talking about why you left the Commission and your circumstances for that, but we were going to go back a little bit and follow up with a few things. It looks to me like the thing to start with would be the market break of '62.

DS: Okay. By current standards it was not really much of a market break. I don't quite remember how far the Dow moved and what the percentage amount would be but it was pretty formidable in its day. I'd like to start with sort of a generalization. I was through two market breaks while I was at the SEC. The first one was May 28th '62 and the other was the market break, if you'd call it that, which attended the assassination of President Kennedy in November of 1963. Thereafter, after I left the Commission, I was able to observe other market breaks particularly the large break in October of 19--.

KD: Eighty-seven?

DS: --'87, the '87 market break.

KD: That was a substantial one.

DS: When I was at the ICI and still had some connection with the events that took place my first observation would be that at times of market crisis, as the numbers parading across the tape reach the national consciousness, the national administration reacts. And they may not think very much about Wall Street, the doings of a market as such day-to-day but when there is a crisis suddenly people in the White House wake up and they start looking around for what instrumentalities are available to either get the best information or perhaps even to do something about the situation. And so the SEC is discovered periodically by the White House staff in these events whose first thought is that as these things happen, watching, we have to do something about this. And so they call the Chairman of the SEC.

I think that the expectations of the Administration as to what the SEC can do about the situation is always vastly overblown and I think of an anecdote which I heard from Manny

Cohen when he was Chairman. There was some market break, not big enough I think to hit the historical record, but he received a call from Lyndon Johnson who proceeded to give Manny a pep talk on how the SEC had to do something about this and concluded the conversation with Manny--as Manny recounted it to me--Manny you're my Mickey Mantle and I expect nothing less **[*Laughs*]** from you than the Yankee fans expect from Mickey Mantle. I think I heard that anecdote within a month or two after the event and **[*Laughs*]** I think Manny was still somewhat in a state of shock.

KD: It sounds like Lyndon Johnson.

DS: And kind of wished he wasn't in the office that day. But Johnson had a penchant for tracking down even when they weren't.

To go back to that first market break in May of 1962, if my memory is correct, there were some national events associated with what happened to the market. There had been some steel price increases and the Administration was concerned and there was talk of perhaps an anti-trust conspiracy on the part of the steel companies, and I think Bobby Kennedy, who was Attorney General at the time, actually sent some FBI agents to roust out of bed a couple of steel executives at night, or at least that's what the story was at the time, and this contributed to a kind of jittery state of affairs on Wall Street and the market had been conceived to be at a peak sometime before May of '62.

The Special Study was in full swing by May of '62 and as I've mentioned I was probably the staff member most closely associated with the issues arising with respect to trading on the New York Stock Exchange, etcetera. One night and it may have been the night of May 28th when the tape ran very late and this market decline took place I received a call at home about 8 o'clock at night I'd say, from William Cary. At that point while I knew William Cary and the other Commissioners, the SEC always being a wonderfully open organization with respect to contact between staff members and Commissioners, nevertheless I was surprised, flattered, and somewhat upset to get a call from the Chairman at home. And in his very, very genuinely deferential approach to people, Bill first apologized for calling me so late at night and told me that he had received a call from the White House; he didn't say who. And there was one of these calls obviously that I mentioned--what's going on, what can you do about it, what's going to happen, etcetera. While he again didn't mention the call or the specifics of the conversation he made it clear those are the kinds of questions he was facing and he said right off the bat, he realized there was absolutely nothing the SEC could really do about a market break or (b) really only having the ability to collect some limited information but (c) he thought he had to respond to the call and would I mind going to the Exchange that night and being present at the opening on May 29th and get an open telephone line to him so I could report to him? And as he made it clear, so he could tell the White House that he had somebody-- an agent on the scene as it were.

At that time there was an overnight sleeper to New York which I got on and turned up at the Exchange at around I think 8:30 in the morning and was surprised, although perhaps I shouldn't have been, that as far as the Exchange was concerned, it was business as usual; nobody turned up until 9 o'clock. So I was waiting in the street until I saw a staff member of the Exchange who I recognized and he brought me inside and brought me up to the Executive Offices where I met with Keith Funston as he arrived.

Nobody told me this but I inferred from what happened next that the Exchange officials rapidly formed the belief that I had in my briefcase an order closing the Stock Exchange, which the Commission has the power to do on the signature of the President. And I could see a certain fixation developing with respect to my briefcase--that's when I sort of formed the belief that that's what they thought I was there for, and indeed they insisted that I sequester myself in the office of the Chairman of the Exchange, that's ordinary only used when he's around, which was right next to Keith Funston's office, because they didn't want anybody to see me because this would give rise to the story that I was there to take drastic action. I think this may have been part of the *us* versus *them* mentality that set in between the Kennedy Administration and certain segments of the financial community; of course nothing was further from anyone's thought that that's what we would do--at least in Washington. And my suspicions were somewhat fortified because within a half hour the very distinguished outside counsel to the New York Stock Exchange, Sam Rosenberry from Milbank Tweed turned up to keep me company. And I was then informed that everyone really believed that the market would straighten out, it would not be any terrible repetition of the tape being hours late, and indeed based on historical form--after a day like May 28th it would not have been that unusual at all for there to be some recovery on May 29th as indeed there was.

KD: Did you come up with an explanation as to why the break the day before?

DS: No; we didn't engage in any study of causation. What we did study thereafter, and it appears in the Special Study report, was the behavior of members on the floor, of the specialists, members trading on the Exchange, etcetera, and there was no indication of any conspiratorial action to knock prices action or to cause any kind of panic. The specialists we found—what we had found thereafter that it was a mixed picture. Some specialists did exactly what they were supposed to do--tried to moderate the action of the market. Some, but not many, seemed to accentuate the market trend downward by dumping their positions early and often. And so there was no conclusion about the system based on the market break except in a sense a potentially positive thought that if a number of specialists were able to perform the function of maintaining a fair and orderly market insofar as circumstances permitted, then appropriate regulation could potentially encourage such behavior, as against a situation where you found that no specialist would be acting in a positive fashion which would lead one to suspect that the system itself was a total failure and that it was economically impossible for specialists to function in a positive manner.

KD: One of the questions of the Special Study was whether the specialists should be allowed to continue like that as a function in the Exchange. So it sounds like this is one of the arguments…

DS: Yes; and as I say one which pointed at least to a positive conclusion about the system. And as I mentioned last time, under normal circumstances, stocks are much more thinly traded than people have historically believed with all the volume being spread over a long trading day and that during the routine humdrum activity of the day specialists did serve to prevent large price discontinuities during the course of the day.

So, so much for the May '62 market break; I don't remember if I was made to wear a face mask when I left the Exchange.

KD: Smuggled out the back door maybe?

DS: [***Laughs***] and I suppose we can fast forward to the more tragic events of November '63. Actually two things happened at once; one --the national calamity of the President's assassination; the other a more parochial calamity involving the New York Stock Exchange and the brokerage community itself and that was the infamous situation involving a man called Tino De Angelis and the so-called Salad Oil Scandal which brought down the firm of

Ira Haupt and Company which at that time was about the sixth largest brokerage firm I believe.

We first got word, taking this sequentially, a week before November 22nd that there was some trouble involving soy bean oil futures on the street and the press centered in on Ira Haupt and Company as being in potential difficulty. Again we were still in the Special Study but I think by that time it was recognized that the personnel of the Special Study had the most current expertise--call it that--about the Street, so in a sense we were pressed into an operational mode rather than a study mode.

Just through the Special Study however I had met a senior lawyer--I forget which firm--who represented Ira Haupt and Ralph Saul and I were talking about these rumors and I suggested with his concurrence that I call the lawyer for Ira Haupt to take a sounding as to what was happening. I did call and the lawyer confirmed that there was a problem involving warehouse receipts, futures trading, and particularly soy bean oil futures, and that the situation was still very uncertain. There were several potential problems as a result of this; at that time there was no SIPC, there was no Securities Investors Protection Corporation--that's its name – to make good on losses of monies and securities held for them by a bankrupt brokerage firm. There was not even the predecessor to SIPC which actually was created after the Ira Haupt failure and that was a fund maintained by the New York Stock Exchange to bail out customers of failed firms. Indeed, the only precedent for New York Stock Exchange action was a very limited one which had occurred in the late '50s when a small New York Stock Exchange firm called DuPont Homsey had failed and the Commission itself, not the staff of the Commission, pressured the New York Stock Exchange to come to the relief of the retail customers of DuPont Homsey. I should have mentioned just for the record although I think that people that look at these archives will be acquainted with this--is that the problem here arises from the fact that retail customers of brokers will have on deposit huge balances of cash and securities which they own which are left for safekeeping or for margin purposes with Stock Exchange firms. If a Stock Exchange firm or any broker/dealer fails, there is at least the possibility that customers having nothing to do with the failure, their funds and securities will be in some jeopardy--at the least tied up for periods of time in bankruptcy proceedings, and at worst would actually be in jeopardy of losing significant assets.

The rules of the Commission and the New York Stock Exchange did require through various formulas capital maintenance requirements applying to the Stock Exchange firms limiting the amount of debt that they could undertake and requiring capital to be generally in liquid form and unencumbered. However these formulas, while providing protection in the ordinary course of business, would not necessarily stand up when either fraud was involved or some other dramatic failure of a brokerage firm.

Under the Commission rules then and probably still today, the Commission has its own capital rules applying to broker/dealers; however there is an exemption for members of Stock Exchanges whose rules are more strict than the SEC's rule. However, there had always been the SEC's position that if a member firm of such an Exchange violated the Exchange's capital rule it would then fall under the Commission's capital rule giving the Commission some handle with respect to that situation.

In any event, the situation during the week preceding November 22nd with respect to Ira Haupt became more and more serious and I went to New York on the night of November 21st and tried to meet with some people in the New York Regional Office of the SEC who didn't seem to have a complete picture of what was going on. We agreed to meet again before the opening of business on the morning of November 22nd and we did and made an appointment while I was at the SEC to see the Vice President in charge of Member Firms at the New York Stock Exchange and we went over and with me was somebody from the Regional Office and again one of the people from the Special Study whom we had resident in New York City.

KD: Who was that?

