Securities and Exchange Commission Historical Society
Interview with Nelson Kibler
Conducted on May 4, 2009, by Kenneth Durr

KD: Interview with Nelson Kibler, May 4th, 2009, in Fairfax, Virginia, by Kenneth Durr.

NK: I went to law school late in life. When I went to the Commission, I had a junior college degree and an associate degree in accounting, and I went to the chief accountant's office. I had a CPA. You were able to sit for the CPA exam at that time with a two-year degree. I went to American University at night to get a bachelor's degree in accounting. And then much later on, I went to law school, what is now George Mason School of Law.

KD: So you got an accounting degree. You became a CPA around '66?

NK: Yes, that's about right.

KD: Were you thinking of getting into the SEC, or how did that work? How did you come across that job?

NK: I always went to night school. Poor kid off the farm up in Northern Virginia. I started at Strayer Junior College at night, and I had a job during the day with a small regional brokerage firm here in Washington. It was then called Mayclin & Co, ultimately merged into Johnson, Ltd., and has now disappeared, but it's now part of Ferris, Baker Watts. I was a cashier with the brokerage firm, so I had a brokerage background. I was going to school at night, got my associate degree, did the CPA coaching school, ultimately got my CPA, passed the CPA exam. What am I going to do? And then while I've got the securities background, I'm interested, and I applied to the SEC.

Actually, once I got my CPA, I went to the District Government as an internal auditor, D.C. Government. Did Lorton Reformatory, which was an interesting experience in its own right [laughter]. And then applied for the SEC. After my two years' experience, I applied. And Andrew Barr, who was a chief accountant at that time, hired me as a financial analyst, and I promoted to a staff accountant under the agreement that I would go and get my bachelor's degree. I went to American University at night and I finally got my bachelor's degree. So I was with the chief accountant's office for a number of years before I went down to what is now market reg. It was trading and markets at that time.

KD: Tell me a little bit about Andy Barr and what his office was like.

NK: Andrew Barr was an institution. I think he was the second chief accountant that the SEC had. He was from Illinois, he was an old bachelor. I made the mistake the first week in the office of writing a memo that said Andrew C. Barr, and he called me in his office and said his family were Scots and they couldn't afford middle initials, so it was just Andrew Barr. He was a quintessential professional. Wonderful person to work for. He would give you work, check with you from time to time, and then expect you to come back and give you a lot of latitude to do things. It was always interesting to go to meetings with him, and I learned an awful lot when he had all the top people come into his office to discuss accounting issues.

All the accounting firms, the major corporations, everybody came to see him at that time. He usually knew what the answer was before the people came in, but they never knew it. He would always let them talk. Usually, they talked themselves into what he wanted them to do. He would rarely say no. They usually walked out feeling that they had had a full and fair hearing, and it was just a great experience to see him do that sort of stuff. I learned a lot from that.

KD: What kinds of issues was he dealing with at that time?

NK: Well, at that point, I don't think the AICPA was really in force at that time. They didn't really have the accounting board or anything like that. He was, basically, the center of the accounting profession at that time, the state societies. There was a national accounting association, but it wasn't nearly the board that we have now. So he was, basically it, in terms of what the accounting was going to be for things.

KD: So setting guidelines.

NK: Setting guidelines, yes.

KD: Would he get down into the weeds with some of these accounting firms and say, "This is how you're going to do this?"

NK: Yes. All the major accounting firms would come and visit him sometimes, and he would go on a circuit. He would go around and speak at all the state societies and things like that. As he put it, he had a message to deliver and he would go around. The accounting firms would come visit him on accounting issues. I'm trying to remember exactly when the AICPA really started to set standards. They did, but it was really in conjunction with him. He was really the leading force for that.

KD: You said he had a message. What was the message?

NK: He was setting the standard for accounting in terms of what the accounting standard should be, the reporting standards. And he spoke for the commission, and he was able to influence the accounting profession dramatically. Old bachelor. Lived in the University Club, one room at the University Club in Washington. Bowled every weekend.

KD: Was he the chief accountant for the whole time you were in that—

NK: Yes, he was. When he retired, I guess when Casey came, there was a reorganization. He retired, I left the chief accountant's office because they were setting up a new broker-dealer examination group in what was then trading and markets in Irv Pollack's division, under a fellow by the name of Alex Brown, who had been the regional administrator for the Washington Regional Office.

