

Securities and Exchange Commission Historical Society
Interview with Eugene Rotberg
Conducted on May 14, 2007, by Kenneth Durr

KD: This is an interview with Eugene Rotberg on May 14th, 2007, in Washington, D.C. by Kenneth Durr. I want to start with background. Looks to me like you must be from Philadelphia.

GR: Yes, I am.

KD: Did you go straight from Penn to the SEC?

GR: I went to Army, then the SEC. So right after law school, I went to the Commission. Almost. I worked for six months for a lawyer, running some errands, but my first professional job was at the Commission.

KD: When you were studying at Penn, did you know you wanted to get into corporate law or securities law?

GR: No, I was much more interested in civil rights and civil liberties issues. My father was a lawyer, and I didn't think that I would be going to the SEC at all. But by some accident, I heard that there was a potential opening at the Commission. I went down to the Commission, met Manny Cohen, and Manny hired me on the spot.

KD: Was he head of a division at that point?

GR: He was at that time either the Director of Corporation Finance, or the Associate Director. It turned out that he had just come back from a year's sabbatical—I think a Rockefeller Foundation grant—and in the interim there were some political appointees. He was not sure what his authority was when he came back to the Commission after his sojourn overseas. I walked into his office; he asked me whether I was a lawyer. I said, "Yes." He said, "Let me see now if I have the power to hire and fire." He came back a few moments later, and said, "You're hired."

KD: Who did he go to ask if he had the power?

GR: Barney Woodside.

KD: Okay. He might have been Director of Corp Fin.

GR: I think he was Director of Corp Fin at the time. I went into Corporation finance, and, as most young lawyers do, I had to work on registration statements and proxy statements.

KD: Tell me a little bit about that process. It sounds like some of the less glamorous work.

GR: It was the training ground to examine registration statements and proxy statements and accounting statements. And the job of the lawyer, as well as the accountants there, was to examine the documentation and to see that there was full and complete disclosure. It was routine; it was, on the other hand, quite thorough, and it gave most of the lawyers a great deal of background in corporate finance and disclosure. At a certain point, of course, when the disclosure was deemed to be not only inadequate but deliberately false and misleading, that then shifted the matter into an investigatory stage, whether there was either a civil or criminal potential activity. And indeed, that is what happened in several cases that I had.

KD: How can you tell whether you've got full or complete disclosure? On the face of it, you'd think that these registration statements would be geared towards slipping through the eyes of the unsuspecting.

GR: What happens is that you see a disclosure which—or you hear from the street, or you read about an event that has occurred which is not consistent with what the formal disclosure is. For example, I remember reviewing the Chrysler proxy statement. And it came to our attention—and I do not remember the source—that the son of the then president of Chrysler was providing, on a sole source contract, some material to Chrysler, which would have been a material event. That then led to an inquiry, an investigation, on the grounds that the proxy statement did not disclose that potential conflict of interest. We even had occasion to subpoena Juan Trippe and many of the other directors—

KD: Was that Juan Trippe of Pan Am?

GR: Who was then at Pan Am, concerning what he knew and what they knew about the secret holding of the son of the president of Chrysler in a company that had a sole source contract to provide a major portion of the Chrysler car—which was not disclosed in the proxy statement. That was rather typical. Or in another case—and this is more relevant to, I think, the subject you're interested in—I was assigned to what they then called Regulation A - the registration statements for very small issues. These were companies which were raising as little as three hundred thousand dollars for the first time they were going public. The disclosures were rather straightforward, but what I noticed—and indeed, my colleague and I noticed—is that for scores of those companies, the stock would be, say, registered to come out at eight dollars a share. The first day of trading it would be sixteen dollars a share. Or the stock was registered to come out at ten, the first day of trading it traded at twenty. And that opened up our interest in determining, first: why that would happen; and how it would happen; and the circumstances under which a company would so apparently under-price their issues. That opened up for myself and a colleague, Fred Moss, the whole question of what was entitled 'hot issues.'

KD: Now, were you still in your entry job at that point?

GR: I would say it was in the first two or three years of the Commission.

KD: How did you get from the position where, essentially, you're sitting at a desk churning paper, to the point at which you're able to take something like this and really study it, and devote your time to it?

GR: I think what begins to happen is that as you become more proficient in doing the routine matters, you bring to your superior—in my case it was Manny Cohen or Barney Woodside—strange phenomena that you see occurring rather frequently, which raises policy questions—the 'hot issues' being a typical one. And they then ask the Commission for the authority to do simply a private inquiry or investigation. Or they may assign you a research project to do an analysis of what happened; or what happens, for example, in the 'hot issues,' see whether it only occurs very rarely or whether it is widespread. And of course, if the matter is widespread, then it may be raised to either injunctive relief, criminal relief, or simply fact-finding. The hot issues became—and I think you may have seen a memorandum that I wrote, asking for permission to look at perhaps thirty or forty companies whose prices went up between fifty percent and a hundred and fifty percent within a millisecond after it went public, and to see whether or not there were any violations of the Securities Acts. In another area we might receive documents which involved a public figure. For example, the Commission had a registration statement for a company called Canadian Javelin that I was working on. And it was fraught with disclosure problems concerning the rights to various minerals in Newfoundland, which were given to this company. We made some inquiries as to why the principals of the company got these rights. The matter became quite controversial; an investigation was opened up. And it turned out that the Premier of Newfoundland, Joey Smallwood, had granted these rights and had—according to our analysis—apparently received some private payments for granting these rights, which were run through some Swiss banks. That then opened up a major investigation; and the matter was, at one point, referred to the Canadian Royal Mounted Police for fraud investigation of the Premier. So the staff would follow up leads; and sometimes it was narrow, like the one I've just described; sometimes it related to the market, like the hot issues matter. And all this occurred in the first, I would say, three years of my staying at the Commission. By the early 1960s I was no longer doing the registration statement and review; but I was involved in matters dealing with investigatory matters, adversarial matters; matters dealing with fraud or manipulation of the market; or in the case of hot issues, the structure of how the market worked. And that, in turn, permitted me, and one or two other colleagues, to evaluate—not necessarily for purposes of injunction or criminal relief—how markets functioned; in this case, the over-the-counter market.

KD: Did your hot issues experience lead to an over-the-counter market study.

GR: Yes, that's precisely how it led to it. We got subpoena power from the Commission to talk to the market makers. What do you do? How do you function? Why are these prices doubling? What are the deals that are being made with the company, or amongst the underwriters? What's the relationship between the managing underwriter and the after market people? What's the relationship between the underwriters and their client and their customers as to whether they're allowed to sell immediately? Who gets these so-called hot issues initially?

KD: Were you talking to the brokers and market makers and underwriters?

GR: Yes.

KD: What did they think of you coming in and grilling them like that?

GR: Well, that's interesting. Frankly, up to that point, the Commission had had very little personal contact with the Street—this is, keep in mind, the late 1950s, early 1960s—and little knowledge of how the street worked. And we assured them—which was the fact—that in the case of, for example, the hot issues, we were not interested in some kind of punishment or injunctive or criminal relief; we simply wanted to know how the market worked. For the most part, these discussions occurred not under oath, but just going up to New York and having meetings with them. You may have read on a number of occasions, the meeting of Fred Moss and me, first with Morgan Stanley, when we went up and talked to them about hot issues.

KD: I've heard about that peripherally. Tell me about that.

GR: Well, it's a story that's told, and it's been exaggerated somewhat.

KD: Well you can give me the real story then.