DS: Dick Meyer. And we got to the Exchange, again probably before the opening of business, and did meet with Bob Bishop who was Vice President of Member Firms, and found that the Exchange also had very little information. They had inspectors at Ira Haupt but they had come up with no conclusion as yet as to what was really happening.

And so I had previously put in a call to the lawyer for Ira Haupt telling him that I was going to be there and that we would probably be at the office of Ira Haupt around 9 o'clock in the morning. And so we went from the Exchange to the offices of Ira Haupt and were greeted with a sight that must have been—to anyone who had lived through it--reminiscent of what happened in 1929. By this time the financial columns were pretty full with the Ira Haupt story and there was a line of customers stretching down the street, hundreds of feet, waiting for Ira Haupt to open so they could get in and get their funds and securities out of the firm.

We fought our way into the lobby and at that time a gentleman approached us who said that he was from the CEA, the Commodity Exchange Administration, which was the predecessor to the CFTC [***Laughs***], and that he inferred from what we were doing that we were agents of another government agency who told us that he had absolutely failed in his attempts to get into the firm and could he join our group. [***Laughs***] So we did and we got over to the receptionist desk and found things very confused. We waited about 10 minutes and finally I made one of these threatening messages that if they didn't see us in the next 15 minutes we'd see them in District Court. And what made this urgent is I could observe down the corridor there was the cage -- in those days it really was the cage -- and that was the place where funds and securities were delivered in and out of brokerage firms on a routine basis during the course of the day--except that we discovered that this was no longer routine--that there were four bankers from Ira Haupt's creditor banks, four vice presidents of major New York City banks who were creditors of Ira Haupt standing inside the cage and divvying up money and securities as they were delivered in to Ira Haupt. This of course was disturbing to us because again from our point of view we conceived our mission to be the protection of customers' securities.

So finally we were ushered up to the sixth floor, or wherever it was, to the senior partner's office and we found out the reason for the chaotic reception we received and that is until that morning the firm was under the belief that the trading operation of De Angelis, which was designed to corner the soy bean oil market, had left them nearly bankrupt but still solvent. Although they were in violation of the capital rules, nevertheless they believed that they were still solvent to about a half a million dollars. That was predicated on the belief that the warehouse receipts that they had of the oil farms, that you could see across the river in New Jersey, were filled with soybean oil in the tanks. But somebody had gone over the night before with dipsticks and it was discovered those tanks were empty or contained water. This meant that the warehouse receipts were worthless and the Ira Haupt firm was in fact insolvent to the amount of about $30,000,000.

The interruptions were constant as people were coming in and out and finally the partner in charge put somebody at the door and said don't let anybody else in and started to suggest that the firm should file bankruptcy as their quickest way to protect investors. About five minutes later somebody did walk in. It was the secretary of the firm's chairman and she had the first tear sheet off the Dow Jones ticker that the President had been shot in Dallas, whereupon the scene dissolved into complete chaos and all I could think of doing was to say that we would adjourn the meeting but reconvene tomorrow morning, Saturday morning, at 9 o'clock. Again while I recognized that the national situation took precedence, there was still the question of the customers of the firm.

I was up and back to Washington twice that weekend and of course concentrating from my point of view and not on the national problem but on the Ira Haupt and the Exchange problem, all the thinking on that occasion was really in sync with that of Keith Funston, the Exchange's President, and the Exchange should not reopen until the Ira Haupt problem was solved and the customers of Ira Haupt were made whole. There was tremendous opposition from Wall Street as to having to make contributions. The usual refrain was I didn't cause the problem; why should I have to bail out these crooks, etcetera--etcetera--etcetera?

KD: So this whole plan to make good was something orchestrated by the Exchange?

DS: Well it was developed in conversations with the Exchange and I think the Exchange was thinking that already. The Commission had the DuPont Homsey precedent and so that's what the Commission wanted, and so that's what we pressed on the Exchange but found the thinking to be in sync.

This time on my trip to the Exchange I was not sequestered. Keith Funston asked me--this was on Monday morning-- to sit outside his office while he had in the senior partners of Exchange members marching in and out and obviously it was my function to be the bad guy sitting outside **[*Laughs*]** and I'm sure that Funston used my presence there to twist the arms that either they put in the money or that was the alternative and the that was left unspoken as to what would happen. And so the matter was put to bed that day, and that gave rise as I say to the fund created by the New York Stock Exchange for such purposes which itself came a cropper when the back offices collapsed due to heavy volume some years later. The potential losses proved too demanding on the Exchange Fund and SIPC was therefore created by legislation.

These are nice anecdotes, but the point that I'd like to leave is that there is this misunderstanding of what the Commission can really do in situations of market crisis. Actually in the Ira Haupt affair there was, as it turned out, something the Commission could do through jaw-boning and implied threats to at least ameliorate that part of the situation on the street; certainly nothing the Commission could do to ameliorate the fallout that was going to occur from the President's assassination.

Ironically, on the afternoon, going back to that Friday afternoon after the assassination, I suppose I was the senior staff member from the Division in New York, and I tried to call both Ralph Saul and the Chairman and found all the Government tie-lines at that time completely clogged and jammed and commercial telephone lines were all clogged and jammed to Washington. So there was no way I could contact the Commission and no way--as I discovered later they were trying to contact me--the reason being that on both sides for why I wanted to make contact is to make sure that the Exchange did the sensible thing and would close right away after the President was assassinated but the Exchange did that on their own in any event; so anything the Commission might do was moot at that point. And indeed, somewhat ironic because the Commission's authority to close the Exchange, as I said, required the signature of a President. But the drafters of the Exchange Act never contemplated that the President would be assassinated. The last thing Johnson would be doing in Texas would be signing orders with respect to the Stock Exchange.

But again the basic point is that there's really not much the Commission can do beyond symbolic activity, at the most, when market forces are creating pandemonium on the street. I think Harvey Pitt for example did the most the Commission could do and did it very well after 9/11 when he appeared at the opening of the New York Stock Exchange to express confidence in the fact that the market was going to be able to function properly. After this was all over, Chairman Cary asked if I would write a memorandum on what steps the Commission might take in a market break and I made a few technical suggestions such as suspending stop loss orders, trying to slow down activity on the Exchange with other measures, but at the end I put in sort of a point six--whatever it was and said that the only thing that would be really effective would be to create a false ticker tape showing the market going up **[*Laughs*]**. That was tongue and cheek and we all recognized it as such; maybe that memorandum still resides in the Chairman's safe.

KD: Yes, you never know. [***Laughs***] Well we talked a little bit last time about the interim period when you left the SEC and you had been working for Bernie Cornfeld for a while there. I wanted to talk about your becoming involved with the Investment Company Institute and your area of experience.

DS: I spent a very exciting year representing the American subsidiary of IOS, but found myself being involved in the SEC investigation of IOS which was simply uncomfortable for me even though represented no direct conflict with the SEC. And so I determined to leave at the end of the first year. And I did and in deciding what to do next I spoke to a number of people and it was recalled to me that the SEC was probably moving in the direction at that time of further regulation of the mutual fund industry and that the mutual fund trade association, the Investment Company Institute, then located in New York, was really not geared to handle regulatory matters. And it was suggested that I might talk to the President of the ICI, Bob Augenblick, which I did and that led to my joining the staff as Associate General Counsel. Bob was General Counsel and President; sorry he was actually General Counsel at that point; the President, a gentleman by the name of Dorsey Richardson, was retiring and the understanding was that Bob was going to become President upon his retirement seven or eight months later which in fact occurred. For a year or two Bob retained the title of General Counsel; I was Associate General Counsel and then became General Counsel.

KD: Were you aware of the ICI in earlier years? During the time of the Special Study did you know about the Institute?

DS: I knew it existed.

KD: Did it have a reputation or anything?

DS: Not much of a reputation one way or the other. I was once in Chairman Cohen's office when a delegation from the ICI visited him on kind of a courtesy call and Manny asked me to stay; I guess it was really just a courtesy call lasting about 10 or 15 minutes and after they left Manny said something like, well I won't see these fellows again until next year; so the contact between the ICI and the Commission was less than routine.

KD: It was pretty *pro forma*.

DS: So right from the beginning I was hired with the understanding that my role would be to reestablish a more direct contact with the Commission and follow the regulatory or legislative activity that was going to result from the Studies the Commission was performing, which basically was a follow-on to the Wharton School Report of 1957 and as I mentioned last time—which itself was somewhat fueled by this residual fear in Washington that again coming out of the Great Crash that if the mutual funds ever unwound for any reason it would lead to calamities in the marketplace as funds dumped their securities on the market to meet redemptions, etcetera.

What became clear after a while is that Manny Cohen had decided to make this reform of mutual fund regulation a centerpiece of his regime. I have always personally felt that a new Chairman of the SEC, as anybody coming into a new significant job, looks for his own projects and don't put as a first priority the projects being pursued by his predecessors. So Bill Cary having sort of occupied the field with the Special Study and its implementation **[*Laughs*]**, the white whale left for Manny was the mutual fund industry and he set about with great energy, vigor, and supreme intelligence to formulate and enact legislation.

KD: Was there any kind of ground swell or public sentiment that this needed to be done? That the mutual fund industry needed a study? The Special Study certainly had important incidents that generated…

DS: Yes; all those headlines I showed you--

KD: Right.

DS: --last week.

KD: So how about the mutual funds?

DS: No. And that probably was an inhibiting factor as far as the ability of the Commission to achieve easily its legislative goals. We could spend a couple of days on the details of the legislative combat that took place between 1966 when the Commission published its report analyzing and extending the old Wharton School Study under the title of *Public Policy*

Implications of Investment Company Growth. The primary author of that was Dick Phillips and Mike Eisenberg worked with him on it.

KD: Was this combat between you and the SEC? Where was the combat?

DS: Yes, it was a legislative combat that lasted for four years. And it ended up I think in reasonable compromises. The problem on the industry side was, as one does get in every industry I suppose, those who want to fight government regulation to the death; others who take a more statesman-like view. I think I have to sort of make a general comment about the nature of trade associations generally and the ICI in particular: you naturally contain members whose economic interests and business interests overlapped tremendously but are not necessarily wholly congruent with each other; so that forgetting about differences of philosophy, temperament, personality--proposed government regulation or legislation will impact the organizations within an industry somewhat differently so that there is potential division among the membership of an industry simply based upon the economic aspects of their own situations and the more detailed or in a sense even narrow government regulation is it will particularly impact upon specific organizations and may leave others relatively untouched.