KD: Before we jump into that, tell me a little bit about the kind of work you did in the chief accountant's office.

NK: Research. Basically, pull documents, pull financial statements, go through and review them. There would be an issue. We'd go try to find other examples, just like you do with finding precedent in the law. You go look at what other people are doing. The biggest thing that happened during my time with his office was segmented accounting. It was segmented accounting, as breaking down conglomerates reporting by business line.

KD: There were a lot of conglomerates at that point.

NK: There were a lot of conglomerates. That's right.

KD: Gulf & Western?

NK: Yes. Textron, I think. Gulf & Western, Litton Industries, firms like that. I've forgotten half of them. They disappeared.

KD: So you were responding to the emergence of those.

NK: He was at that time, right.

KD: Was there a push back?

NK: Yes, there was. Ultimately, what happened is the accounting profession sponsored a study by a professor from the University of Illinois by the name of Mautz, and he did a study. Ultimately, the Commission adopted rules that required segmented accounting. The chief accountant also at that time was involved in broker-dealer reporting, and the capital requirements for broker dealers.

KD: Were you involved in that?

NK: Yes.

KD: That became a large part of your career later on.

NK: Yes, it was.

KD: What was your involvement at this point?

NK: I was very junior. Actually, there were only about eight people in his office. And he relied on the outside people. He organized people outside the Commission to do studies, to do reviews, to do things. He was a master organizer in being able to get people to come together on these issues. And he was the, "Let's do this right, fellows" kind of person. And he had the stature, the stature of the Commission's office, as well as his own personal persona. He was able to motivate people to do what he thought was right.

KD: So a blue ribbon commission type thing.

NK: That sort of thing, yes. Accounting firms would get together. He would organize panels, he would organize groups. He would say, "Here's a project, you know, get this done." And we would review things. And we were basically advising the Division of Corporate Finance at that time as to what accounting issues would come up, and he would basically decide it. He had huge files that were indexed as to all the accounting issues that had been resolved by the Commission. And you go through the process of doing the research and applying it. He did a couple things. One, he would, with corporate finance, review reporting done by corporations as to whether they were conformed with the Commission's standards. He would consult with the outside accounting profession in developing accounting standards. He was a wonderful person to work for.

KD: So it sounds like a lot of this corp fin was driving, sending business your way.

NK: Corp fin would send business our way. But he was also very active in the profession, tremendously active in the profession. Every two or three times a month, he was out speaking somewhere.

KD: In the absence of an AICPA, there must've been—

NK: Yes, there was. There was an accounting profession, but they were not the accounting financial standards board. There was nothing like FASB at that time. Nothing like that.

KD: Wasn't it that it was mostly voluntary, and as long as it was this voluntary organization, nobody could really get together?

NK: Well, he was the center. At least in my view, he was the one that made it work. He was succeeded by Sandy Burton, who was effective as well, very effective. I had not worked for him because, when Mr. Barr left, retired, I went to what was then trading and markets to set up this new office for broker-dealer examinations.

KD: What was the SEC like back in the mid-60s?

NK: Fraternal, collegial.

KD: I get the sense that it was pretty different back in those days.

NK: I think so. I don't mean this pejoratively, but there was a split. Most of the senior staff at the Commission at the time I was there had come there after World War II. They came right out of the Army. And they had been long-term government professionals, in the best sense of the word. Just as I was coming in a few years later, particularly after Casey came, you started to see a much younger group of people, and those people starting to retire. There was a major turnover at the time that Casey came. Even then, it was a very collegial, tight-knit fraternal group of people. Everybody knew everybody, it seemed. Not a lot of turnover. Even then, you were able to get the best kids out of law school, and they'd come looking for a career.

KD: Would you work with people in divisions besides corp fin, trading and markets for example?

NK: I worked a lot with trading and markets because of the investigations. Trading and markets, investment company, I forgot where investment companies was at that time. There was no separate division for it. I think it was in trading and markets. I've forgotten exactly where investment companies were lodged at that time.

KD: Well, tell me a little bit about the opportunity to shift over then. Was this in response to the back office crisis?

NK: It was just before that. Casey became chairman, and there were three study groups, as I recall. The one I was most particularly concerned with was the financial reporting for broker dealers. As a matter of fact, I was the staff support for that, and worked on that. And that's where we came up with uniform reporting for broker dealers.