GR: The real story was that no one, as far as we knew, had been to Morgan Stanley for decades. In fact, the contact was very minimal, the last contact being when J.P. Morgan testified at the Pecora hearings in the early 1930s. And a meeting was set up with my colleague, Fred Moss, and I to go to Morgan Stanley; frankly, because they were not involved in these hot issues. They were a very elite investment banking/brokerage firm and they would never bring these small issues to market. They would never be the managing underwriter. So we thought we would interview them and talk to them about this phenomenon, which was getting a great deal of publicity, to see if they could give us some insights and whether they thought it was good practice or wise practice.

So Fred and I went up to New York; and it was quite a meeting. We were ushered by men who were dressed in livery—red coats and white stripes—to their offices, and the doors opened to an extremely large room. And in one far corner of the room was sitting someone underneath a huge portrait of J.P. Morgan. And then there was someone directly in front of us, someone to the far left, someone immediately on each of the four corners. The doors opened, and no one said anything. And this voice came from beyond—from the desk, and said, "Who are you?" And I said, "My name is Gene Rotberg. As you know, a meeting has been set up. I'm from the SEC. This is my colleague Fred Moss." And there was a pause. And he asked again, "*Who* are you?" And I think I repeated it, and they asked a third time. And finally, the man behind the desk said, "Let me tell you what I mean. My name is Perry Hall, managing partner at Morgan Stanley; Princeton." And then he pointed to someone else and said, "Hudson Lemkau; partner, Morgan Stanley; underwriting." Then he pointed to another far corner

and he said, “His name—Frank Petito; partner, Morgan Stanley; research; Princeton.” And he pointed to someone else, a somewhat elderly gentleman—and I think it was John Young. He said, “Partner, Morgan Stanley; Williams.” And he was captain of the football team. Well you can imagine how terrified we both were. We had never been to Morgan Stanley, no one from the Commission had been there; we were simply overwhelmed. And the story goes that Fred Moss said, “The name is Moss, M-O-S-S. And before that it was Moskowitz. Brooklyn College; Law School.”

Now what I have added as a twist—that he also then went on to say, “And before it was Moskowitz, it was Morgan. And in 1933 we changed it from Morgan to Moskowitz.” That last part never happened, of course; but he did say that before that it was Moskowitz, and Brooklyn College Law School. I then said, “We came here because of potential fraud in the securities markets, and we thought that this was the best place to start.” That sort of broke the ice. And later, in the meeting, Perry Hall told us his experience with hot issues—that his housekeeper went to him one day and said, “I’m making a fortune in the stock market.” And he said, “How is that?” And she says, “I buy these stocks at eight dollars, and they go to fifteen the next day.” He said, “Well how do you get the stocks?” And she says, “Well I would just call them on the phone, and say to them, ‘I see this security is coming out; this is Ms. So-and-so from Perry Hall’s residence, of Morgan Stanley.’ And they sold me the stock.” [Laughter] Well, we discussed the matters with them and they were very, very helpful. And later, of course, I had many relationships with the firm because of my later activities as the Vice President and Treasurer of the World Bank. So we looked back upon those early years with a great deal of humor and pleasure. But that was the typical interview. And they were helpful. And then we went to firms – market makers, integrated firms – who actually were doing transactions. But that led, for me anyway, to an interest in how markets worked, so that we began to look extensively at the operations of the over-the-counter market. We did receive from the Commission the right to conduct the studies; and we were well on our way to examining the way the over-the-counter market functioned—not only right after new issues came to market but how the over-the-counter market functioned in general. At about the same time that that was going on, Dave Silver was working on Jerry Re and the activities on the American Stock Exchange—how the stock exchanges were working. So those two threads were becoming very visible, not just in the street, but within the Commission itself. And for the first time, the Commission began to focus not so much on corporate disclosure but on the way markets worked. The information that began to be developed by the staff—which was, of course, being brought to the Commission—began to become publicized. And of course, very shortly thereafter, the Special Study was formed to formalize these private inquiries, which had been ongoing—I was assigned the over-the-counter market, and Dave, the American Stock Exchange.

KD: Can we back up just a little bit? These studies that you’re doing—your initial over-the-counter study, Silver’s study at AMEX. AMEX hit the front pages, and there was a lot of reason for a study. Was Gadsby still chairman at this time?

GR: I think so.

KD: Because I understand that the Special Study was really ginned up by Cary coming in, and everything being new, a new energy to the Commission.

GR: I think that's right.

KD: But it sounds like there was some energy—

GR: Oh, there was energy before. And it was basically being driven not just by the Commission but the directors of the divisions, because the staff was very strong. And there was no political agenda at all involved in any of this. This was a Congressionally-mandated Special Study. That was extremely important, as it later turned out; because the subpoena power came therefore from Congress to the Special Study, not from the five politically appointed commissioners. It also meant that the study, as it turned out, would be sent to Congress by the Special Study. And although the Commission would get it first, and they could make comments—it could agree to this recommendation; disagree with this recommendation; or we're neutral—they did indeed make written comments to the study, to Congress. But they did not at any time have control over what the study said. That was Milt Cohen and his staff. When Milt came in, he saw these two major things going on with Dave and myself; and then he wisely did two different things. He added to it matters dealing with the investment companies, matters dealing with automation, matters dealing with marketing, sales practices—the whole panoply, not just the over-the-counter market and the operation of the stock exchange. The second thing that he did is—we were rather young lawyers—Milt, at the time, was a very sophisticated partner in a law firm; and he wisely brought in two or three senior people, who would supervise the SEC lawyers. He also brought in a number of other lawyers. I would say though there were probably a half a dozen of us—maybe four or five from the Commission, and then others from outside.

KD: Who were some of those senior people that he brought in?

GR: Ralph Saul. Now I'm just trying to think—yes, I think Ralph Saul was not then at the Commission. Dick Paul was number two. He brought in, I think, Bob Mundheim. He brought in a very, very bright young lawyer, Roy Schotland, who did much of the rewriting; now teaches at Georgetown Law School, I think.

KD: Had you gotten anywhere with your over-the-counter study before the Special Study kicked in? Had there been any results?

GR: Yes, we knew what the issues were. But again, it was focused on hot issues. We had established relationships with perhaps a dozen firms, where they trusted us and we trusted them. And we were focusing mostly on issues dealing with selective use of potential manipulation by blocking all sales of the first several weeks; and therefore, if there were only two or three buyers, the stock would double on virtually no volume. In other words, it was control over future sales by saying to customers, 'You're not allowed to sell.'

KD: You create a shortage.

GR: Yes. And they created, therefore, a shortage, so virtually no buying would double the price. The second thing that happened is the people who got the stock were friends and had very close ties with the major underwriter. There was also some evidence that these people who got the stock gave kickbacks to their underwriter; and in other cases, either the firms that were members of the syndicate had special deals with the managing underwriter: ‘We’ll do this for you if you give us the stock.’ There was also evidence that the stock was not even sold to the public; it was just kept by, in some cases, the manager. All of which raised issues. But the important part is we learned how the over-the-counter market worked and we began to see how that functioned. We also had issues dealing with markups; that is, since the after market trades were principal trades in the over-the-counter market, there was often non-disclosed compensation. In other words, the bid and ask might be fifteen bid, sixteen ask; and the firm would charge eighteen. And so you’re getting it at eighteen, there’s no commission. Well, in fact, there’s a huge compensation through the markup. And it was that kind of rather routine issues that came up. It was not until we had the mandate to do the chapters in the study on the over-the-counter market that we began to look at normal after market or secondary market trading, just as my other colleagues were working on the trading on the stock exchanges. And then, of course, what happened is we began to become aware of the existence of something called the third market; which was functioning in the over-the-counter market, for listed stocks, which we also began to examine during the Special Study. And this is the early 1960s.