KD: Because the change is more concrete?

DS: Yes; more--

KD: Worried about it?

DS: Well no; if you're making black widgets and the proposed regulation says you can't make black widgets, people that make gray widgets and brown widgets are saying let's make a deal. **[*Laughs*]**

KD: Okay; right.

DS: It's too bad, Charlie.

KD: They're all for this.

DS: Also then you really do have to get into next the questions of philosophy and personality, etcetera. The mutual fund industry is one part of the securities industry, especially when we go back as I said earlier to the '60s with the memory of the '30s and '20s still relatively fresh, the center of gravity within the securities industry strongly recognized government regulation as a positive and not as a negative. The degree of regulation was good for a quarrel and the burden of regulatory compliance argument was always around and bureaucratic interference has always been viewed as a problem, but nevertheless when all is said and done I think that the securities industry has had a more positive view of government regulation than you might say ordinary industrial organizations throughout the economy.

Translating the generalization into the SEC's legislative program between 1966 and 1970 you did not have a situation in which there was total rejection and a declaration of war on the part of the fund industry. On the other hand, you had very significant organizations that were dedicated to opposing, in part or in whole, specifics of the legislative proposals and so it was a very mixed situation. There were so many recommendations that the SEC had come up with and embodied in the legislation that the potential for rulemaking after the legislation was enacted that the proposals potentially affected the whole industry one way or another and forced everyone to try to figure out how they were impacted or potentially impacted.

From the point of view of the trade association, that kind of situation, while very complicated and difficult, also presented the opportunity of intra-industry negotiation because everyone was now impacted one way or another and so that you couldn't have a situation where you had some people saying black and other people saying white and never the twain shall meet.

KD: Your job is to harmonize all these interests?

DS: To harmonize the interests and in a way which is not simply for the purpose of presenting a united front but presenting a united front which is reasonable and plausible from the point of view of reaching a result. I think the Institute under my predecessors and under my successors has been uniquely and I use the word *uniquely* in full understanding of its dictionary definition--unique among financial trade associations as not reaching consensus merely for the point of view of reaching a consensus to reject the Government's position or to not come forward consensus position which is objectively doomed to failure. And most of the four-year period between ’66 and ’70 was devoted to on the one hand trying to develop the best arguments--to the extent that we could--opposing the SEC’s legislative proposals but one step behind the curtain, trying to achieve an industry of consensus on proposals that would have a chance of enactment.

KD: Was this Augenblick’s position; was he the one who brought this to the scene as a guiding principle?

DS: Yes; Bob was a good lawyer and in practice as a lawyer for many years and lawyers are generally compromisers. And it was very strongly my position that there was absolutely no long-term solution to the SEC’s legislative program except the enactment of a legislative program. It would not go away and that all that could happen over time was the erosion of public confidence in the industry and then simply through the passage of time there would be some event or some scandal or something which would provide the engine of more punitive legislation.

KD: How well received was that position within the industry?

DS: It generated some sympathy and more sympathy as time went on. During the late ‘50s, fund performance had been pretty good; during the ‘60s, performance was not as good. This is my memory; I don’ know if this is borne out by the numbers as such but by the perception of people in the industry that the climate was not as good from the point of view of the industry as it had been in the ‘50s.

But compromise comes down to the specifics--developing a response to the specific recommendations that the Commission had made. A good deal of the time was devoted to that--developing creative positions which we thought would be acceptable and then taking that around the industry and you’d get agreement on this one and you’d move onto the next one. And sometimes more often than people care to admit problems can be solved through communication. When you get to things like new government regulation that nobody has tasted before, communication becomes all the more important as to how you’re going to meet that situation. Also there’s always tremendous misunderstanding on the part of industry of what the government is really after. Very often--well much less often than people think the government has a specific objective in mind; they don’t. They usually have a process in mind or they’re looking for a way to re-channel existing practices rather than ending them. Let me put it this way; the whole question of advisory fees was the centerpiece of the legislative program. The government did not come in and say one-half of one-percent of assets per year is too much and it ought to be one-tenth of one-percent. That was in no one's mind. The SEC staff didn't really have the faintest idea as nobody else does as what is an optimum advisory fee from the point of view of investors and a decent return on the part of industry? So the government, while there may be a feeling that the present method of setting management fees leads to an unfair fee, the focus is really on the method and not on the fee. So that the negotiation is not over the fee but it's over the reform of the method of arising at the fee. When you recast the issue that way rather than arguing about the level of fees there is room for compromise. And that's what we ultimately did with respect to fees.

KD: Is this some insight that you got by being in a regulatory--?

DS: Yes; very much so. I had a good deal of trouble persuading the industry of the things that I'm saying right now, especially those people who believe that the government are a bunch of no goodnicks out to get us, and I had to do a good deal of missionary work around the country.

KD: Did you have to do any within the ICI?

DS: No. Within the Executive Committee of Members we were blessed with a particularly enlightened group of people who, while representing a range of views, who were simply amenable to discussion and reconciliation of differences and who didn't start with intransigent ideological positions. So basically the difference between what the SEC was requesting and that is that in legal terms that management fees be reasonable was changed to a formulation in which the advisor was deemed to have a fiduciary responsibility to the funds with respect to fees.

Now it was our feeling and one I was able to successfully persuade the industry on--there was a much greater difference between those two formulations than appeared on the surface--that the requirement that fees be reasonable would put the duty on a judge to engage in a rate-making proceeding or would force the court in that direction. Based not only on my experience again with the agency with the SEC, but going back to my prior experience as a law clerk to a Federal judge for two years in the District Court, I thought I had a pretty good insight as to the way the courts approached these kinds of issues. And my insight here was that the courts are much more comfortable with passing on a process and the decency of a process than they are in trying to come up with numbers. They're not economists; they're not accountants; the studies are always equivocal that the parties come in with, and so the necessity of coming up with a number is something which is not really part of the historic judicial function. We leave it to juries usually to come up with the numbers with review on the part of the court.

However that may be, nevertheless courts are much more familiar with process and more comfortable with process. And so the imposition of the duty--a fiduciary duty on advisors would more clearly lead to a process orientation on the part of the Courts than the term reasonable which is a rate-making term. And I think history has borne out the fact that we were correct in that kind of distinction. Of course, we don't know what would have happened if the word reasonable had been put in, but we felt that process would be more easily achieved through a fiduciary duty approach.

Other kinds of problems also were amenable to an informed negotiating stance than simply a confrontation between industry and the SEC. For example, on the question of sales charges it was determined to--as part of a compromise that sales charge levels be essentially delegated to the NASD subject to review by the Commission as they have the authority to review other NASD rules and regulations. However we did as one of our negotiating points insist that the standard would have to also provide for reasonable compensation to sales personnel so that you had a double standard--reasonable from the point to deal with investors and reasonable from the point of view of providing for reasonable compensation for sales personnel. We ran into tremendous arguments with the Commission staff who wanted unfettered Commission review power based upon the charge to investors alone. And here an understanding of the imperatives that drive the staff in situations like this, that are very different than what people in industry would think those imperatives are. Here the imperative really was that in the various review authority that the Commission has over the self-regulatory organizations they didn't want one of them suddenly circumscribed in a way that could lead to similar demands on the part of other self-regulatory organizations for various kinds of limitations on the Commission's review power.

Now in this kind of situation the industry thinks they're only looking at their thing and they say if they don't want to provide for reasonable compensation to salespeople and they're arguing against that they really must have something terrible in mind for the industry. Yet, we achieved the same result which the substantive result was not the result quarreled with by the staff although they didn't know it at the beginning. But when we simply suggested that the NASD's initial authority be circumscribed by the requirement that there be reasonable compensation to sales personnel leaving the Commission's review power unfettered we would achieve exactly the same results because the Commission's review power over a standard which included reasonable compensation to sales personnel could be plenary but nevertheless would have to allow for reasonable compensation because that's what the basic standard would be. And the Commission accepted that without quarrel. I went into this rather tedious explanation merely to show that there is always a lot going on under the surface when you're discussing matters between industry and government and you have to understand the imperatives that are driving government to take certain positions which have very little to do with the worst-case scenarios that people in the industry dream about in their nightmares at night.

It's for that reason that over the years, at least during my tenure at the ICI and I suspect my successors take the same point of view, that lobbying as such has to be under the control of people technically proficient with the matters at issue--that you can get the smartest lobbyist in the world who will do the job diligently and learn about the matter they're lobbying about but nevertheless will miss opportunities that will almost always present themselves along the way to reach a decent compromise and viewpoint of industry because they just don't see the crack that someone technically proficient in the area would see as opening a route to a reasonable outcome.

KD: Which comes from having a sense of what's underlying things and what you can't see?

DS: Yes, a familiarity as I say with the imperatives driving government which are different than the imperatives driving industry.

KD: You're talking about lobbying and I want to get some sense during this four-year period, who were the key players? Who were you talking to on a daily basis?

DS: Senator Sparkman's staff, Senator Bennett--not the present Senator Bennett--his father on the Republican side, Congressman Moss on the House side.

KD: Morse?

DS: No, no, M-o-s-s from California.

KD: Oh Moss, sure.

DS: California--I don't remember the senior Republican; he was in Massachusetts that represented the cranberry bogs. I just don't quite remember his name; on the Senate side, Harrison Williams under Senator Sparkman and at the end was I think the Chairman of the Committee when the legislation was actually enacted. And there were last-ditch opponents on the part of the industry who down to the very last day of the last voting on the bill by the Senate Committee were trying to do their best to scuttle the whole thing.

But I think that the outcome of the legislative program was positive; it was I think a win-win situation for the government and for the industry and investors.

KD: Were all these different legislators, the folks there and the officers you talked about earlier, did you have to negotiate different interests that came from ideology or came from who they represented? Was it a challenge dealing with Senator so-and-so and this other guy over here?

DS: To an extent but basically this legislative package was looked upon as being so complex and not a matter of great public outcry, as one of your first questions suggested, that both in the Senate and the House side it was left to staff to a much larger extent than was conventional at that time.

KD: So did it take four years because it was so complex or--?