KD: Why did he create the study groups?

NK: This was Casey. Casey was reforming the Commission. He, basically, split up trading and markets into market reg and enforcement. I think the issue was philosophic, that people who were regulating shouldn't be investigating or prosecuting, if you will. Irv Pollack was the director of trading and markets at the time, and Stan was his principle lieutenant, as I recall. Shelly Rappaport was there. There was a close group in trading and markets, and Casey broke them up.

KD: And these three study groups, that was to help figure out how to—

NK: I think part of it was to deal with corporate finance, part of it was to deal with broker dealers, and quite honestly, I'd have to go back and look. I forgot what the third group was. We all produced reports. It was an outside group. The chairman of my group was a fellow by the name of Stepenack, William Barrett out of Milwaukee, I believe it was. And we had Eli Weinberg, who was with, I think, White Weld at the time. Cunningham, I think, from the New York Stock Exchange, and I forgot. There were a couple of other people like that on the committee. And we came up with a report on broker-dealer reporting and that sort of thing. It was relatively well received.

KD: The back-office crisis hit late 60s, early 70s.

NK: That's exactly right.

KD: You must've been looking at some of the fall-out from that.

NK: [Laughter]. Well, with all due respect to the current crisis, that was as dramatic, I think, as this. The only difference being that broker dealers were not as prominent in the national economy as banks are today, since Glass Steagall is gone. I think there were sixty members of the New York Stock Exchange that are gone. We did the unsafe and unsound study. You're not aware of that?

KD: No, I haven't heard that name. Give me a little bit of background on the unsafe and unsound.

NK: Congress authorized us to conduct a study on unsafe and unsound practices of broker dealers in the 60s, as a result of the paperwork crisis. It was a couple-hundred page report. It was comparable to the study that was done in the early 40s with respect to the old special study. It's comparable to that in its scope.

KD: Were you involved in that?

NK: Yes. Very much. Deeply involved in that.

KD: Was this people from all through the Commission that came together?

NK: I have a copy of the report at home, and it's online. It was largely either trading and markets or early part of market reg. I think it was done in trading and markets. We did an inspection of the New York Stock Exchange and other exchanges at the time. The New York Stock Exchange, American Stock Exchange, Philadelphia Baltimore Washington Exchange, Boston, Chicago, Kansas City, Pacific Stock Exchange, both floors, the Spokane Stock Exchange.

KD: Were they happy to see you coming?

NK: No. This study, unsafe and unsound practices, was in response to the very difficult time that the broker dealers were having in New York, mostly under the supervision of the New York Stock Exchange. And the report focused largely on the regulatory supervision by the New York Stock Exchange. And we did an examination, you would call investigation perhaps, and were critical of the New York Stock Exchange. It required them to come to the Commission and defend themselves a lot. There was a fellow by the name of Bob Bishop there and he used to come often, and was eloquent and bitter about the whole process, a very effective guy for the Exchange. But the result was a sea change in the way the regulatory system worked for broker dealers. That's really where that study came in.

KD: Got a '69 study of the New York Stock Exchange firms.

NK: Yes, that was another one. There were two at the time. Those programs are run by lawyers out of what was then, I think, trading and markets.

KD: What was the sea change?

NK: The capital requirements for broker dealers at that time was fragmented. Each exchange had their own capital requirements, and the NASD applied ours. The only capital rule that was opposed by the SEC was the one that were the NASD members only. So we adopted a uniform net capital rule that applied to all broker dealers. And it, basically, took the authority of the exchanges away to interpret them. So we did the interpretation, we did the enforcement. We reviewed the exchanges to see that they were enforcing the rules.

The second thing is each of the exchanges had their own reporting systems for their members. We had one meeting where Bishop came in, and all the exchanges were in, and we were anxious to have them share information from their reports. And Bishop said no. They were regulated by the New York Stock Exchange. They weren't going to share anything. So, eventually, they lost that ability. We adopted a uniform financial reporting system that came to the Commission and reviewed by the Commission. Also at that time, one of the major problems that happened was in the paperwork crisis, brokers were having difficulty getting financing.

Each day, a broker dealer settles his transactions. And when the securities that had been purchased by customers would come in, the broker dealer would pay for them. But at the same time, the broker would be selling customer securities, so he would have an obligation to deliver the securities to the street. So they would just roll it around and put it back out because they needed the money. They weren't allocating the securities that had been purchased and paid for to the customers.