KD: Was Weeden in there?

GR: Yes, Weeden was key, as was M. A. Schapiro in bank stocks in the OTC market.

KD: Ah yes, Schapiro.

GR: I don’t know if you know, that M.A. Schapiro—Morris Schapiro, a delightful person—has great fame in Wall Street to this day; but his brother has even greater fame. His brother is the famous art historian at Columbia, Meyer Schapiro – I think – who is, you know, world-known as an art historian/art critic. He died a few years ago.

KD: Well we’ll get to Schapiro. I want to talk about the Special Study, though. Sounds to me like it was probably assumed that you were going to have a part in this study.

GR: Yes, I was assigned the over-the-counter market piece. And I had three or four lawyers working with me, and two or three financial analyst types.

KD: How did you structure your part of the shop?

GR: Well, I never paid very much attention to organization or management. What I did is: Dick Meyer and I—who was my closest colleague—said, “We’ve got to find out how this market works.” And we simply scheduled private interviews. We would go up to

New York and we would see perhaps two firms a day—sometimes under oath, sometimes not under oath. “Tell me what you do for a living? You get up in the morning and you go to your desk. Tell me about that desk. What’s on the desk? Who do you have lines to? Who do you deal with? Who do you clear with? How do you finance yourself?” And we would talk to them for hours upon hours upon hours. And the first questions we would ask, of the first interviewee, would be very naïve. By the second or third interview, we would know a great deal. By the fourth and fifth interview, we didn’t know as much as the firm we were talking to, but we knew how another firm did it; and therefore, we knew almost as much about how the street functioned than any one firm did. And then we asked to watch the traders on the telephone. We asked to look at who they had lines to; who paid for the lines; how they decided to record their transactions; who recorded the transactions; why and when they changed their bid and ask; how they knew who to trust; how fast did they communicate, if at all, with their competitors as to an overhanging block that was being sold in the market. We may have interviewed as many as ten or fifteen pure over-the-counter market makers who had no institutional or retail sales force, but were purely market makers. What became obvious to us was that that was just a piece of it. There was then the integrated firm, like the Merrill Lynch, or Bache, which also traded in the over-the-counter market for over-the-counter market stocks. That was a wholly different kind of situation because they were not only making a market in the company—in a given company for institutional investors, or for other market makers sometimes—but also to service their own retail force and their own institutional sales. For example, a specialist doesn’t have a retail client base. A pure market maker like Troster Singer did not have a client base, but Merrill Lynch did. Well, what did they do? Were they operating in any different way? How did they finance themselves? How much capital did they need? We would do this not just day after day, week after week, month after month; we would have perhaps as many as a hundred—ended up with perhaps as many as a hundred highly-intensive interviews. We would then write them up, not just the interview, but we would try to focus on what we saw as the strategic issues which were raised. And we would tell the firm, “Look, just tell us what you do. We’re not looking for fraud.” And in fact, as far as I knew, nobody ever was enjoined, or there was never any criminal activity; we were just trying to increase our base of knowledge.

KD: You did have to use a subpoena every now and then.

GR: Yes. And often to get records, because some of the records were confidential; we were asking the firm for the names of their clients, their customers, and who they were dealing with. We even, on occasion, went to banks. “Well, how do you finance these firms? And why do you finance them? With what collateral?” So we got to understand how the securities market functioned. And while that was going on, my colleagues were doing the same thing on the Exchanges: “What does an odd lot dealer do on the stock exchange? What does a floor trader do? What does a retail firm do? What does a specialist do?” So you can imagine tens and tens of thousands of pages of information that was being synthesized.

KD: Did you ever get together, say, with David Silver, who was looking at the New York Stock Exchange, and compare notes?

GR: Yes, we were constantly talking to each other, because the Special Study was a very tight group. We were mostly young lawyers and we were doing all this work. We did not have an *a priori* view, 'Ah, this is where we're going to come out.' What we wanted to do was just get the information. Then we began to develop what the public policy issues were. And jumping way ahead: the knowledge base was so substantial, that is the reason why you see so many of the Special Study people then become partners of law firms, heads of stock exchanges, heads of the New York Stock Exchange. Fred Moss became the president of Boston, I think, and Philadelphia. Ralph Saul became the head of the American Stock Exchange, Bob Birnbaum became the head of the New York Stock Exchange, Dave Silver became the head of the Investment Company Institute. Others became senior partners in major law firms. I stayed on. I did not leave right after the Special Study. Then we focused on the policy issues.

KD: As part of the Special Study?

GR: As part of the Special Study.

KD: It was the analysis?

GR: What, if any, were troublesome, almost fraudulent, activities; what were not fraudulent, but raised questions of public policy; what were issues of fairness; what were issues of structure. And recommendations were made as to whether regulation or legislation might be needed. Those, of course, after the Study was concluded, went up to the Commission; they agreed or disagreed; and then went over to Congress.

KD: And when you're writing this: the ultimate consumer is Congress. They've asked for the study.

GR: Right.

KD: So was there some sense that, we want to be aware of what some of the legislative fixes might be? I mean was there the idea that you're writing it for that audience?

GR: I don't think so. Oh, we knew legislation would be needed, but there was no politics, in the sense: 'Well, what will a Republican or Democrat say about this?' It was simply: 'This can be done by regulation by the Commission's existing power or this might need legislation.' Keep in mind, this is before automation. There are major sections on automation which began to creep into the Special Study. When we realized that a lot of this could be automated—and there were major recommendations on automation—

KD: The '62 market break came right—

GR: Right in the middle.

KD: Yes. What was the effect?

GR: There was a special part of the study, which did a case study of the market break. And again, keep in mind that there were at least a half a dozen of us who had established very good, very deep, ties with the Street. And we immediately went to them and said, “What’s going on? What’s happened? What do you think?” And because we had a substantial background, the language got short-cuttled, in the sense that, ‘Well this-and-this happened, and so-and-so went short, and this caused the banks to pull their lines of credit; and we had to draw down margin here.’ It wasn’t as if we had to start de novo: ‘What is this thing called the market?’ We were deeply into it.

KD: It must have been an interesting experience for you to develop these relationships with people on the Street, and vice versa.

GR: Yes, I think it was interesting. We did develop close relationships, and in fact, I think there was a mutual trust. If you talked to people on the Street at that time, we gave them our word that we were trying to find out what the facts were; but they knew that we were representing the public interest, that we might recommend things which were highly adversarial to them. But we were not out to “get them.” This was not a fraud investigation such as you will see on insider trading. And, therefore, the relationships were very good. But they were respectful and distant. When you put someone under oath, there is an adversarial nature to it. And keep in mind that all of us were lawyers. So we tended to be somewhat adversarial to begin with, and we were from the SEC. So there was distance, in that sense.

KD: What was the high point for you of that experience, of going through the Special Study?

GR: Well the whole thing, for all of us, I think, was a high. Virtually every day we couldn’t wait to get to work, because it would be at a new firm we were going to visit; and we were going to learn, not just for ourselves, but we’re going to memorialize in a document the way the securities market worked. And the Commission, if you think about it, never had done that before. The Commission had focused on accounting rules, disclosure, inside information, immediate dissemination of information. It looked, therefore, at corporate governance; it looked at events or conditions which would enable the public to feel comfortable that the corporation was disclosing to the consumer all relevant information in a timely basis, and that good corporate governance would not facilitate insider trading. Nothing about how the markets worked. They’d never looked at that. The Commission never looked at how markets worked. And that’s the reason for the study. And it became clear to us that that was a big omission. How markets work, actually work—to this day, the general public doesn’t know how markets work.