DS: Yes; and just a long time to simply work out both the substantive compromises and (b) to bring the industry around to speaking with a unified voice. Also the fact that we successfully resisted the legislation for two years, I think probably put the Commission in a disposition to compromise where they would not have on day one.

KD: Was that a conscious strategy--hold them off for a while so they cooperate?

DS: I don’t think it was a conscious strategy; I think everybody was aware of that kind of thing but that was not the strategy. The strategy was really trying to formulate an industry position on the merits. Whether it was going to be a fight to the death or a compromise was uncertain but the public face had to be resisting it while we were doing that work. I think that from my personal point of view, again I’m talking about my own personal fortunes here, that I probably accumulated a good deal of equity on the part --put it that way--with the industry because of what was generally conceived as a successful outcome of that legislative endeavor. That probably made my job much easier for the remaining 10 years or so that I was President of the ICI.

KD: I seem to recall there being some sort of deadline proposed, the efforts being done by the end of the year or something like that.

DS: Yes; I think it was Senator Sparkman who one day --at one of the hearings which were well attended by industry people-- kind of read the riot act that unless there was agreement between the industry and the Commission that the committee would impose a solution. I think that’s probably what you’re referring to. I can't exactly remember but it would have been something that was helpful to those of us who were trying to reach a compromise with the Commission. There were a lot of things to work out; for example limitations on performance fees; the Commission wanted to ban performance fees. We finally negotiated this deal where you could have a symmetrical performance fee. You could get a performance fee for good performance, positive, but you had to get a negative cutting your fee for under-performance of the benchmark. So these were compromises that were sort of very logical compromises on a lot of stuff, which really were not compromises in the sense that anyone’s position was being compromised. But the solution was to move to a different plateau rather than all kinds of compromise, where one person is at five and one is at ten and you say seven and a half. Well not that kind of compromise but trying to find more creative solutions to the problems that the Commission perceived as wrong with the industry which you know most people in the industry would say well it’s not like the Commission says but maybe they have a point in what they’re saying. And that is the crack in the door so to speak.

KD: Is this the point at which front-end load funds that were taken out of play?

DS: Yes; that was a very specific problem because it was only a minority of the industry that had the very high 50-percent first year front-end load. The solution, which was a spread load and refunds on early redemptions etcetera were really worked out by a man by the name of Bob Loeffler, who was on our Executive Committee, who was a Senior Vice President of IDS, which was the largest front-end load group at that time. He's passed away but he was a man of broad vision and from the beginning was working on that compromise so that was really the one aspect which we deferred to--the staff of the Institute had less to do with than the other recommendations.

KD: And IDS would have very good reason to come up with an alternative seeing this since the front load was so much of their business.

DS: Yes; and also that the Commission had a strong case.

KD: Which was--?

DS: That someone who redeemed through change of economic circumstances at the end of the first year would lose 50-percent of his or her money. **[*Laughs*]** Something I got in one sentence. That by the way—that pattern of charges is a carryover from the insurance industry; that's the way insurance commissions work and work to this day.

KD: But insurance is a different animal.

DS: Well there's always been a lot of arguments about that. Yes; to an extent insurance is a different animal but --let's say sales charges are too high in the insurance industry, you could get more life insurance with the same dollar. So the problem is not that different and second--and this is one problem that is an insoluble problem under our present pattern of securities regulation is that the insurance industry and the securities industry compete for salespeople and a lot of these folks are indifferent as to what it is that they're selling as between financial products and so there is an inter-industry competitive problem or a level playing field problem when two segments of an industry compete for the same retail outlets when there's differential regulation involved. So that's a problem which has never been solved in our country; in England for example the Financial Services Authority, the FSA, has complete jurisdiction over all financial products. I'm not certain how this has worked out--their universal jurisdiction is still too new I think to have done much with respect to competitive considerations inter-industry competitive situations but it's a very interesting project to follow and see what would be done. Here it's impossible; anyway moving on--if you want me to move on with the ICI.

KD: Yes; you talked about this four-year period and I think with the emphasis that this put you in a good position for the presidency of ICI starting in the '70s. I want to talk about, once you've moved through this somewhat transformative period where we have the new legislation and basically a new set of rules, what were your goals for the organization and what did you feel like the organization needed to accomplish long-term?

DS: Well the outcome of the legislative program in 1970 had a lot of spin-off not only personal to me but personal in another sense; the Institute moved from New York to Washington. I think we were early in the parade of trade associations that moved from the locus of the businesses they represented to recognizing that the action was in Washington and not in Peoria. Even the ABA moved from Chicago to Washington in the mid-'70s.

I very much felt that the Institute should have a proactive program rather than being in a situation of responding to new government regulation. And as the opportunities presented themselves there were certain goals which I had in mind from the beginning. One was to find a tax advantaged program for the backbone investors, which were--you might call small investors. The basic genius of the open-end fund is its redeemability at net asset value at any time, but of course at the same time that's a tremendous vulnerability of the industry in that everybody can leave tomorrow. So you can't just stand still when you have an open-end fund.

And both on the sales side and the retention side a tax advantaged situation would encourage people to enter mutual funds but also to remain. As the '70s progressed, there were general economic feeling that the United States was suffering from a lack of capital formation and therefore an atmosphere congenial to the idea of tax incentives for capital formation developed. We seized that opportunity to argue for an investor-directed tax program which would achieve the goals that I just mentioned. And I went back and looked and I found this press release of May 16th 1979 when I unveiled at a General Membership Meeting the idea of a universal scheme for, at that time, tax relief for investment in equities since as I say the--sort of the national feeling of capital formation was reflected by equities and not just saving generally. The plan we unveiled talked about equities and--as I said, in unveiling this program at the General Membership Meeting and I'm quoting, "Higher levels of capital formation are urgently needed to modernize and revitalize America's industrial base. The plan would give an investor a tax deduction in the years that investments are made in equities. Any earnings on the investment would be tax sheltered; the principles are the same as though that which apply to Keogh Retirement Plans--it's a small business retirement plan--and could be subject to the same $7,500 a year limitation."

I had little doubt that such a program would act as a mighty stimulus. The evidence was not theoretical because France, Canada and Japan--had all recently adopted specific tax incentives as per investment. And basically I presented a scheme that existed in France which had been very successful in encouraging average French citizens to invest in equities which were not that popular in France.

KD: So was your sense that we needed the legislation to create the tax opportunity at that time? Is that what you were thinking or you were suggesting the creation of something similar to what was in France?

DS: I'm not quite sure I get--

KD: You needed something that would take advantage of a tax loophole or there would be something in the United Tax Code that would make it possible?

DS: Yes--the enactment of tax legislation that would make this possible.

KD: Right.

DS: And again under the, as I say, if not a consensus, at least a national feeling that something should be done to increase capital formation and encourage investors to invest in--in equities presumably. So we set about first by unveiling this plan and second to contacting our sometimes rival, sometimes friendly financial trade associations to see if we could present a common front.

Now each of them had their own ideas of what kind of tax breaks they would like for their industry's customers. They each came up with their own plans. We were at the Institute very, very fortunate in having as historic outside tax counsel a man who just passed away very recently, Eddie Cohen, who was one of the great tax theoretical minds in this country and recognized as such for decades who had represented the Institute back before there was even an Institute--represented the industry since 1936, and was responsible for the basic taxation of mutual funds which involved a pass-through to investors so as to avoid double taxation.

And Eddie was recognized by the Washington based trade associations as being one of the great tax minds, so we were able to in the meetings we had brought Eddie along, which was very helpful, and we developed a strategy of saying to all these other organizations, look, we have a plan which for you might not be quite as good as the plan you're developing for yourself but our plan will work for all of the financial institutions and therefore why don't you give us a second place endorsement that if your plan isn't going anywhere legislatively sign onto our plan? And they did by and large and that was the birth of the Universal IRA. It ended up as the IRA legislation, which accounts, I think, for 10-percent of the assets of the mutual fund industry now if I'm not mistaken. I think it's been a very, very good deal for the industry and for the investing public.

KD: So in Congress did all of these other financial groups, trade groups--did they all introduce theirs and when everything washed out that it was the IRA?

DS: Well no; what basically happened is that it was all mostly behind the scenes. You had discussions up on the Hill with the tax writing committees, with the Treasury etcetera and it was pretty clear that the IRA was going to get more support and so I think by the time it came along it was a pretty universal agreement. The '70s were not a good time for the equity markets.

KD: Right.

DS: Performance was a problem; we were faced with an aging shareholder population. And then of course came the period of hyper-inflation following the first oil crisis and the birth of money market funds. Probably 10 years ago everybody would remember what Regulation Q was; today it requires, I think, an explanation. Regulation Q limited banks to paying five-percent interest on savings accounts; S&Ls I think were given a slight break. I think they could pay five and an eighth and that was always a subject of internecine warfare between the banking industry and the S&L industry who were number one and two as far as lobbying capacity in Washington and around the country.

But with interest rates rapidly exceeding five-percent levels and indeed ultimately going to sixteen-percent short-term rates, the money market fund rapidly became a contender for savings dollars as well as the historic industry approach to investment dollars. All long term bond funds do attract savings, but as far as short-term, stable savings vehicles we had none until the money market fund. A tremendous hole as I saw it and others saw it in the industries product line.

KD: Well this is a period of net redemptions?

DS: Yes.

KD: So that would be the sort of the hole I guess.

DS: Right.

KD: Can you be a little more specific on the reasons for--for that period setting in and you mentioned that you know equities in general were not doing well. Was there more to it though that particularly hit mutual funds?

DS: I think possibly disappointed expectations on the part of investors; but there were no specific scandals.