So that was a major, major problem. Ultimately, the New York Stock Exchange had a building fund, I think $25, $30 million that they were going to put a new building down on Wall Street down on the wharf. So they took that money and, basically, bailed out a number of customers, paid off customers to do it. That was the impetus for SIPIC. It was, basically, that they didn't have enough money. And DuPont and some of the other firms went out and took the whole building fund.

KD: Net capital rules are really important here, and my understanding is that the SEC had something.

NK: In 1940, the NASD proposed a capital rule that would be applicable to all broker dealers. And the SEC said, "No, some of the Exchange rules are more stringent than that," so they denied the NASD. And then the SEC adopted the NASD's capital rule itself, and then left the various exchanges to enforce their own capital rules.

KD: What was the difference between the one that the SEC adopted, and the New York Stock Exchange's rule?

NK: The 40 Rule?

KD: I've got 15c3-1.

NK: Yeah, 15c3-1 is the rule. It has gone through several iterations. The first iteration was the rule they adopted in 1940. Then in '72, I think I got the date right, they adopted the Uniform Net Capital Rule that was applicable to all broker dealers. That was much more comprehensive than the 40 Rule, much more comprehensive. But you had a relatively uncomplicated business back in the '40 compared to what it was in '72, much less compared to what it is now. But the rule that was ultimately adopted was the New York Stock Exchange Rule plus additional things. But equally important was the customer protection rule, which addressed the other issue I was talking about where broker dealers would bring the securities in, pay for them, roll them out again and not lock them up for the benefit of customers, which was another rule we adopted, which is 15c3-3, about the same time.

KD: Now did all of this come out of that group that you joined when you went into trading and markets?

NK: Yes. It all came out of that and iterations of it.

KD: Who were you working with during this period of time?

NK: Well, when the office was first set up, a gentleman by the name of Alex Brown, a long-time Commission employee out of Chicago, regional administrator, Washington regional office. We set up the office. I started to go around, review the examination programs of the various exchanges, stuff like that. Looked at reports, that sort of thing. Then the paperwork crisis started to evolve. He left, and as Casey came in, the people I worked with primarily was a fellow by the name of Lee Pickard.

KD: He would have been associate director of trading and markets?

NK: He was an assistant director of market regulation. Ultimately, became the director of the division. A fellow by the name of Bruce Heard, I think his name was, had sort of a notorious career at the Commission. He did the examination of the New York Stock Exchange, and then wrote a book called *Unsafe and Unsound Practices*.

KD: Is that why he was notorious?

NK: Well, he didn't last long after that. He had gone to Casey and asked Casey if he could write the book, and Casey said, "Sure." After he wrote the book and got the securities industry all furious, he didn't last very long under Casey.

KD: Casey ended up not liking the book being out there, I guess.

NK: Originally supported it, but when it got so much heat, he told Heard to leave, so Heard left. It's called *Unsafe and Unsound Practices of Broker Dealers*.

KD: I've got to get a copy of that.

NK: It's probably not in print anymore. I think I've got it somewhere.

KD: New York Stock Exchange had a lot of leverage at that point, I guess, over the Commission.

NK: They lost a lot. During that period, they lost tremendous leverage, and they lost a lot of authority because of the crisis. Whereas before, the Commission left them alone; after that, they couldn't do anything without the Commission's oversight. Lost a tremendous leverage. So what came out of that was the focus report, the Uniform Reporting System for all broker dealers, the Uniform Net Capital Rule, the Customer Protection Rule, Rule 15c3-3. We got involved in the accounting profession too, and we asked the auditors to report any material inadequacies of broker dealers, and that was a major fight. They didn't think they should do that, but we adopted the rule, and so now they report as to whether there was any material deficiencies in handling customer funds and securities, or compliance with the capital rules, stuff like that.

KD: Did the Commission see a change after that? Did they start reporting these things?

NK: Yes, they started reporting. We did get reports. I just have to reflect a minute on that. That was a major fight with the accounting profession. They really didn't want to do that.

KD: Why not?

NK: Well, under generally-accepted accounting principles, they were going to report on compliance, whether the financial statements complied with GAAP. This was a special purpose work, and our point, of course, was that the focus report was not a general-purpose financial statement, that it was a special purpose report to report the financial condition to the Commission for regulatory purposes to determine whether performance was in compliance with net capital. So it was not a general-purpose report. It was a special report. If they wanted to do audits of broker dealers, they were going to have to do a special-purpose report.