KD: And the market likes it that way, I would think.

GR: The Commission today knows how cash markets work, because of the Special Study. But they do not know how the derivatives markets work, because they have never had a

special study on that huge complex area. And that is to their enormous disadvantage. Nor does the Fed know. And the only way to find it out—well I'm getting too far advanced—is to have dedicated, reasonably intelligent people sit down and methodically, month and month, say, 'Tell me why you do this, and what you're doing, and how you make a living, and how much it costs, and who developed that technique, how is it financed, with what collateral, what are the accounting conventions?'

KD: But there probably was a political window that made this possible; that allowed Congress to say, 'SEC, we want you to choose a group of people and just let them do this.'

GR: Probably. Could it happen at any other time? Possibly. But there was, in fact, a window. Also, between Manny Cohen, Bill Cary, and Irv Pollack you had three very strong public policy oriented leaders. In addition, it was "fortuitous" that Dave Silver found not just policy issues but fraud on the stock exchange. That, of course, was an incendiary matter. My area, the hot issues, had nothing to do with fraud; it had to do with greed. That also made it somewhat incendiary, when people doubled their investments overnight. So the two combined opened up that political window. It also made it difficult for those who did not like the idea of a study to close the window.

KD: Who were the people who didn't like the idea?

GR: I'm making a theoretical statement. But you know, as the Special Study reached its conclusions, the Commission became much more involved, and much more nervous about what was being recommended. And there were political—not political in the sense of Republican, Democrat—but Wall Street was saying, 'They're going to recommend *what?*' And they would go to their buddies on the Commission. Keep in mind that the Freedom of Information Act didn't exist then. It also meant that the staff of the Special Study realized that. Milt Cohen, for the most part, ignored it. We were very fortunate that Cary had, as his executive assistant, Art Fleischer.

KD: Why?

GR: Art—who subsequently became managing partner of Fried Frank—was very intelligent, very ethical, very honest, and politically aware of what Cary could do with a split Commission. And there were sessions, I'm sure—I know—where Art would give his views on a particular recommendation, Milt would give his views, and we'd essentially follow what Milt said. This is not to say that Art was opposed to them, he just wanted the Commission—the staff—to realize that some of these things were not likely to be unanimously approved by the Commission. And indeed they weren't. And he would tell us where there were differences of opinion amongst the commissioners.

KD: My understanding is that Congress didn't want the report from the staff. Congress wanted the report from the Commission. Is that right?

GR: Well, they wanted it from the Commission, they wanted to have the Commission's views on it, but they did not want the Commission to have the power to change those views

before they (Congress) got it. And so that's what the compromise was. You got the Commission's views—which Congress is entitled to and what they wanted—on what this independent study recommended; but they could not change the recommendations of the Special Study. Nor did they. And that's to Milt Cohen's credit.

KD: Yes, there wasn't any self-censorship, so to speak—of doing things because you know that this is what the Commission—

GR: No, because the Commission was split on most of the issues. And the reason they were split was, in part, because these were very complicated policy issues, and reasonable people could differ. And did differ.

KD: And one would wonder how much the commissioners actually knew about all this stuff.

GR: They knew very little. And in a sense, the study was modest. It didn't say, 'You must do this.' But it was strong. It would lay out both sides of most arguments, also. You probably have the study. I have it somewhere over there, many volumes.

KD: Yes, it's a big document. Well, moving on from that: you talked about how a lot of the people learned so much in this process, and then they took that knowledge and went somewhere else.

GR: Right.

KD: You went into something called the Office of Policy Research?

GR: Right.

KD: Was that office, itself, a product of the Special Study?

GR: Yes.

KD: Tell me about the idea.

GR: Well the idea was: here is the study; it's done. And there are hundreds of recommendations. Well, which ones are you going to look at first? I became the Chief Counsel of the Office of Policy Research under Walter Werner, who was the director—a superb lawyer. People began to leave the Commission, leave the Special Study, and take jobs elsewhere. But I liked policy research, and I liked thinking about policy. And as a practical matter—although I had been offered a number of jobs in Wall Street—my wife and I were quite happy to live in Washington and I did not want to move to New York. I thought that there were a number of issues which should be looked into, focused on and resolved. And what else was I going to do at the Commission? I'm not going to go back to reading registration statements. And I wasn't all that interested in enforcement; although I did hire for the Special Study, Stan Sporkin. He subsequently, as you know, became the Director of Enforcement, and then became the General Counsel of the CIA.

And then, of course, he became a federal judge, and is still a close personal friend. I might mention that all of us who worked on the Special Study, almost without exception, see each other often, socially. We see each other now, a couple times a year at some event, or at some social gathering; and we are all very close. In any event, I decided to stay on. And Mike Eisenberg also stayed on for a while – concentrating on investment company matters. Well, they formed this Office of Policy Research, essentially to pick those things in the Special Study to implement.

KD: So the Office of Policy Research was looking more to implement things than to continue doing research?

GR: Yes. Except in one area; and it was the one area which linked the over-the-counter market and the New York Stock Exchange, and that was the third market, driven by Weeden & Company and M. A. Schapiro. In addition, the New York Stock Exchange was going through—I don't know if it's once every ten years, or how often it was—raising its commission rates through its so-called I&E Reports. That's the Income and Expense Reports, which went to the Commission—which had never been looked at even on an informal basis.

KD: These are the Exchange's income and expenses?

GR: No, the member firms' income and expense reports, to justify the fixed commission; and that landed in the Office of Policy Research. And what became obvious is, one: no one had ever looked at this stuff before; and second: to the extent we began to look at it, it was clear that the Exchange, which forwarded these reports to us, was making the case that their profits were not excessive. And we were supposed to look at this massive amount of data to see whether their profits were excessive from the commission business; that is, whether the firms could not charge more than X, because to charge more than X—to have yet a higher rate—would mean that their profits were excessive. And the Exchange said, 'Under the Exchange Act, you have to approve this; and that approval is your stamp of approval (and our anti-trust exemption).' Well it occurred to me that a.) For the first time we were really going to look at this stuff, rather than simply say, 'Okay,'—but that it was the maximum rate which we were evaluating—that is: you can't have more than this rate that you are proposing, otherwise it'll be excessive—not that this is the minimum rate that you should have in order to stay viable. Later, that became an extremely crucial legal issue, as I'll describe to you, because the New York Stock Exchange argued the Commission gave it a seal of approval; therefore, the Commission has approved our price fixing as a minimum, because they, as a government agency, have said we need that minimum amount to stay viable, and to maintain our regulatory posture. It was clear to me when I began to look at that data, that we were not asked that; that we were being asked to approve it as a maximum. It also became clear on looking at the data—which we already knew—that firms charged commissions which were fixed minimums, and then gave away huge amounts of their commissions. That, then, raised the question as to what, in fact, this commission really was.