KD: Right; well you talked about an aging…

DS: Shareholder population, yes. At the same time we were trying to from a marketing point of view because we did undertake some overall marketing initiatives for the industry--we were trying to encourage the so-called family of funds concept. Technology has been the biggest hidden driver in the whole securities financial world that you could possibly imagine, or not imagine, for changes in products, services, organization of the industry. There had always been the ability among many fund groups for investors to transfer their money from Fund A to Fund B within the same complex without any payment of sales charges but with a very small $5 administrative fee. As technology developed, it made it possible these sort of rights of transfer to become much more efficient and easy for the funds to offer this as a routine service at very inexpensive or nominal costs to themselves or to their investors. So this sort of facilitated the idea of a family of funds concept or as a fund for all seasons so to speak – all of which could appear on one account statement. But there was that hole of the safe haven--you could find safety in bond funds but they are amenable to short-term swings as interest rates change. The money market fund created the potential for a vehicle which would be (a) a savings account, but (b) a safe haven in times when if you wanted to get out of the market or the bond market and just put your money in a safe interest-bearing account, so as we became aware of those first money market funds we saw a tremendous potential of completing the industry's product line and finally closing the circle on the family of funds concept, which now meant that when there was a market break, you no longer had to take your money out of mutual funds and put it in a bank somewhere. You could keep your money within the fund group so you remained a customer of that fund group and as the investment climate changed, you could switch back into more volatile funds. This is not rocket science; but it filled a real need as we saw it and also was a wonderful way of retaining customers.

KD: The way you're putting this is interesting and it's not what I would have expected. You're really talking about creating another service that complements these other things. Given the situation I would think that your first thought would be "at last we've got something that can compete in this era of high interest rates," because essentially the equity funds aren't surviving and money market gives you a way to create something that will keep pace with inflation.

DS: Right; that was certainly there. I'm speaking now from the point of view of sitting at the trade association and observing these developments in the industry and looking at all these factors. And I chose the one that the ICI had been stressing as well which would not necessarily be readily apparent as to what the significance of money market funds were to be.

Somewhat countering this suggestion you just mentioned, there were a lot of people in the industry who said hey wait; wait a second: money market funds are not going to be very lucrative to the industry. It's not the most difficult managerial investment managerial problem to manage a money market fund portfolio. We have to keep fees at the barest minimum because you're not promising capital growth at all. And some people may actually choose the money market as against an equity fund so we may be creating a vehicle which would be counter-productive from a pure economic basis in the long run.

Now those were sort of negative arguments certainly not shared by everybody in the industry but it was sort of a minor theme and these funds were new and weren't thoroughly understood and the full potential that I was mentioning was not apparent particularly.

We then did the very first study which I unveiled and I have it here somewhere in a speech again at an annual Membership Meeting in 1982. We did our first study of money market fund shareholders and I unveiled the preliminary results in my talk. Basically our message is that we now have 5,000,000 money market fund shareholders; there are an unusual amount of college graduates among them and an astounding amount of those 5,000,000 have graduate degrees beyond college. They're 15 or 20 years younger than our shareholder base and that these are going to be our shareholders of the future. You're going to be able to sell the full product line to these 5,000,000 people who've never owned mutual funds before.

By that time I think that a good part of the industry were waiting for that kind of message. They had started to observe some of these things themselves. Of course while all this was going on from a marketing point of view and an industry point of view, our competitors were not resting on their huge amounts of money in savings accounts; they decided they would try to do away with money market funds. And it's something we knew would happen, it was almost inevitable that it would happen. First they tried for legislation on the Federal level to essentially kill money market funds and there were hearings before the Congress. Interestingly enough we found that while the really powerful lobbies of the banking and S&L industries had kept the bank regulators and the Congress nominally sympathetic to Regulation Q that beneath the surface and behind the scenes regulatory people from the Fed on down were not comfortable with this idea of limiting interest rates to 5 percent on the savings of people of modest means. And that became apparent at the hearings that were held on the Federal level when the Fed disapproved of legislation to knock out money market funds and the Director of the National Credit Union Administration turned up in opposition to the legislation to knock out money market funds. And when the SEC turned up which would be more expected to be supportive, they went event further; we regulate money market funds and there's no reason why anyone should think that they're unsafe vehicles. So where the political will in Washington didn't exist to knock out Regulation Q--.

KD: To knock out money market funds?

DS: No; to knock out Regulation Q over the objections of the banks and S&Ls, this translated into not knocking out money market funds because it was seen that this was the market's answer to Regulation Q and an oblique attack on Regulation Q, and indeed within a couple of years Regulation Q was gone. But we recognized that the lobbyists involved -- as I said, the bank and S&L lobbies were number one and number two in size all around the country and the mutual fund and securities industry generally from a lobbying point of view do not have the built-in weapons that the other financial trade associations do. So you look around the country, thousands of branch offices of banks--banks are pillars of the local economy, all over the country, so the money centers in the states are in the banks, with thousands of branch managers and employees of the banks and the S&Ls. Go to the insurance industry--thousands and thousands of insurance salesmen all over the 50 states. So in other words, most of the great financial trade associations are able to muster a huge grassroots constituency to affect Federal and state regulation. The securities industry has absolutely nothing to match that and the mutual fund industry is in the worst position; our member base was Massachusetts, the historic home of the mutual fund industry, some on Wall Street, and some centered in California and one or two outliers in Kansas City and Minneapolis. Moreover, these are not labor-intensive organizations with the thousands and thousands of salesmen in branch offices.

KD: So it was never an option to have the lobbying muscle?

DS: No, no that was impossible and as this heated up it struck me that--and we had to obviously gear up for what was going to be a huge legislative fight around the country--and assessing our strengths and weaknesses it occurred to me we had one tremendous strength and that is that we had actually achieved the goal of every marketing person and that is product superiority. Banks are paying five-percent on savings accounts; we're paying fifteen-percent. This oral history project has made me remember things that I had really forgotten because it simultaneously occurred to me that product superiority was not necessarily enough to win the fight. And I remember a *New Yorker* article a long, long time ago when fluoridated toothpaste first came along before fluorides were in the water and a *New Yorker* article--the details of which I don't remember but which went into great detail on how in the toothpaste industry it was every marketing person's dream to really invent toothpaste that was better than anybody else's toothpaste yet Crest or whoever the first one was didn't sweep the competitive field. The lesson is that you do not automatically win the competitive race by coming up with the better product. So it seemed to me that we had the potential for winning the race--legislatively; but that there was enough static that could be generated and enough misunderstanding and other impediments to not being able to automatically say we're a better product and we win.

KD: People still wanted their passbook and wrote everything in there?

DS: Exactly. And so we had to find a way of bringing out message to the public, which short-circuited the normal lobbying processes. We didn't have the salesmen, we didn't have the branch officers, etcetera. The first thing I did was call a meeting of members and said we got a problem and I need money--I need $1,000,000. Interestingly, the dispute that I got, both overtly and behind the scenes was "he doesn't really understand it because it's going to cost a lot more than $1,000,000 and therefore--did the ICI really have a handle on the problem?" And they were prepared to put up more than $1,000,000.

So I called this meeting and had about a two or three-page paper analyzing the political situation as I saw it and how we could combat it. Number one on the list something which is commonplace today but wasn't then was political radio advertising. You could get on the air very, very quickly, you could give your message, and it wasn't terribly expensive. Second, we had to gear up a legislative team for every state; we needed a good intelligence system to determine what was going on in the states since there were going to be legislative hearings; we thought there would be legislative hearings in a number of states. Third, we had to get a corner on the securities law professors in the states to be able to testify on our side. There was a problem--most securities law professors knew nothing about the Investment Company Act. It had always been the stepchild of securities law. Solution--you had to be able to give the securities law professors some comfort and therefore we had to retain a nationally respected securities law authority and we settled on Dick Jennings at Stanford. At the time, Lou Loss at Harvard and Dick Jennings at Stanford were the two great national experts who would be known to every securities law professor in the country, and so that under the shelter of the national expert you can give comfort to the local securities law professor that he was not being asked to join a venture which was unsound legally.

KD: So if Jennings says it's okay then it must be okay?

DS: Well at least he tells me where to look in the Act and I can check out what he's saying rather than having these guys from Washington telling me that this is on the up and up.

Well we did create a national uproar as I'm sure others have told you but I don't think anybody has probably shown you this. We even made *Doonesbury*.

KD: All right; I have not seen this. We definitely need to get a copy of this.

DS: Without going into a lot details state by state, twenty-eight states--

KD: That's a lot of detail.

DS: **[*Laughs*]** I'll just mention two and one not typical and that was Utah which was the first state in which there was a major contest. The reason there was the major contest in Utah was a strategic decision by the banking industry because Senator Garn who was Chairman of the Senate Banking Committee was from Utah and presumably their strategy was that if they could get repressive legislation in Utah it would convince Senator Garn that there was a public ground swell which he could then translate onto the national scene.

Also there was pending in Utah by coincidence a General Banking Reform Bill which was in general terms was a much needed update to Utah's banking laws and no longer controversial; all the details had been worked out, etcetera and the bill was ready for passage; and so all that was done was to put in an amendment to a bill, which was important and had general support, which would have had the effect of killing money market funds in the state.

Unfortunately this surfaced in Utah without our knowing about it in Washington and had been bubbling along for three or four weeks publicly before we found out about it. The group most involved was Merrill Lynch in Utah. The attack had been on Merrill Lynch's money market fund and it was being handled by Merrill Lynch's lobbyists in Utah in a way which we had already indicated and decided was a loser. One could not win a traditional lobbying battle against the banks and S&Ls and therefore Merrill Lynch was very much in a losing position. Also Merrill Lynch in Utah represented Wall Street, and this is not a part of the country a very favorable image to project.

And so when we found out about it the first thing I thought we had to do was to take out the image of this is merely Frankenstein versus Godzilla and leave the Frankenstein in the picture and but divert attention elsewhere. Now a Washington based trade association cannot necessarily portray itself as a man of the people; the image is not generally sympathetic but all things considered I thought that the best thing to do was just to get it away from banks versus Merrill Lynch and so we particularly tried to draw attention to ourselves. And basically we then took over the fight in Utah.