KD: Did you call that a focus report?

NK: Yeah, FOCUS, Financial Operation Uniform Combined Report. Also, another player at that time was Dan Polaro. Casey brought a group of people with him. Casey had been a major player in the Nixon election campaign, and he brought a number of people with him. Pickard was one, Polaro was one. There were some others, I've forgotten who, but they came to the Commission at that time. There was tremendous tension between enforcement and market regulation at that time over this kind of stuff, tremendous attention.

KD: Did market regulation want to cooperate more?

NK: Well, part of it was personality; part of it was professional, I think. Irv and his group in enforcement didn't trust market reg, didn't trust the new people who were coming in. Didn't trust Casey.

KD: But, of course, Casey's the chairman.

NK: Yes, but there was tremendous tension [laughter]. I was in a very difficult position because I'd worked in trading and markets. I thought he was a wonderful leader, a tremendous leader, someone to work for. Particularly Polaro had been a political operative and was a notoriously difficult person to work with. And there was tremendous distrust between enforcement in our office at that time because of this. People didn't trust Polaro at all in enforcement.

KD: That he wasn't interested really in doing a serious job of regulating?

NK: Well, I don't know about that. Dan was sort of amoral in the sense that you never knew where he stood. He was a difficult person to work for because in his office, he'd divide people up one-on-one. You know, you worked one-on-one with him. Very difficult time. There was about two years there where it was sort of delicate, trying to moderate between difficult things.

To illustrate the tensions at that time, Pickard was the director of the division, and Polaro was my boss. He was an associate director, I believe. I was an assistant director at the time. It was the time that the Chicago Board Options Exchange was just beginning, and Joe Sullivan, who was president, was coming in and trying to get the exchange organized, and ultimately, the Commission let them do it.

I think Sporkin was then the director of the division of enforcement, and it's not something that he wanted to see. They had a hearing. Shelly Rappaport was the hearing officer. All the Exchange is supported. So they were approved to do it. So we had our office, Polaro, had the responsibility of what are the capital requirements going to be for the floor participants, people on the floor who are going to register, going to do the trading on the floor? The Chicago Board Options Exchange at that time had a number of players who were over on the commodities side. You know, this is a subsidiary of the Board of Trade. And so they had a lot of floor brokers, operators from the Board of Trade who had a seat on the Chicago Board Options Exchange, and they were going to support the traders there—they were going to do the trading.

But no one had any clue as to how to trade options, listed options. So they didn't recruit from the floor of the commodities exchange, they recruited people off the street and basically trained them to be traders on the floor. So these guys came in, and they had no capital and no experience, but they would go through a training session and give them money to trade, and explain to them, they'd let them do certain types of trades until they got more experience. They'd give them more money and let them do different types of trades.

So our mission, Polaro and I, was to devise capital requirements for these floor traders and the brokers who hired them, who they were working for. So one time we went out to see Sullivan in Chicago. And, more or less, off the cuff, we're standing on the sidewalk getting in a cab going down and Polaro says, "What are we going to tell them?" And I said, "Well, why don't we say these brokers who are supporting these floor traders, if they're going to support them, why don't they take capital charges for the exposure that these guys have in their capital requirements?"

We sort of set up, off the cuff, a system that the brokers who were carrying these traders would take capital hits based on their positions. This was off the cuff, standing on the sidewalk before we go down to Chicago.

KD: Common sense kind of thing.

NK: So we go down and we talk to Sullivan. "Okay, we'll do that," because he wants to get this thing going. So we come back down to Washington and we propose this scheme, this plan. And we get a lot of support for it, except from enforcement because Stan was looking at the traders on the floor, pimps, hairdressers, taxi cab drivers, and I forgot what other terms he used [laughter], but he was not impressed with it, and at least in my understanding at the time, he was not very happy with options trading. So we go to a Commission meeting where this is going to be discussed.

We've got a proposal, we're going to do it. And Pickard was there. Tony Snodgrass, who was chief counsel for the division at that time, Polaro and I. And, of course, Stan is over here on the other side with the Chicago Regional Office sort of people. And they oppose this on the basis that they would be extending unsecured credit, which is illegal under Reg T. So there is a verbal debate—I'll put it mildly—before the Commission over this. At one point, Snodgrass says to Sporkin, "If you want to know what the rule says, why don't you ask the guy who put pen to paper? Tell him, Nelson." [Laughter].