At the same time, Frank Weeden and Don Weedon would come in, as would M. A. Schapiro, and say, 'Look, we're making this market; we can sell to institutions and to New York Stock Exchange members at a lower price than these institutions are paying because we are over-the-counter market makers operating with bid and ask. We get a profit between the bid and ask.' I asked, rhetorically, "Do you do much business with stock exchange members?" They said, "No. Of course not, we do zero with them, because they're not allowed to deal with us. We only deal with institutions. And of course we do that." And that led to this enormous study of Rule 394, which is what should be the rules with respect to stock exchanges' members being able to deal with third market makers. That, in turn, got very close to the subject of automation. What is a market? Who are the buyers and sellers? So the Office of Policy Research found itself heavily involved in what the role of the third market should be, and the role of the regional stock exchanges—which was covered by the Special Study. And here you had a group of us in the Office of Policy Research who knew what went on on the regional stock exchanges, which was a part of the Special Study; second, what went on on the New York Stock Exchange; third, what went on in the third market; and fourth, what went on in the over-the-counter market in non-listed stocks. At the same time that's happening, the New York Stock Exchange wants an approval of its latest set of commissions, as a maximum. And I remember one of my first discussions with the New York Stock Exchange members, saying, "You're talking about maximum, aren't you?" And they said, "No, no. Minimums." I said, "Oh. Minimums. What does minimum have to do with how much profit you're making?" And they said, "Well, we can't be lower than this, otherwise we'll go out of business, or can't supervise." And then, of course, as you can imagine, this rhetorical question then opens up the floodgates to a whole range of issues, which are volume discounts, institutional membership, and the propriety of fixity of commissions—all of which is in the Special Study. I mean all of which is raised in the Special Study, and is being examined by the Office of Policy Research.

KD: Right. You couldn't separate any of these issues; they're all bound up.

GR: Of course. And for the first time, we're very fortunate, because we have people who know all of the different parts, how each part works.

KD: Now, about this time, isn't Morris Schapiro filing his lawsuit and getting things moving in one direction?

GR: Yes. Well, seven things are happening. I happened to write them down, and I'll be glad to share them with you.

KD: It's around '65, something like that?

GR: Yes, '65, '66. Irv Pollack has now become the Director of Market Regulation. And I am asked to become the Associate Director for Market Regulation, under Irv. Stan Sporkin is the Director of Enforcement. And Irv and Manny Cohen, who's now Chairman, say, "Look, no longer is this a matter for research; that is, the Office of Policy Research. We

have got to look at how we're going to respond to this package of issues, because the New York Stock Exchange has these I&E reports in front of us, and they want to have a commission increase. Therefore, Gene, how about you moving over to actually come up with some rules."

KD: So your job title followed the issues.

GR: Right.

KD: From the study to rules.

GR: Right. Study, research, execute. And I draft up this 394 report, having already had over the previous years, extensive discussions with Morris Schapiro and Don Weeden, and New York Stock Exchange members about their OTC business. And at that time, having been through the Special Study, there is this—for want of a better term, not subliminal, but—undercurrent that if you want to get something done of substantial magnitude, the Commission itself, the five members, are not the vehicle to get it done. That is, they have become politicized.

KD: They've become a captive agency?

GR: It's not so much captive. It's more that they're there because they agree to begin with the people who put them there. They're not taking orders; they just feel that markets should work, or people should work in a certain way. Whatever our prejudices and biases were, it was clear the staff felt that the Commission might have to, at the end, approve things; but it should be unavoidable. That's a terrible thing to say. But that is, in fact, what the staff felt, for better or for worse. It's not something I'm particularly happy about. Ultimately, you have to go through the Commission; but the Commission should at least get the benefit of not only what the staff thinks, but they should make decisions based upon what the facts are. So, what we did is the following, in Market Regulation. We knew, because of our previous incarnation at the Special Study and the Office of Policy Research, that members of the New York Stock Exchange would charge, say, a hundred thousand dollars commission—a fixed minimum, and would give away almost eighty thousand dollars of it, at the direction of the client—the customer. They would say, 'Keep twenty thousand, and take eighty thousand of it and give it to firms A, B, C, D, who are selling our mutual fund. Or give it to firm D, E, F, who give us research.' So the firm that did the execution would keep twenty thousand dollars, even though they had to charge a hundred under their agreement with other members. Second: the stock exchange, we knew—since the Buttonwood Agreement—is not where executions of orders take place. The stock exchanges are where orders are recorded, but the transactions occur in the offices of the firm, where their institutional sales people would find buyers and sellers by picking up the phone. When the two agree to a price, they then take the order to the stock exchange, where it is recorded. We also knew that the Buttonwood Agreement, which formed the New York Stock Exchange, simply established that there are people who are members, and there are people who are non-members. All members had to charge each other X; all non-members had to pay ten

times X. All a stock exchange was, therefore, was a facility to separate members and non-members—to have one rate for members, and another rate for non-members. And a non-member is all customers; and a member is anybody who isn't a customer, who's an investment banker. Well, that's interesting. And the stock exchange had this pretense that it's where orders get done. Well, some orders get done there, yes; but the big stuff gets done in the offices of the firms, and then they're brought to the stock exchange. So we asked, "Well, you're giving away all this money, why don't you give volume discount?" And the firms said, "Oh, we can't give a volume discount." I said, "Well you're giving a volume discount of eighty percent anyway." And they said, "Ah, but we're dividing it amongst members." But they weren't. Because it turns out that they would often cross the order on a regional stock exchange. They would do the order in New York, say between Fidelity Fund and IDS would agree on a price of thirty; they would then bring the order and record it on the Pacific Coast Stock Exchange. Not New York. Why? Because the New York Stock Exchange rules said—you can divide your commissions, if you're members of the New York Stock Exchange, only amongst our members. The Pacific Coast Stock Exchange said you can divide your commissions only among our members. And by the way, any one of the eight thousand NASD members are members. So you now could divide it to this little firm in Iowa, who's not a member of the New York Stock Exchange.

So you have Goldman Sachs, or Salomon Brothers, doing an order on the Pacific Coast Stock Exchange, and giving it to a non-New York Stock Exchange member—eighty percent of the commission. So the money wasn't even kept by New York Stock Exchange members; it was given to one of eight thousand NASD members. We knew that, too. And then, there were some firms who said, 'I'm not going to even join the New York Stock Exchange; I'll do these crosses myself, and do them on Cincinnati.' And orders would get done on Cincinnati, because Cincinnati had rules which permitted you to give part of the commission to virtually anybody in the world. Well, we knew all of this. But what was not known was that every firm in Wall Street did not know what every other firm was doing. A firm knew what it was doing, how it was dividing up commissions, but it did not know what other firms were doing on other stock exchanges and for what purpose. So money was given for compensation having nothing to do with order execution. Money was being given, as I said, for selling mutual funds, or for research. Money was given to some brokerage firm because a child of the firm doing the order went to work for that firm; they just gave him the money—part of the commission. And other firms did not know what their competitors were doing. So, I thought that it would be nice to have this publicly disseminated, so that all firms would know what everybody is doing. So that was the first thing we did. We decided to have public hearings; and in the public hearing we are going to explore with dozens of firms, what their practices are, and how they divide up the commissions. Well, that caused an enormous economic pressure, because the firm realized, 'Hey, I can do what they're doing.' The New York Stock Exchange was rather distressed, because they realized now what Pacific Coast and the Midwest Stock Exchanges were doing. They have a rather small membership on New York. These others had memberships in—up to eight thousand, all the NASD members. So the New York Stock Exchange realized, 'Oh my heavens, Fidelity Fund won't give me the business, because I can't reward this firm in

Ohio, because they're not a member of New York; but therefore, they'll bring the business to the Pacific Coast Stock Exchange or Midwest, because they have a wider distribution network; and the money isn't going to the New York Stock Exchange—the transaction. And if it doesn't go to New York, that means the specialist doesn't get the order.' So the specialists get very upset; business is going to the regionals. This increased enormously the economic pressure to do something.

New York, therefore, wanted to say to its members, 'You can't bring your order to Pacific, or to Midwest.' In walks the president of the Pacific Coast Stock Exchange to the Commission and says, "Why are you trying to hurt California?" In walks the president of Chicago, "Why are you trying to hurt Chicago?" And we said, "We're not trying to hurt you. It's New York that is doing it." They then said, "We're not going to let those guys do this." So there was antagonism between stock exchanges. The staff, of course, is on the side of supporting the smaller regional stock exchanges, who have enormous support in Congress and everywhere else, against the New York Stock Exchange. It did not bother the staff to have the argument between the New York Stock Exchange and the regionals. That was not an accident. So after publicity that was the second element.