We, of course, had to retain local lobbyists in each state who would always tell us at the beginning you're dead because no one ever beats the banks and S&Ls; usually they're fighting with each other. And here they've combined against you and we can arrange an honorable surrender but that's it. We would have to say that's not what we hired you for. We just want to know the way to the state capital, who the players are and arrange meetings, etcetera. And in Utah we found that it was possible to reach the head of the largest indigenous Utah bank, Zion National Bank, who was relied upon by leading Utah businesses and had strong Mormon connections in Utah. And it was arranged to have a meeting with the President of the bank and this was purely one-on-one, and it was extremely interesting. One of the things he said to me right off the bat was, "Look; I stay awake at night thinking that we can only pay our depositors five-percent when real interest rates are fifteen-percent and it's just not a wholesome situation. On the other hand, I can't turn my back on all the other small bankers around the state who will see their deposits cannibalized by money market funds." And the banks had spread certain rumors about dealers, that they were unscrupulous people taking money out of banks and putting them in these fly-by-night mutual funds, and there was one dealer they kept on mentioning and fortunately I had heard about this and found out the actual circumstances. When the President of the bank brought this up I was able to straighten it out. He swiveled around, pressed one button and had his branch manager, and said, "John Doe, the name of this dealer--what do we know about him? Yes, yes, yes." He hung up, swiveled back and said, "You're right; we lend him money on his signature." He finally said, "Well look; I told you I can't and I won't desert the bankers and the S&Ls but we'll stay neutral." And I thanked him.

The other great event--two more great events in Utah--was by this time, old Senator Bennett, generally beloved in Utah, had retired from the Senate but he still occupied otherwise vacant downtown offices of the Bennett Paint Company, his old family business. And I found out that he was an outside Director of the Waddell and Reed funds in Kansas City and he was the Director of their Money Market Fund and so I went to see him. And I was scheduled to testify before the Utah legislature the next day but it was really an invitation to a lynching. There was no question about what was going to happen when I testified. But Senator Bennett kindly agreed to accompany me to the hearing and introduced me to the committee. **[*Laughs*]** And this was one of the great surprises that we were able to spring on everybody because here the lynch mob was formed and I come walking down the aisle to sit down with probably the most respected political statesman in the state, who gave me the usual effusive Washington, DC introduction making it sound like we went back about 70 years together. I made my three-minute statement; they asked me two pro-forma questions and got me out of there.

The second was **[*Laughs*]** that the Utah legislature--I don't remember which branch it was--the Senate or the House--the House I think--met as a Committee as a whole on occasion and they would take outside people making statements. We found a retired school teacher who had been the third-grade teacher of about half the people in the state legislature, who owned money market funds; she came in and gave them a lecture. I have the two-minute tape here somewhere--gave a two-minute lecture on how they were going to take her retirement income away from her if they do away with money market funds. **[*Laughs*]** Anyway; the great vote came and they had machine voting in their House and it was like a tote board --I don't know how many minutes it stayed open, and the vote total was going up and back. Nobody knew how the Speaker of the House felt about all this because he was the one that pressed the button and we were ahead by two votes when he pressed the button, and killed the bill in Utah, and they had to come to us the next day to resurrect the Banking Bill. This was the whole Banking Bill which went down to defeat.

KD: Oh right.

DS: After that our intelligence became much better because the fight became nationally known. This was important as efforts would often start by sneaking anti-money market fund amendments in unrelated bills in etcetera. In some cases we'd get a reporter who would call the ICI and say "are you interested in money market fund legislation?" In other cases, and this is interesting, on the state level the securities regulator is very often subordinate to the bank regulator and so when the bankers were busy formulating anti-money market fund legislation they would call in the securities administrator to find out exactly what dosage of poison to mix, to put it that way **[*Laughs*]** that would effectively kill money market funds easily and expeditiously. In a couple of cases we then got calls from the state securities administrator who would sneak outside to a telephone booth and tip us off as to what was going on.

There's one other state I'll mention--because this went on in more than 20 states--Kentucky was an interesting one. Our first pitch would always be to the Chairman of the Banking Committee in the state, with jurisdiction over this matter and say look; you may not understand what this bill really does. It doesn't regulate money market funds; it puts them out of business. In Kentucky I met this fellow with very, very cold eyes who looked at me and said "I hope so." **[*Laughs*]** So that drew the battle lines in Kentucky and we again followed the usual pattern. I'd send in three or four people with credit cards because local radio stations want cash when you give them advertising and in some states I'd have to start them off in various sections of the state crisscrossing by road **[*Laughs*]** with their American Express cards delivering copy to the radio stations and we could blanket the state very, very quickly. I think in Iowa we did it so quickly—and these ads were read by DJs on radio and the next morning, the local television news would pick up pictures of the DJs reading this copy and of course DJs usually are often the kind of people that hate banks and so they would embellish the stuff. They were absolutely delighted to get ads attacking banks. In any event, the battle in Kentucky lasted some weeks and finally it went down to defeat. Senator Rogers who was the fellow I first saw who told me he hoped that the legislation would kill money market funds, the Bill was Senate Bill 306, introduced a different resolution. The resolution at the end of the day that Senator Rogers introduced was to retire the number of Senate Bill 306 because he was sick and tired of hearing it. **[*Laughs*]** And it was filled with all kinds of facetious whereases if you look at the beginning.

KD: Oh my; that's quite a document.

DS: Well at the end it was 28, I think, to zip and I'll just mention one other thing that was disturbing to me and which was never made public. We wanted to run one of our ads in the

Washington Post and it was refused on the grounds that it was scandalous, libelous or whatever. It wasn't really necessarily that we run the ad in the *Washington Post*, but I really got mad and decided to put on as much pressure as we could and of course we determined that the control over advertising copy is purely on the business side; the reporters are on the news side and the business side is separated from each other. **[*Laughs*]** So I said this is one of your problems; you need to speak to your reporters, they know all about this. So we asked for a meeting and they finally agreed to meet with us and I retained Harvey Pitt. This was long before Harvey was Chairman and he wrote a great First Amendment-type brief and we went and met with them and I insisted and they agreed that there be somebody from the financial desk on the reporting side at the meeting. And when Harvey made his First Amendment plea you never saw as embarrassed as bunch of people as the *Post* people. I don't remember who from the financial desk; they ran the ad.

KD: Well how did these state initiatives inter-relate to ICI versus Camp--?

DS: It actually had a sort of opposite effect. We had won the case of ICI versus Camp in 1966 which said that Glass Steagall says the banks can't be in the mutual fund business. It certainly put a lot of pressure on the Camp decision; the banks now had an equitable argument they could make after they lost in the states in putting money market funds out of business to say hey look; on the one hand you're going to let money market funds in; on the other hand you're keeping us out of the mutual fund business--that's not fair. Our answer to that is best as we can make it--hey look; your problem is Regulation Q; it's not being able to have money market funds. So the two did become interrelated to an extent and it gave the banks a somewhat better argument than they had ever had.

I mentioned that before the Federal hearings that there were a whole bunch of Federal regulators that came in and testified against killing money market funds; the banks had also tried to convince the Justice Department that the mutual fund industry was violating the Glass Steagall Act by going into banking. And it was one of those situations--never ask a question until you know what the answer is going to be because they got a devastating answer out of the Justice Department saying it was not a violation of the Glass Steagall Act—this was not banking because investors were at risk. If there was a default in the portfolio of money market funds, the asset value could go down. The investors were shareholders--that though the portfolio was managed in a way to absolutely minimize risk there was still technically a residual legal risk unlike a bank where you're a depositor and you're a creditor. It doesn't make any difference to you whether the bank is profitable or unprofitable. They have to pay the rate they guarantee to the depositor.

So that response by the Justice Department was pretty devastating and also in a sense helped maintain the line between Glass Steagall between banking and mutual funds.

Thereafter we spent a lot of time perfecting, on a cooperative basis with the SEC, the regulation of money market funds to minimize risks of default, etcetera and the vehicle as now subject to a special set of rules that a fund had to comply with in order to be able to call itself a money market fund. We presented the key provisions that enabled the money market funds to maintain a net asset value of one dollar. And the way most easily to do that is to limit the maturity of the high quality instruments that you must have in the money market fund so that they're not going to fluctuate very much but also permit a straight line amortization on which you can calculate net asset value rather than the tiny intermediate market fluctuations which even means very short-term instruments might be subject which might push the fund down to 99-cents or up to $1.01 but if you can just amortize on a straight-line basis until maturity then you have evened it all out -- that's the basic concept of money market fund regulation. And this was the very first draft of the rule which I presented to the SEC staff. It was adopted in a somewhat different form but the principle is still there and the rule is now 13 pages long. **[*Laughs*]** That's the way those things go, but that was the beginning. And so for all of the reasons that I've mentioned so far we devoted a lot of time and effort to the care and feeding and integrity of money market funds, so really as I said, it rounded out the product line and it's almost two trillion dollars now. I guess a trillion plus. Well they've lost assets because of the very low interest rates over the last several years but they're still the great cash reservoir. And of course the innovation which we didn't see on day one but came along pretty quickly was check-writing on money market funds.

KD: Well now we want to get you to the bank.

DS: Yes; that was one of the issues and on that one, personally a man I admire very, very much, Paul Volcker, was against money market funds and Matt Fink and I went over to his office one night—he said he wanted to talk to us about a whole range of issues--Glass Steagall and others--and we got into money market funds. It's wonderful how even the most brilliant among us, and Paul Volcker is one, will make a decision based on a personal observation. His wife worked at a company or a small business and apparently the guy that ran the company was very, very far-sighted because what he did was get rid of his bank and check cashing and put all the firm's cash in money market funds and all the businesses' checks were written on a money market fund. So Volcker was under the impression that 80 percent of the country's business was now being transacted through money market fund checks and we kept on saying it's a small percentage; we've done studies. It's minute. I don't think he ever quite believed us when we said it despite the fact the numbers didn't bear them out. Personal experience sometimes submerges the objective facts.

Anyway enough about money market funds; over the years there are a lot of other things we could talk about.

KD: Well I want to focus a little bit on the Board of Governors case. Was this--?

DS: Camp?

KD: Well we talked about ICI versus Camp a little bit which was brought by ICI. And ICI Board of Governors was brought by the Board of Governors or it could have been the other way.

DS: Yes; there were a series of cases which were all brought by ICI. That's why you kind of confused me; usually the plaintiff is first but sometimes it gets reversed--on appeal they reverse the titles. The outcome of the Camp case itself rested to a certain extent not wholly but to a certain extent on a blunder by the Comptroller of the Currency, who was first Saxon and then Camp succeeded him, and that's why the case is ICI versus Camp. And what he did was simply by a kind of *ipse dixit* saying that banks can go into the mutual fund business through this co-mingled managing agency account without any rationale. And so when the case got to the Supreme Court, as a matter of fact I think what happened is that--now this goes back before my time when the case was started; I was with the Institute when it was decided by the Supreme Court but I think I just started when the decision came down from the District Court. But when the case got to the Supreme Court, to read the decision closely, what they're saying is hey look; we've got to look at this in the most extreme--they don't use this word but I'm just translating--the most extreme form. This guy is just saying banks can go into the mutual fund business. There's no rationale, there are no protective regulations, he's never explained why really these aren't prohibited by the Glass-

Steagall Act etcetera, so it was sort of a naked act and all of the inferences were drawn by the Court in favor of the ICI's position because he, the Comptroller, had positioned himself that way. Later we recognized that Camp was not finally dispositive.