KD: Did you tell him?

NK: I said, "Mea Culpa." [Laughter]. Anyway, we went through it, and the Commission disapproved it, and all hell broke loose. All the exchanges who were going to do this asked for a meeting with the Commission. Actually, Irv Pollack was still director of the division at that time. Sporkin was the chief guy on this, but he was still the director. So the exchanges all came in with their counsel, and they had a meeting before the Commission to discuss this. And then they had their say, and the Commission sent them out of the room, and then we had a further discussion, and ultimately, the Commission approved it.

KD: Was the idea that instead of the broker dealers, that the traders themselves should've had the capital?

NK: No. I think Stan's objection was an objection to the whole principle. The concept is still there. It still works. I mean, it's worked fine over the years. It stood the test of time.

KD: It seems like you spent a lot of time working out net capital rules in various places and areas. The first one was just for broker dealers in general after the back office crisis, right?

NK: Well, after the crisis, I became assistant director. Polaro moved on. Lee moved on, Pickard moved on. The new director, I think, was Scarf, Doug Scarf, as I recall. His general counsel was still Snodgrass. No, I think Snodgrass left. I've forgotten who his general counsel was. The next crisis when I was with Doug was the silver crisis with the silver crisis with the Hunts.

KD: Oh, in the late 70s, early 1980s, something like that?

NK: Let's see. The paperwork crisis was the first issue. That was dramatic. The second issue was there was a credit crunch in the securities industry. They couldn't get funding. Then came the Hunts with the silver. That was interesting too.

KD: Well, go ahead and tell me about that since you brought it up. I know the Hunt thing was around 1980.

NK: The Hunts cornered the silver market, and it became a national event. At one point, I think the fed, and the treasury, and the SEC, and I don't know who all else had a major meeting over it. I'm getting confused now. I have to sort it out. And then the Commodities Futures Trading Commission was around at that time. They were involved in it as well. Actually, it was Bache, I think, who had the major exposure there. We had to work our way through that crisis, but that went away. I've forgotten exactly how it was resolved, whether the treasury bought it, or whether the market simply went away and evaporated.

There was also a major crisis when they allowed gold to be traded. People own gold, and we went through a whole exercise revising the segregation rules. And then when the first trade took place, nothing ever happened. A non-event [laughter].

KD: I guess that's a good thing.

NK: I guess that was a good thing.

KD: '75, you moved up. You were a broker dealer financial regulatory officer.

NK: Yes. Then when Polaro walked, I became assistant director. That's how it worked.

KD: Assistant director of financial responsibility was the title.

NK: Yes. What did that mean?

KD: Yes. Tell me about it, what that title was about.

NK: It was 15c3-3, 15c3-1, the net capital rule, financial reporting, Reg T to the extent the Commission had a role on that, coordination with SIPC in liquidating broker dealers, and coordination of the Commission's examination program, oversight of the exchanges examination program. A lot of fun.

KD: Did the examination program consume a lot of your energy?

NK: Not so much, because the regional offices were very effective. We would have periodic get-togethers, coordination, all that stuff. Actually, Polaro did a very good job at that. He instituted a program of having regular meetings, bringing those people in, getting them before the Commission in a sense because they had been in the back water, and he basically gave them a lot more importance, which was a good thing, and improved their morale and effectiveness tremendously.

KD: So you must've seen a pretty big difference compared to from 1970 to 1975.

NK: Yes. In the 60s, the Commission's examination program was in New York, and it was a one-man show, if you will.

KD: Do you remember who the man was?

NK: I do. I can't remember his name, obviously, now. It was like one or two people, but he was an old-timer and wore spats. I cannot remember his name.

KD: And '75 is the date that I have for the Uniform Net Capital Rule.

NK: That's about right.

KD: And this is about the time, a lot's happening in '75.

NK: Oh, yes.

KD: With congressional legislation that revises the whole Act entirely.

NK: Well, there were changes to the Act, that's true.

KD: I'm wondering about the Uniform Net Capital Rule. Did that have any relationship to all these other changes that were going on at that time?