KD: And those were the hearings that you held around '65 or so, on Rule 394.

GR: Correct. 394. This is in '67 now. There was a third event. The third market then testifies that they're willing to give a price at a much lower rate than on the New York Stock Exchange. And that has an interesting twist. If you're a mutual fund, or insurance company, and you have beneficiaries, or you have stockholders, and somebody is testifying for the first time that he can give you a better price, why are you going to the New York Stock Exchange member at all? Why aren't you going to the third market? And of course the reason you go to the stock exchange is because the costs are being borne by the holder of the mutual fund—not the management company. The reason you're going is because they will generate eighty thousand dollars of commissions that you can give to help the management company sell more shares. And if you go with a third market, it's a net principal trade; there's nothing to give away. You don't have any extra "soft money" to give away for selling mutual funds, which has nothing to do with the value of the portfolio. So you're all of a sudden caught between what's in the best interest of the management company of the mutual fund, or the insurance company, and what's in the best interest of your beneficiaries. You don't want to be in that position, when it's public; because you know that within a week you're going to get sued for defrauding your stockholders, and not lowering the total cost to them. The mutual fund then answers, 'But they give us research sometimes.' The staff said, 'But wait a minute. You're already charging for research.' 'Well this is extra research.' 'Well why don't you pay for it out of your management fee? Or raise the management fee and/or just disclose it.' And the thing begins to snowball. So the existence of the third market begins to put on pressure.

While that's happening, you get a fourth development. We open up discussions with the Justice Department, with Lionel Kestenbaum at Justice. We say, 'Lionel, we've got an

anti-trust problem here. It's one thing to have a fixed minimum—apart from whether we “do approve” it as a minimum or maximum. But even if it is approved as a minimum, one thing that will destroy an anti-trust exemption (if you have one) is if you take the amount and give it away through a rebate. They're rebating their commissions. And they're rebating it to strangers who have nothing to do with the New York Stock Exchange or any of the members of the New York Stock Exchange, and it certainly had nothing to do with the transaction. And therefore, whatever anti-trust potential exemption they have, they've lost it.' We've showed they were giving as much as ninety percent of their fixed commission away. And as first piece of public testimony with the New York Stock Exchange, I remember asking Bob Bishop, “Do you have a fixed commission?” He said, “Yes.” I said, “Do you give it away?” He said, “Yes.” I said, “What's fixed about it? You're rebating it.” He said—competitive pressure. It was very hard for him to defend its “fixity.” Because that's what you have to defend if you're trying to get an anti-trust exemption.

KD: So they were creating the illusion of fixity, in order to—

GR: Yes. But they couldn't create it for more than two seconds, because all the firms would testify that they weren't keeping it. The firms were then complaining to New York that this has proliferated so wide through all the regional stock exchanges that they're being left with virtually nothing. So the disclosure was beginning to hurt them, the third market was hurting them, the mutual funds and the insurance companies were afraid of lawsuits; and then come the lawsuits. That was the fifth piece.

KD: And was Morris Schapiro driving this?

GR: Morris drove one—they weren't dealing with him. And the Pomerantz Law Firm also began to sue all the mutual funds. And I must tell you that one of the members of the Pomerantz Law Firm was my colleague in the over-the-counter market, Dick Meyer. He went to the law firm. So we, then, at the Commission, called in the mutual funds, under oath. And there's a very interesting transcript of my examining Johnson at Fidelity. And I said to him, “Why don't you deal in the third market?” He realizes a record is being made, that he's being told about this. And then he was asked, “Did you direct give-ups from Goldman Sachs to go to X, Y, Z?” He said, “Yes.” “And did you do often transactions on another stock exchange, and direct give-ups to people who weren't even members of the New York Stock Exchange?” He said, “Yes.” So the next question was: “Do you know that the give-ups can go to any NASD member?” He said, “Yes.” And of course, the next question was, “Why don't you become a member of the Pacific Coast Stock Exchange and keep the commissions for your stockholders? You're allowed to become an NASD member.” That raised the question of institutional membership. “And therefore, direct the commissions back to yourself—yourself, being your stockholders?” Now all of a sudden, he now has a record in front of him which became the subject matter of the lawsuit because he now knows he can go to the Pacific. And Pacific basically says, ‘You can become a member.’ That subsequently went to court. And there is a footnote in Judge Wyzanski's opinion, said to the effect, “It is true that Gene Rotberg did point this out, that he could do this if he wanted to, so he had advance notice of it.

But Rotberg was only a subordinate employee at the SEC; he had no reason to follow that suggestion or advice.” Well, Wyzanski, I think, subsequently got reversed because he [Johnson] had been told by an official of a government agency, ‘You can do it.’ But I didn’t have to tell him; he knew it.

So you now had a situation where the mutual funds were being put on notice and were being sued privately for taking these commissions and using it for purposes not for the benefit of their stockholders. You had pressure amongst the firms themselves to copy each other’s techniques and lower the commissions even more, or keep the commissions to even lower amounts. You had the regionals who were thinking of all kinds of new ways now to divide up the commissions to people who weren’t even members of the NASD. You had the third market going public with what they were doing. And all of this was being publicly disseminated—

KD: How was it being publicly disseminated?

GR: Hearings. Public hearings. In the newspapers.

KD: And this is the ’68 hearings.

GR: Yes.

KD: Okay. This is the summer of ’68 hearings.

GR: Yes, these are all going through. First it was private; then it was public. We then decided we needed one more piece to this, to increase essentially the economic pressure, because we all believed in free enterprise and competition. It came from what you might consider an unlikely source—Merrill Lynch. And I remember conversations with Don Regan, and Don would say, “Gene, we don’t need fixed commissions. We’re going to put all these other firms out of business, because we’re so big, we have so many branches, we have so much retail business; we’ll just lower the commissions and we’ll get even more business. But we can’t, we’re not allowed to under the New York Stock Exchange rules.” So here you have the head of the biggest firm, in terms of retail, withdrawing support for the fixity of the commissions because he thought he could put everybody else out of business that had retail customers. If that wasn’t enough, we had Gus Levy at Goldman Sachs also coming to the staff and saying to the staff, “I’m giving away too much of my commissions. If I can only negotiate and not have to give anything away, I’ll be better off. And we’re more efficient than other firms; we’ll be able to do these crosses in our office. I don’t want to be pushed to be doing them on Midwest or Pacific Coast. I’d like to be able just to offer them what I can.” So you had Goldman Sachs also breaking away from the New York Stock Exchange. Then the third firm was IDS, Investor Diversified Services. Bob Loeffler came to us, and said, “We think we’re going to join a stock exchange. We might as well get these commissions for the benefit of our stock holders.” Now, why could IDS do it and not Fidelity or Putnam? The reason is that IDS had its own sales force. It didn’t use other brokers to sell the mutual funds. Since it never had to pay for selling funds, it could afford to just get a lower

commission. It would advertise its lower commission. It would become a member of a stock exchange. It didn't have to pay an outside firm for selling its shares. It had its own internal sales force. That put enormous pressure on the other funds, from a legal point of view, for not doing the same. What were they going to argue? 'No, we need somebody else to make our fund bigger?'—and get a higher management fee, cause the management fee, as you know, is based upon not performance, but is based upon the size of the fund; so you would pay commissions to people who would sell the funds.