KD: That was my question.

DS: And so we brought very, very few cases. It's only when we felt that we had gotten to a breaking point where if we didn't bring another case Camp would be gone anyway that we would bring a case. So what finally happened of course was that when the Fed got into the act etcetera and they started to write rules and rationales for those rules and so the Supreme Court was able to distinguish the Camp case from the later case and so the vulnerability of Camp finally undercut it. But from the viewpoint of the fund industry the 15-years or 20-years or so that Camp was perceived as keeping banks out of the mutual fund industry and then the rear guard action and we fought in the Congress to prevent Camp being legislatively overruled provided, I think, the needed time for an industry to grow from 20-billion dollars, which was the size of the industry when I joined the Institute, to a trillion dollars and stand on its own two feet and compete in the marketplace. I think had the Camp gone the other way the industry would be pretty much be wholly controlled by the banking industry as it is in other countries. It is partially now through mergers and acquisitions, but there are a lot of healthy stand-alone mutual fund organizations.

KD: How about insurance industry competition?

DS: With the insurance industry the major quarrel that the fund industry had with the insurance industry were in the areas of the variable insurance products in which you would have life insurance but the amount of the insurance you've got would be determined by the fluctuating price of a basket of securities. And there the Supreme Court ruled pretty four-square on the mutual fund industry's side in that the transfer of the investment risk from the insurance company to the investor was enough to take this outside of the life insurance exemption in the securities laws and recreate this as a security subject to SEC regulation.

So once the variable products were brought under SEC regulation, although I have to say the SEC has not regulated the variable products with a heavy hand, nevertheless the fact that it was brought under the umbrella of securities regulation makes them a competitor but not from the viewpoint of the fund industry an unfair competitor. That episode of variable annuities--I should have said variable annuities because there was a later case involving variable life insurance posing exactly the same problems and coming out the same way not through litigation but through an administrative proceeding before the SEC. The insurance industry came in saying this is variable life insurance; it's different than variable annuities. We should be exempt and the SEC held a hearing in which I argued that case. There was an evidentiary hearing actually held and the SEC ultimately said that it's under the '33 Act; we're not sure about the '40 Act but it's under the '33 Act. And that brought variable life under the umbrella also.

So there are a lot of variable annuity companies which are members of the ICI now so that's long gone.

KD: I want to talk a little bit about the organization itself, the ICI and its growth in your years. I got some from that thing that when you came into the Investment Company Institute it was still sort of being run out of your pockets, it wasn't a very large organization.

DS: Right; as I said I started in '66--the industry had 20 billion and we had 20 employees.

KD: Twenty employees?

DS: Very symmetrical given the odd billion and the odd employee or two. **[*Laughs*]** Although Matt is quite right -- we didn't show tremendous increase in staff until later -- it was the legislative fight with the SEC between 1966 and 1970 which really established the Institute's credibility among the industry. Unlike other financial trade associations, we performed all of the functions that a trade association can perform for an industry. We kept its statistics. In other industries there are organizations which keep the statistical information of the industry. We did their legislative and regulatory representation and we did their public relations and industry-wide marketing--not marketing for specific companies. Whereas if you look at the insurance industry or the banking industry you'll find that those functions are fragmented through to a number of organizations. This is not only more efficient I believe for the industry to do this with one organization but each part of the organization is able to draw on the expertise of the other part of the organization. For example, in legislative matters, regulatory matters, I was able to draw upon the economic capacity and the statistical capacity directly under one roof.

And I think the industry saw the advantage of keeping this all under one roof, so while there have been entrepreneurs in one area or another--either statistics or marketing where they tried to form trade associations for the industry, by and large they were never successful.

KD: Has the ICI expanded in order to keep up with entrepreneurs like that or match services to what other people say need to be provided?

DS: Occasionally we would review what we were doing because you can sort of take it as--that if somebody sees the possibility of moving into an area, let's reexamine our own programs and see that we're properly meeting the industry's needs. I think that to really get back to the ultimate bottom line here, the success of the Institute is very, very closely correlated with its ability to engage in the continuing dialogue with the SEC and other regulators. As necessary and not starting from the proposition that the government is evil and therefore must be combated at every foxhole— "fight them in the streets and fight them in the hills" kind of thing. But with the recognition that while government agencies may not be right, there is, most of the time, some reason that they're acting the way that they're acting and therefore it is not only expedient but prudent to look at what the agency is saying while trying to satisfy a public need. And we've had our arguments and fights with the SEC over the years some--sometimes public and sometimes not, but the Institute I think has today been fundamentally trusted by the SEC. When we say something there's a foundation underneath it.

We also have acted informally as the eyes and ears in industry for the SEC and they're grateful for that. I mentioned that in my last incarnation at the SEC that one of the things that the Special Study found lacking at the SEC was contact with the industry it's regulating and that I think it well behooves industry to see that as a legitimate need on the part of the regulatory agency; a well-educated regulatory agency is much better than a regulatory agency that has a lot of power and doesn't understand what it's doing.

KD: Did you deal regularly with people from Division of Investment Management individually?

DS: Oh yes.

KD: Who were some of the folks that you dealt with?

DS: I don't want to step on a lot of toes of people who are now my personal friends, but I think that all would agree with me that of the modern division the combination of Sol Freedman who was the first Director of the Modern Division and Syd Mendelsohn, his direct successor, probably had a unique relationship with the industry and a unique relationship with their own lords and masters up at the Commission, which gave them perhaps a much greater freedom of action than some of their successors. They were long-time Commission employees, each going back 25 years and both very practical people who once they were convinced that a course of action, a new product, or a new service being developed by the industry was not antithetical to the public interest or investor protection; their approach was "okay let's see how we can do it" rather than "you can't do it" because Rule 30-37.5 says that you can't. As I say they may have been -- not because they were the smarter than--or more well-intentioned than their successors -- but it may because they had the degree of self-confidence arising from their long tenure at the Commission. But basically the Division has always been staffed at the highest levels by very capable people. I would go through all their names but I'd leave some out…

KD: That's okay.

DS: Which I don't want to do.

KD: You were talking about filling out a range of services for the industry in responding to specific needs, is that how ICI Mutual came about? Was that something that people were saying we really need this; do something for us please?

DS: Well yes. Nobody said you should have an insurance company but a number of people came to us even way back in the '70s that they were having problems with insurance. Now the statute does require a form of bonding of people in the industry so this is directly in, what you might say, the traditional ICI mandate if they're having a problem getting bonds from insurance companies. That's a problem we would ordinarily be expected to work on. But at the same time they would have general problems with their Directors and Officers liability insurance and their errors and omissions insurance. Their complaints would be that the insurance industry doesn't understand what mutual funds are and they lump us together with banks and S&Ls, and when the S&Ls got into big trouble, the premiums being charged for mutual funds went way, way up. So we were getting these complaints from the industry; as I say we had a little experience because we helped the industry work out certain problems with the fidelity bonds that are required by the Act. Then there would be other situations where an event would fall between the cracks. They wouldn't be covered by the bond, the fidelity bond, and wouldn't necessarily be covered by the E&O but it might fall in between or if they had separate E&O and D&O policies they could fall in the cracks between those policies.

So during the late '70s or very early '80s we had helped work out sort of a model form which combined the coverage of the E&O and D&O coverage--but that was just on an ad hoc basis. But when the real premium crunch came in the '80s with the S&L failures we tried to approach the insurance industry and say "hey look; we don't present this kind of risk" and it fell on deaf ears. We were told that by the providers that they don't really control this; the re-insurers control this. I sent Matt Fink to London once to talk to Lloyds about it and he came back saying it's pretty well hopeless. So we retained Marsh Mac to do a study for us and they came back and Option Four--we didn't like the first three options, and Option Four was to create your own captive insurance company. And that's what we did. We needed $40 million to capitalize the company initially under the business plan and I had to go on the road and actually became a security salesman because the usual 80/20 by the way applies to here as to everything in life.

KD: Oh yes?

DS: We had a meeting of the Board of Governors and it was great enthusiasm for starting this venture until they had to put up the money and we only got 20-percent of the money we needed. And things stopped.

KD: The rest of it was promises?

DS: The rest were promises.

KD: So you went out and peddled this case to the industry?

DS: Yes. I made trips around the country.

KD: What did you tell them? They must have thought that this is awfully ambitious and you'll never be able to succeed with the insurance companies opposing you.

DS: What I think the main argument was—both sort of defensive and offensive at the same time—was look; we can hire the insurance expertise we need. Actuarial science is a science; we all understand what the basic principle is and we'll retain that expertise. Where we are experts is in the areas of what would cause the underlying loss to a mutual fund, what the legal requirements are for mutual funds, and therefore what it is that creates liability. Our understanding of that is the critical aspect which differentiates us from the commercial insurance industry and will enable us to go to the reinsurancers which is critical. You've got to get reinsurance. And that we can go to them with a company which is now capitalized by the industry with a trade association whose legal expertise is well recognized; we can get decent terms of reinsurance. Also that we're dealing with you directly and not through the brokers will bring down premiums dramatically. And that was the argument with the industry and the argument that did prevail. The insurance industry did their best to strangle us in the crib and not get out.

KD: What sorts of things did they do?

DS: Well there's one international fund organization who for many years had wanted insurance--D&O and E&O insurance for their offshore funds and weren't able to procure it and one of their senior people had been a big booster of the idea of ICI Mutual. In the last frantic three weeks as we were trying to fill that gap I got a call from this person saying look; I still think that this is the best thing since sliced bread, but I've got to tell you that the major insurance company of the business has come to us and told us that they would now be willing to provide insurance for our offshore funds. Can you do that? And I had to say no; we're not prepared to offer that. He said well I have to take that to--I just really feel I have to take it to our owner. And he came back to us days later and he said the boss just laughed and said you know go ahead with ICI. So that sort of tactic was used across the board. The insurers knew what the wish lists were of various people.