NK: As we said a little earlier, this was a seminal time for broker dealer regulation. I mean, everything changed at that point in time. Everything from capital compliance, handling customer funds and securities, to audits, to reporting. And SIPC became a factor. Everything changed at that time. The whole regulatory scheme changed.

KD: Did the '75 Act—

NK: I've forgotten exactly what happened with the Act. I've forgotten how that affected us. That may have given us some authority that we didn't have before, but I have honestly forgotten what that was.

KD: There was a study, '76, '77, a deliberate study on net capital for options markets. Is that the time period you were talking about before?

NK: Yes. Well, I've forgotten. That could have been. No. That was different. We're getting into the time now when Black-Scholes became important. Black-Scholes provided a trading model for people who were, particularly on the floor, for them to price options and trade them. And a lot of different strategies started to evolve. Straddles, hedges, all kinds of things. Being able to put together risk-limiting strategies and things like that. And we didn't have anything that could deal with it, so it was a major task to try to put together. Try to: one, understand the strategies; and two, to put together a capital program for it that's scheduled. That's one of the appendixes to the Net Capital Rule. I think it's B or C.

KD: Did you go to Chicago and camp out, and watch what people were doing? How did you do this?

NK: [Laughter]. I remember going to Chicago one time, and one of the members of the Chicago Board Options Exchange, who was a major player on the floor, he had a broker dealer who had all these traders on the floor. But he was a commodities trader, and he took me over to the Board of Trade. Nice, wonderful mild-mannered guy. He says, "I'm going over here. You stand here." I was in the pit on the side. He said, "You stand here, keep your hands in your pockets." So the bell opened, and this mild-mannered man went crazy. It was just amazing [laughter] to see the transformation that happened to him. I went to another, went to the silver pit, and I thought they were going to call the cops. I thought it was a riot.

KD: So did he tell you to keep your hands in your pockets so you wouldn't buy anything by accident?

NK: No. I think it's just so I wouldn't be a distraction or anything else.

KD: So you did this study.

NK: Yes, we did the study. Actually, the study, as most Commission studies are done, it's done largely with the cooperation of the brokers involved. And, one, you're at a tremendous disadvantage because if you don't do this stuff every day, it's very hard to do it, hard to catch up with it, hard to understand it. So you rely upon the experts, the people who are doing this, to put it together, and then you review it and try to understand it and try to make sure that it provides customer protection, the customer protection that would be appropriate.

KD: So and then did a new rule follow that study?

NK: Yes. There was an amendment to the Net Capital Rule. It's one of the appendices. I've forgotten which one it is. It's A, B, C and D, and I've forgotten whether it's A, B, C or D. D is a subordination agreement, A, I think, is consolidation. It's one of those.

KD: You would think that the options traders or the brokers or whatever would—

NK: See, if it was just the floor traders we didn't have a problem because they were covered by the capital that governed the people who employed them. That was not the issue. The issue was where it was being traded by arbitrage guys at broker dealers as part of their broker dealer business. Off the floor, if you will. The Merrill Lynches started to do this stuff, they started to have desks, the major wire houses and so forth.

KD: They sat back and waited for options to become viable?

NK: Well, once Black-Scholes was adopted, once the professors came forward and had a model for pricing, you had a more rational basis for doing trading.

KD: So then the big guys come in.

NK: Big guys come in. And, of course, the New York Stock Exchange is a major player too and CBOE.

KD: In '82, then, market reg was sort of rearranged again.

NK: Actually, in '82, I'm leaving, I think.

KD: Okay. Yes. I have joint inspections office.

NK: Oh, that's right. That came after I left.

KD: Well, tell me a little bit about the decision to leave.

NK: I expected to be a Commission employee, and I enjoyed it. It was an exciting, interesting and rewarding place to work. I liked the people, I liked the work. It was exciting to be involved in important things and to have an impact, and I enjoyed it. I liked it, so I thought I'd stay. But Touche Ross at that time did not have a broker dealer audit practice, but they, through acquisitions to their clients, Prudential and Sears, acquired Dean Witter, and I've forgotten what the firm was. So they now had a practice.

They had decided as a strategy that they were going to focus on the financial services industry and put together, since they had a core business, they were going to try to build a practice around that in the financial services area, banking investment companies, broker dealers. So they started to recruit people to build that practice. They approached me at the Commission as to whether I would come and join, and it was a great opportunity, and I did.

KD: This would have also been just about the time that John Shad was coming in.