KD: Is the idea here that IDS could be in the New York Exchange, where the others couldn't?

GR: IDS could join the regional. New York said, 'You can't join the New York Stock Exchange; under the Buttonwood Agreement, you're called a customer.' IDS says, "Fine. I'll join a regional." And the Commission, therefore, would get a request from the regional to change their rules. We said, "Fine. You can change your rules." All that is going on. All these things are going on at the same time. Obviously, Justice then gets involved and brings a big anti-trust lawsuit – lots of potential damages. So from every way, the pressure simply became too much. There were these six or seven things going on simultaneously. The New York Stock Exchange found itself in an intolerable position. Big headache for New York. They tried to negotiate—they tried to not negotiate, but they tried to first come up with a volume discount. That wasn't enough.

KD: Wasn't that sort of a half measure?

GR: Yes, exactly. But that wasn't enough, because you could still give away part of the volume discount. So the purpose of the public hearings was to bring all of this together, in '67, '68. I was given the responsibility for essentially conducting these hearings. They were very gentlemanly. They were nice hearings; they were not adversarial. We would just simply go through: "What do you do?" Same as I had done five or six years before. And, "So, you give these commissions away? Do you know the firm?" "No." "How often do you do it?" "Every month." And, "Why did you bring this order to this exchange?" "Because the customer told me to." "Well why didn't you go to the third market?" "Because the New York Stock Exchange doesn't let me." Well they just were just building an enormous case for both private lawsuits, anti-trust lawsuits, and fiduciary lawsuits against their institutional investor—for their failure to take advantage of what could be done. Then the regionals would come in, and they would basically say, "Yes, we're not hurting the market at all." Then the New York Stock Exchange made, I think, a tactical error. They brought in—I think it was **Samuelson**—to argue their case in the public hearings. He said if the New York Stock Exchange went to negotiated commission rates, it would be the end of the stock exchanges, because the rates would go so far down, there would be what he called "destructive price competition" because some firms would put other firms out of business. The rate which they would charge wouldn't be sufficient for them to maintain their supervisory responsibilities under the Securities Act. And he testified on and on about this. What he apparently did not know was that New York Stock Exchange members do not have to charge, nor did they ever charge, a fixed commission on their markets in over 8,000 over-the-counter stocks. I asked him, "What do you think would happen if there were no fixed commission with respect to the

purchase of Bank of America, which is in the over-the-counter market?” He says, “Oh, the same thing would happen. The market couldn’t exist; the firms would go out of business.” Then I went through two or three other stocks, which were over-the-counter. I asked whether he knew that there was no fixed commission in the over-the-counter for New York Stock Exchange members, and apparently it did not result in “destructive price competition.” He thought that the fixity applied across the board.

KD: Did that get some headlines?

GR: I think all that stuff got publicized. Eileen Shanahan of the *New York Times* and Carol Loomis at *Fortune* were covering this stuff. And just the combination of these things that I’ve described, and the fact we had some big member firms taking the same position as the staff. When the Commission saw all this stuff, and the New York Stock Exchange saw it, there was no issue left to debate. It was just a matter of time before the whole fixed commissions after 200 years would collapse. The anti-trust suits were going on, triple damages against all New York Stock Exchange members for violations of the Sherman Act. There was big money involved. And that essentially then rippled across into England; it became the Big Bang. The whole thing dissolved.

KD: It took a while, though.

GR: It took a while.

KD: But you’re saying it was inevitable that commission rates would become unfixed?

GR: Right. It was inevitable. Keep in mind, what was happening when I was conducting these hearings in the fall of ’68. The election was in November. Nixon wrote an open letter to Wall Street. I think Chuck Colson wrote it. He wrote that he was going to get rid of—if he were elected—all these young liberal Kennedy-type lawyers who were giving Wall Street such a hard time. I thought this was targeted at me and my buddies at the Commission, who were conducting these hearings.

KD: Probably was.

GR: Probably was. But Wall Street had already given up, under their own economic pressures, let alone their fear of the anti-trust. And the institutions were getting sued. There were just too many pressures from all directions. Nixon won the election in November. I was at the World Bank by December. No one fired me, but I knew that I had no future left there. I knew that, hopefully, with others, like Irv Pollack, in particular, and Manny, I helped put things into play which were irreversible.

KD: You may have expended your capital.

GR: Oh, I’m afraid so. And I think the story goes that a couple of the firms had called Bob McNamara, who had just become president of the World Bank, and said, “Get rid of this—take this guy.” But I don’t think that’s really what happened. McNamara had

been, as you know, the president of Ford Motor Company. His investment banker was First Boston. He called the president of First Boston, Emil Pattberg, and said, “Do you know anybody who might”—“who might be useful to be the vice-president/treasurer of the World Bank?” He said, “I know one guy who I would recommend.” And within a matter of days, I was at the bank.

KD: Seems like an interesting leap though, because you’d never been Treasurer of anything else?

GR: Nothing.

KD: You knew how Wall Street worked.

GR: Well, if you look at some of the articles at the time, they said that I was hired because I was an adversarial, a trial lawyer opposed to Wall Street.

KD: And that’s what they needed at the World Bank?

GR: McNamara wanted someone who was not beholden to Wall Street; and who was not going to be overwhelmed by whatever the reputation of Wall Street was. I had very good personal contacts with all these people, even the people who I was adversarial with. It was mutually respectful. I wasn’t trying to put anybody away. I was just trying to make some policy changes that were inevitable from what they had done to themselves. And beyond that—just as a personal matter, I had been offered jobs; and I was going to go to either Salomon Brothers, with John Gutfreund; John had said, “Here’s the deal. You come here, take my place; and I will go to the World Bank, and take that job.” Or I was going to go with Leon Levy at Oppenheimer. I decided I still wanted to be in public service, because I was still then, and still am, much more interested in public service. To me, the World Bank was the ultimate public service. Only this time, Wall Street bankers were going to be my underwriters. It was the perfect Robin Hood job.

KD: Still a little Kennedy liberalism there.

GR: Exactly. And I wasn’t self-conscious about that at all. So within a matter of weeks, I would be going to see these same firms, and saying, “Let’s negotiate now on the interest rate.” We knew each other very well. I had always been close to Don Regan and John Gutfreund, and Gus Levy at Goldman Sachs, and all the firms. And hopefully, it didn’t hurt the bank at all. I was at the Bank for twenty years; and then I went to Merrill for two, to do risk management, after my public career. Well, if you want to go back now, on the Special Study—you may have some questions.

KD: Well, I do have a question—not that far back, but I’d like you to set the scene for me a little bit in those hearings. I understand the very first day you talked to the vice president?

GR: Bishop. Yes, Bob Bishop.