KD: Because they had been hearing it for a long time.

DS: Yes; so that was basically what they did. Matt and I were invited to Connecticut to one of the big insurance companies. A very congenial Senior Vice President met with us in his office and said well we've decided that you're never going to get off the ground. How about lunch?

KD: And what did you say?

DS: We accepted the lunch invitation. [***Laughs***] I think I'm not quite sure of the most recent numbers, but I think that ICI Mutual is now the largest single provider of insurance and its policy forms are the benchmark because when other companies try to sell a policy to a member it's the ICI Mutual policy that they have to shoot at and say you know we're as good as and maybe even better than ICI Mutual.

KD: Did you step down from the Presidency of ICI to move into ICI Mutual?

DS: No; I was President of both.

KD: Okay.

DS: By 1990 I had decided--well in 1988 I guess--for personal reasons, family reasons, I was going to retire in 1990 and that's what I did. But at the same time ICI Mutual had been successful enough in their three years between '87 and 1990 that it was pretty clear that the two jobs should be separated. And when I retired which was not really planned but it eventuated I was going to stay on as a part-time President of ICI Mutual thinking that we didn't need a full-time President. So that's what happened and I did and it was two days a week and then three days a week and then four days a week and finally I found myself having to retire again in 2000.

KD: [***Laughs***] Okay; but that's a long time to stay with that then. You put in 10 years?

DS: After I retired from the ICI.

KD: Well are there any other issues that we should touch on before we wrap up?

DS: A lot of the work that the Institute does with the SEC and other regulatory bodies are not the dramatic big things like legislative combat. In 1988, just to pick this one out, we developed a standardized formula for computing yield and total return for mutual funds. One might be surprised to realize that there are about 10 different ways you can legitimately compute yield and total return and we thought that there was a need for uniformity. We appointed a task force and then went to the SEC and the result of the task force's consideration was ultimately embodied in an SEC Rule. There are a lot of examples of that kind of thing where they're not philosophically controversial at all; it's really just a question of choosing one thing or another equally good but the vice is not choosing one thing or the other but having a multiple ways of doing things.

KD: Right; standardization of the industry--?

DS: Yes; the clearance and settlement of transactions and that kind of thing.

KD: A lot of this I suppose stems from your ability to collect information.

DS: Yes; and also on these sort of technical levels the industry is going to know a lot more about this than the regulator legitimately doesn't know because there are just work-a-day matters which are not subject directly to regulation and there's a problem there which the industry will know about. We ultimately served as the conduit to the regulators, and said okay; this is something you can take care of by a rule or a release. And it's a lot of that goes on which never makes the press.

KD: Not terribly sexy? **[*Laughs*]**

DS: Right; not sexy at all.

KD: Can you, stepping back a little bit, talk in general terms about the ICI when you came in as opposed to when you left and how that organization has changed and how its relations with the SEC administrators changed?

DS: Well in embryo in 1966 all of the functions were there; there was a legal side, there was the statistical side, there was the public information or marketing side if you wanted to call it that; however there was no SEC relationship really except the ceremonial one which I mentioned earlier. Although the ICI itself, I'm sure Matt must have gone into this--was formed out relationships between the industry and the SEC at the time that the '40 Act was being enacted. But the relationship was pretty well severed I think in the wartime years and the SEC went its way to Philadelphia and the industry went its way to 61 Broadway **[*Laughs*]** in New York to be exact.

I think that the ICI, as I say at all its functions, it existed in embryo; it functioned in embryo and it just grew and matured with the industry it represented. The major unique function of the trade association executives are to see what's going to come down the road and try to keep up with it or get ahead of the curve. In other words, I think we foresaw the the potential growth of the industry and tried to accommodate ourselves to what we perceived the coming needs to be.

In a budgetary process one year in the early mid-'80s we went through the usual process which organizations always go through, the various divisions formulate their budget and their wish list and it gets cut back to a higher level and then it would come to me and then go to the Executive Committee of the Board. This mid 80's year was in a period in which we thought we were going to be faced with very large growth on the part of the industry. Senior staff went offsite on a retreat where we considered the draft budget. I bounced back to the whole budget and said okay; this is obviously a reflection of what you're thinking you can reasonably hope to get. Now give me a budget composed on your wish list, your own wish list. And what came back was a budgetary increase of between 18 and 25-percent and we went over that and pretty much on that level I went to our Board and said this is what we're going to need to staff for the future. And the Board agreed. And see you've got to venture forward sometimes. Incrementalism is not the road to success.

KD: Right; that's for sure. Well you emphasized that a lot of what you're doing was trying to look ahead of the curve and what you were doing in a position and seeing and trying to figure out what's going on. Do you ever catch yourself continuing to do that and trying to figure out what's coming?

DS: Yes, I do; it's interesting. I once did in connection with being an expert witness in a tax case involving mutual funds and--not particularly connected with anything we're talking about—I was asked to do a history of the development of the industry and what you see in 1980 is a group of stand-alone mutual funds having one fund, an equity fund, and maybe having a bond fund. And this is essentially the industry I found when I came to it in 1966 and I have to say by the way if I didn't say this in our last session, in the Special Study, I was only peripherally involved with mutual funds and got into it through the Commission rates and all the rest of it, but it just seemed to me that this was the wave of the future--that the sort of Merrill Lynch idea of selling everybody 100 shares of American Telephone and

20 shares of IBM was not the retail business model of the future. I think I've said that before. So my career choices were colored by that.

Then you saw the development of other kinds of funds--long term bond funds, shorter term bond funds, aggressive equity funds--

KD: And of course money markets?

DS: Well the money markets come later, but out of that mix I started to see the family of funds concept. Now I wasn't the first one to use the term family of funds; somebody in the industry used that term but when I heard it I instructed our PR people--this is what we promote from now on; this is the wave of the future. And then as I said before--the impact of technology made the family of funds concept a really doable one and by the way, again technology made the money market fund possible. You could not handle zillions of transactions on an efficient basis without technology.

Also if you think about it the 800-telephone number enabling an investor to call the money market fund without dialing long distance had a tremendous impact on the success of money market funds.

KD: A simple thing like that?

DS: Yes. So then you had the money market funds completing one round of the product line and it looked like the family of funds was going to be the be-all and the end-all of the industry. But it wasn't. Along come people like Schwab who now use technology to say well okay, Fidelity has this wonderful fund there and T. Rowe Price has this wonderful fund there, and we can give you your own family of funds and the integrated account statement. You see, I didn't mention that one of the advantages of the family of funds was the integrated account statement, again made possible by technology. But now you get the Schwabs of this world saying we're giving you your own family of funds.

KD: Everyone is customizing their own portfolios?

DS: Right. Again, the money market fund being created brought by technology dis-intermediating the banks. And sort of the rule that I've evolved out of this whole is technology dis-intermediates and then re-intermediates in new ways. Where that carries the industry in the future I don't know but I do know that the present equilibrium is not the final picture of the fund industry. I think that in one way or other funds are going to be increasingly outsourcing the advisory function. Exactly how that's going to work I don't know; will there be stand-alone advisors who do not manage money on their own but are managing simply providing on an outsource basis advice. I mean you see this in the funds that have multiple advisors now competing with each other. I mean the fund itself is actually just a pool of assets and there has to be obviously a very important but still nevertheless housekeeping function over that pool of assets. But the arrangement for managing that pool of assets can take place in a variety of ways.

I think a big challenge of the fund industry which the SEC has not really faced up to is the 24-hour nature of the fund business. I think in dealing with this question of pricing fund portfolios and this late trading phenomenon, the SEC has essentially stuck its head in the sand and its finger in the dike at this point--that the whole idea of judgmental pricing in absence of market pricing is the wrong way to go. I think you're going to have to have some form of dynamic pricing which again technology will continue to enhance and the ability of investors to come in and come out at a dynamic price as 24-hour trading becomes more and more the prevailing nature of the marketplace. We are now seeing --is New York going to buy London? Is the NASD going to buy the London Stock Exchange? How will this all work? And then you think about carrying this back to the fund industry. You can see this sort of simulated pricing is not the way to go. They're going to have to plug into a dynamic marketplace and basically have a dynamic price.

KD: But technology is--it looks like it's going to be the clue to how that happens?

DS: Yes. The IRA that I talked about before would not have been practical without technology and the ability to manage all your small IRA accounts. There are a lot of people in the industry who said you're crazy to go off on this; we're just going to have 2,000,000 more accounts with $2,000. But the IRA formed a basis for the Rollover IRA in which big bucks come into the industry, which was suggested by an Institute employee up on the Hill that as a solution to the non-portability of pensions that a pour-over into an IRA, an individually owned IRA was the way to go. It was Cathy Heron who is now at the Capital Group in California.

Technology has had the most profound impact on this industry and will continue to have it.

KD: Much like the approach to regulation. It looks like in looking for change you came to look at his process and tried to figure out what to do about the process rather than try to push some arbitrary result?

DS: Yes; one further point I wanted to make--just give me a minute. Distribution is another area which is something which changes but when it changes that's an area which sort of remains the same. The allocation of assets between no-load and load funds sort of stubbornly remains very similar to what it's always been. There are just people who are self-starters and there are people who aren't. There are people who have to pay a sales charge in order to get them into something good **[*Laughs*]** and there are those who will go on their own. So sales charges there will be; the question is who will be the intermediaries who bring the funds to the public? I don't know about what the future is--if that's tied to the future of the brokerage industry or the insurance industry etcetera.

KD: I guess in the middle of all that's changed though it's comforting to know that there is something that stays the same, the human nature represented by the need for the sales charge.

DS: Yes, and there's a field developed in the last several years which challenges the "pure market folks" who say that the market will take care of everything, to a more, I think, sophisticated understanding. I'm talking about behavioral economics and that people don't always behave from the most efficient point of view as argued by the pure market theorists. And I think things like sales charges for example, the great example of that.

KD: Well it's hard to argue with that.

DS: **[*Laughs*]**

KD: I guess that's a good place to wrap up.

DS: Okay.

KD: I really appreciate your time.