NK: Exactly. Shad had nothing to do with it. I wasn't a big fan of Shad.

KD: I guess I wondered if you saw the Commission changing at all.

NK: Well, I think the Commission changed more after I left than that. I think it was largely still a collegial—I don't say it's not collegial now, but it was smaller than it is now. And the Commission was able to attract the best kids out of law school. Top of their class, top 5 or 10 percent, they would come work 10 hours a day, 7 days a week, get their so-called graduate degree in securities law, and then go to Sullivan Cromwell, or wherever and work in a high-profile securities practice. It was a great place, because you've got wonderful people there. I don’t know that they get the same group of people now. I can't tell. But the Commission does seem different now. They've got a union now which was unheard of in those days. I just don't know that you have the same esprit de corps that we had when we were there.

KD: Did you have any involvement in working with municipal securities?

NK: In the board? Very little. That may have happened after I came. The big change was in the industry. When I started with the Commission in the late 60s, the securities industry was not regional. It was largely New York and regional firms, but it was not national. You had partnerships where people had stakes in the business—partners—and that was a major problem in the paperwork crisis. Then later on, Donaldson, Jenrette went public. And now you had public money, and Merrill Lynch went public, and now they are national. Ultimately, whereas Glass Steagall kept them apart, now they're a part of banks. The banks seem to be taking over the industry now.

KD: One other thing that that I thought was interesting from a securities point of view is that you had some kind of role when E.F. Hutton got stuck.

NK: That was after I left the Commission. They were found guilty of a felony, actually several thousand felonies, for using the float of innocent banks without their permission, if you will. And as a result of their pleading guilty of a felony, they were statutorily barred from being a registered broker dealer, being an investment advisor. So the Commission decided, rather than pull their ticket, that they would have someone do an examination of them to see whether they were as aggressive using customers' money as they were the banks' monies. And I was appointed as an independent consultant, the first one as a matter of fact, to do a study for the Commission on whether they were complying with 3-3.

KD: You were the first independent consultant that they chose for something like this?

NK: Yes.

KD: What did you find out?

NK: They were not. The report was an important one in the sense that it was terribly expensive for E.F. Hutton. But they were complying with the rules, and it was a real issue. It was a long report. I've got the report someplace. I forgot what I've done with it. But the report was filed with the Commission. It was a long one, basically said what we did and that we didn't find any violation of 3-3.

KD: Now were you working within Touche Ross when you were doing this?

NK: Yes. I'd left the Commission maybe a year or two years. E.F. Hutton approached me to be their independent consultant. They proposed me and the Commission didn't object. The conditions were that I would hire an outside counsel, which was a problem because I couldn't find anybody who didn't have a conflict except for Jim Treadway, who was a former commissioner who had just left the Commission and joined Baker Botts in their brand new Washington office, so I engaged him and Baker Botts to be my counsel.

KD: Okay. Now this is something that you've done on other occasions.

NK: Several times, yes.

KD: Is this pretty much a common practice at this point for you?

NK: Well, at this point, yes. They've had a lot of independent consultants to do reviews with respect to mutual fund sales and stuff like that, a lot of them recently. It's a fairly common practice now. As a matter of fact, right now, I'm an independent distribution consultant. They brought action against a broker dealer for not disclosing that they had taken money from mutual fund groups to distribute to their funds without disclosing to the customers who bought them that they were taking money from the funds, so they had to give back thirty-some odd million dollars, so we're in the process of giving back. I'm the independent consultant giving back $31 million to a bunch of people.

KD: That must be nice.

NK: It's been four years. It's taken four years to get it done. And the major part of it was getting the plan approved by the Commission. We started to give the money out in December when the market broke, and since sums of money are relatively modest when you divide it over 700,000 people, you send a $25 check to someone and they've lost $100,000, they're offended [laughter]. Send them back to you.

KD: Yes. Kind of takes the gratification away from the job. You've actually had people return you checks?

NK: Yes. Along with a nasty letter [laughter].

KD: So it sounds like this work with E.F. Hutton kind of set a pattern.

NK: Yes. The Commission has used that quite a bit since then, yes.

KD: Well, is there anything that we haven't talked about that springs to mind that we should cover before we wrap up?

NK: There's a thousand stories, but I couldn't remember all of them. Wonderful people. I had a great time.

KD: All right. Well, terrific. Thanks.

[End of Interview]