- KD:** And there was a lot of press coverage, because it's the first day. What was it like in there? Did you feel like you were well-prepared? Did you have support—backup?
- GR:** Well, hopefully, as a good lawyer you never ask a question where you don't know the answer. I don't remember asking a question that I didn't know what he was going to answer. But we had a lot of fun there. I had a big sign I had put up; it just said, "Give up." Give up was a pun, obviously.
- KD:** Two meanings there.
- GR:** Yes, it was a pun. Bob had to defend the indefensible. He finally ended, I think, saying, "Look, the money stays in the securities industry." I said, "But it doesn't stay with New York Stock Exchange members, it—" "No. But it's to all the securities members." I said, "But anybody could become a securities member; it could be like joining the Diner's Club, to become a NASD member." He said, "Yes." I said, "Can I become a NASD member?" He said, "Yes." I said, "Could a mutual fund become a NASD member?" "Yes." So I said, "So who can't become one?" And Bob had to be very careful, because he's a staff member of the New York Stock Exchange. They were, themselves, by that time split. You had Goldman and Merrill not wanting to have anything to do with it. You had their lawyers telling them they were subject to potential triple damages for violations of the Sherman Act. And finally, I remember asking, "Would you like to do away all the regional stock exchanges?" And here you have—very outstanding men are the heads of all these stock exchanges—a very difficult situation with the New York Stock Exchange trying to do away with all these regionals. So you had to constantly defend an indefensible position, which had started in the 1700s, when they formed the original stock exchange. It was the same set of rules, that you must charge a fixed minimum to every outsider. That was the Buttonwood Agreement. And here he has to defend it and the world has changed. And everybody knows now how it's changed. In answer to your question, I looked upon the hearings as not very different than the interviews that I had conducted during the Special Study.
- KD:** Except there, you didn't know the answers.
- GR:** There, I didn't know the answers. There, it was fact-gathering. And it wasn't till after many, many interviews that you know the questions. And the answers were known at the time of the hearings because these pieces that you referred to earlier: the regionals, the third market, the stock exchange, the integrated firm, the over-the-counter market; the difference between what Merrill does and Goldman Sachs, the institutional pressures, the lawsuits—that was all within the knowledge of the staff at the Commission—probably to a greater extent than any one firm knew. And so we would know how the third market finances itself. Merrill didn't know how the third market did it. And often the regionals didn't open up very easily what their rules were to members of other stock exchanges. And when you're in the position where you know how the system works, you have somewhat of an advantage.

KD: So in a sense this is a classic case of shedding light on things.

GR: Exactly.

KD: And letting them sort themselves out in the light of day.

GR: Exactly. And keep in mind, since then we've seen many federal commissions, whether it's Iraq, or 9/11, or thalidomide. But on this one, the reason this was quite so remarkable is you didn't have any differences of opinion amongst the Commission members. We were in fact-finding until the very last two years. And I, personally, believe that the Commission itself, as an entity, has suffered today because of its inability, or unwillingness, to have these kinds of studies on issues which are, to me, very, very important—like derivatives, off balance sheet transactions, which really overwhelm what we knew at the Special Study. In other words, if you ask any of us who were on the Special Study, 'Could you describe the market today?' Any of us who have any degree of sensitivity or modesty, will say, 'Absolutely not.' We have no idea what's going on. We lost it ten or fifteen, twenty years ago. And as of 2007, it's highly doubtful whether anybody in government knows how the market works—knows the importance of various kinds of transactions. Unknown. Is it unknowable? No. And I argued four times on the Hill, in both Senate hearings and House hearings; and at the Commission itself, for a massive study on the way the security markets now operate. No success.

KD: When?

GR: In the last eight years.

KD: What kind of opportunities were these?

GR: Whenever there was a scandal, they would call me down to the Hill to testify. And at one point—the last one—whether it was Long-term Capital, or the Salomon Brothers debacle, or the Barings, or Daiwa, Orange County, Sumitomo—whenever there was a derivative scandal, they would ask me to testify; I would talk about the need for a special study. And the last time they called me I wouldn't go. I said, "Here are my previous transcripts. I'm going to say the same thing." I went to the Commission itself, and I gave a long speech there about three years ago on this subject—not what we're talking about—on how the securities markets have changed, and I don't know how they've changed. And I think it's time for the Commission and the Fed to find out. And this pretense that they know is nonsense. They don't know.

KD: How was that received at the SEC?

GR: I think the staff loved it. But nothing ever happened. And I think there should be a massive study—an independent study—on how the securities markets function. And I think it, frankly, should be conducted not by economists, but by lawyers, who can get the facts out. Later on, there'll be plenty of time to see what you want to do about it. Maybe you can't do anything. But you find out what happens. Who does what, and how do they

do it? Why do they do it? How do you finance it? What are the risks? What is the leverage? The markets today are enormously leveraged.

KD: Well, what's standing in the way, do you think?

GR: Probably partisan politics, and probably the Fed. The Fed is very nervous, given our deficit, about any tinkering, or even examination of what, frankly, goes on in the futures markets, because it supports the bond market. And I know that they have frequently said that we think there are abuses, but they can be taken care of. They don't want to mess with it. And I can understand where they're coming from; they may be right.

KD: If it ain't broke, right?

GR: They say it's not broken, till the next scandal. And there always is a next scandal. The latest one was Enron. Enron had little to do with corporate accounting and corporate malfeasance. That was the vehicle where it exploded. What was going on was a series of derivatives—a virtual reality issue. And they did it through various firms. It just happened to be in the oil and gas industry, which is a product like a stock. Oil and gas is simply like a security. It's called a commodity. Long-term capital was in the bond markets. But there will be another one. The theory is that the banks know how to protect themselves; and maybe they do, maybe they don't. I do know that the SEC doesn't understand it.

KD: Well, I think there are those who would admit that.

GR: Yes.

KD: Certainly on staff.

GR: Yes. And they should find out. When you get another crisis, you at least know where to look, and who to call on the phone—who you can trust. You know, who you can pick up the phone and say, 'Hey, what's really going on here?' Because one thing about that Special Study: all of us, for years thereafter—to this day—can call up people and say, 'What's going on?' And you get the information. As far as I know—leaving the Jerry Re matter aside—I don't know of a single injunction or criminal matter that came out of the Commission in my area. There was a big economic change and shift; hopefully it was for the better. Essentially, what has happened is that the economic distance between a buyer and seller has virtually disappeared. That's essentially what it's all about.

KD: With the electronics?

GR: Well, electronics; and these rules knocking out the fixity of the difference between buyers and sellers. The middleman is the toll taker; that's the investment banker—broker; and he gets a fee for it. You might say, 'Well that's not all that important.' But it did something else: it also, with respect to mutual funds, said, 'We're not going to permit a distortion to sell this security by the compensation system, which permits enormous

compensation to those who sell mutual funds.’ That is a strategic development. That will lower the compensation for that particular form of investment. It, therefore, encourages the no-load fund. And it discourages massive growth where there might be very bad performance, because the compensation system is so high. Now, you still have that problem with compensation systems in the securities industry, but it’s not in the business of buying and selling securities. What it is, is the compensation system for trading, where you get enormous compensation for taking leverage and risk. But that, again, is a subject which is not known much about: how that compensation system works, and whether or not—as I personally believe—it probably increases enormously the amount of risk-taking. Because that’s why you make thirty million dollars a year. But on the other hand, people will say, ‘It’s not a public company; it doesn’t matter.’ But they are public companies now. That’s another development.

KD: Somebody’s always going to pay anyway.

GR: Right.

KD: Well, I think this is probably a great place to wrap up.

GR: Okay.

KD: I really appreciate talking with you. I feel like I’ve been through a seminar—a good one.

GR: One final point: as you may, or may not, know, Mike Eisenberg and I, and then Mike alone, taught law—he still teaches law—at GW, securities market regulation. While all this was going on, these would be our final exam questions to the students: ‘You’re the president of the New York Stock Exchange; how would you defend yourself against the following?’ And we would describe what we have talked about here. Or, ‘What would you do if you’re a mutual fund director, and you had these kinds of pressures? Would you sue if you’re a third market maker? Who would you sue?’ So all of this, for five years, were the final exam questions for the law students. And it was essentially all these public policy issues. At one point, the final exam got in the newspapers: ‘Here’s the final exam for the New York Stock Exchange directors.’

KD: I wonder if they ever did better than the directors did.

GR: Well, I once sent the president of the New York Stock Exchange the best exam answer.

KD: Well, terrific. Thank you very much.

GR: Thank you.

[End of Interview]