

**Securities Exchange Commission Historical Society**  
**Interview with David Silver**  
**Conducted by Kenneth Durr, on March 22, 2006**

**KD:** This is an interview with Dave Silver conducted March 22, 2006, at his home in Bethesda, Maryland. Well thank you for agreeing to talk to me again.

**DS:** [*Laughs*] For the second time.

**KD:** [*Laughs*] I want to start with background. I want to touch a little bit on your education at Harvard Law School and how that took you to the Securities and Exchange Commission.

**DS:** I graduated from law school in 1958; went from there to a Clerkship with a Federal District Court Judge in New York City, very distinguished Judge, Frederick Van Pelt Bryan and had a very exciting two years with him. We freed Lady Chatterley's Lover from a suit by the Postmaster General and I was privileged to watch and sit in on the trial of Adam Clayton Powell for income tax invasion who was defended by Edward Bennett Williams who was then at the height of his career and it was altogether a very instructive and rewarding and interesting assignment.

I went from there to a law firm no longer in existence—Greenbaum, Wolf & Ernst and the name Morris Ernst once meant something and I think one of the reasons I got that job is because 30 or 40 years before that Morris Ernst had freed James Joyce's Ulysses from the custody of an earlier Postmaster General.

**KD:** This is intellectual property rights?

**DS:** Yes. The firm represented a number of authors and publishers. One of the most interesting assignments I had was reading in manuscript Making of the President 1960; all books published in New York State are read in manuscript by counsel because a bona fide opinion of counsel that the book is not libelous can protect a publisher and author from punitive damages in case of litigation.

Although that was very interesting work, it didn't last all that long. Within a year I found myself, totally unexpectedly, at the SEC. It started at a New Year's Eve party where a man I

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knew from the Federal Courthouse in New York, an Assistant US Attorney who had prosecuted together with Irv Pollack a number of important securities law cases in the '50s, mentioned to me that there was an interesting case being investigated at the SEC and that it might be worth my while to look into it because he knew that Ralph Saul, who was then Associate Director of the Division of Trading Exchanges, was looking to hire an attorney to work on what one might call the legal aspects of the investigation. The investigation turned out to be the case against a prominent American Stock Exchange specialist firm, Re, Re & Sagarese, who was violating or accused of violating the Exchange Act and while they engaged in specialist activities on the American Stock Exchange.

The investigation into their activities had lasted for a long time and there was a voluminous record. What had to be done was to put the case into a legal framework for briefing purposes and analyzing the specialist's responsibilities not only in terms of the Securities Exchange Act but in terms of the common law fiduciary duties as agents for investors. And it was my assignment to research this area and assist Ralph in the preparation of the brief.

**KD:** So you were putting the Re case or the charges against the Res into the context of prevailing law, I guess?

**DS:** Prevailing law and looking at the facts which had been developed during the investigation placing them in the legal context of the governing law. This was somewhat virgin territory. The Commission had done little work between 1935 and 1960 on specialists. There were no Commission rules directly regulating the conduct of specialists and the Commission had done very little since the '30s in reviewing Exchange rules governing the conduct of specialists.

I might say that the Re and Re proceeding was an administrative proceeding brought internally at the SEC under the Securities Laws. Such a case is assigned to what used to be called Hearing Examiners, now called Administrative Law Judges, and a trial very much like a trial in the courtroom is conducted; the Administrative Law Judge issues an opinion which can be appealed to the Commission and thereafter to a Federal Court by the losing party.

While the Re and Re case, was in this framework, it developed in an unusual way. The investigation had revealed such a multitude of facts which were damning in their amount and qualitatively with respect to the conduct of the Res. When I say the Res I'm speaking of

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Jerry Re, Sr. and Gerard Re, Jr., his son and as I may have mentioned the firm of Re, Re & Sagarese was the second largest specialist firm on the AMEX at the time.

The Re's counsel, a very good lawyer named Milton Gould, was brought in very late in the case. As I understood it, this all happened before I arrived on the scene— he had prevailed upon his clients and then particularly I suppose Jerry Re, Sr. that there was absolutely no way that the Commission would exonerate the two of them but that there might be some possibility that the Commission would go more lightly on his son. And so Gould entered into a stipulation with the staff, and that would be in this case the Division of Trading and Exchanges, to the effect that the Res agreed or stipulated to the accuracy of the facts adduced in the investigation and did not contest that these facts were violations of the securities laws and reserving only the right to argue with respect to the penalty that would be imposed by the Commission.

This short-circuited the hearing process so that a Hearing Examiner who would ordinarily conduct a trial was unnecessary and the argument that ensued was before the Commission itself and only as I said involved the penalty to be fashioned. I might mention that at that time there was no Enforcement Division at the SEC; enforcement work was done by the various substantive Divisions; thus the Division of Corporation Finance had what was I think called a Stop Order Unit and that is when a registration statement which was materially defective or possibly fraudulent was filed in connection with the offering of securities. The Division's Enforcement Unit would bring a proceeding, most often an injunctive proceeding, to procure a stop order preventing the registration from going forward.

Similarly the Division of Corporate Regulation which primarily regulated the public utility holding companies but also regulated the then infant mutual fund industry had an Enforcement Unit of its own and the Division of Trading and Exchanges, the Division which Ralph was the Associate Director, had probably the largest Enforcement Unit at the SEC because all broker/dealer wrongdoing came before that Division. And this could involve everything from capital violations, technical violations by broker/dealers, or abusive selling or fraud in the sale of securities by broker/dealers whether over-the-counter broker/dealers or exchange members of stock exchanges.

**KD:** So were you in the Enforcement Group in Trading and Exchange or was there such a thing?

**DS:** No; I wasn't. From the beginning I suppose I had a free floating job as simply an attorney advisor I think it was called in the Division and it was understood that I worked for Ralph Saul. There was no central Enforcement Unit at the Commission; the closest to that was that in the General Counsel's Office. Irv Pollack, who was an Assistant General Counsel at the time coordinated all Enforcement work from the viewpoint of making either criminal references in appropriate cases to the Justice Department or brought Court proceedings for injunctions primarily to the Federal Courts for civil violations of the securities laws which would be handled by the General Counsel's Office.

The regional offices of the SEC also played a role and generally reported to the Division of Trading and Exchanges because most of their enforcement work would involve local broker/dealer misconduct but Irv would then be involved also in helping shape these cases up from the point of view—either criminal reference or a court proceeding.

So Irv was involved in one way or another with most of the Commission's enforcement work and was involved somewhat in giving aid and support and time to Ralph in the pursuit of the Re and Re investigation. There had been when I arrived—as I said the investigation was just about complete from a fact-finding point of view and either a briefing schedule had been already agreed to or was agreed to very shortly thereafter and the argument then set down for consideration by the Commission. However, there had been a fair amount of reaction from Wall Street with respect to the investigation and a significant amount of political pressure brought on the Commission from you might say the political friends of people on the Street.

I know of one call that Ralph received I think from Congressman McCormack in Boston—who if he was not yet Speaker of the House was an important member of the Congress.

**KD:** No relation to the McCormick who was heading up the AMEX?

**DS:** No. Not at all.

**KD:** Okay. *[Laughs]*

**DS:** And although I did not know personally of other intervention on the Commission level it seemed clear to me at the time that there had been such attempted intervention because in particular Commissioner Gadsby who had been Chairman until the election of Kennedy as President, under whose Administration the investigation of the Res had formally commenced that in observing him at the Commission and particularly during the argument of the Re and Re case it appeared from his body language and bearing that he regarded the powerful case being presented by the Division as total justification of the investigation and wanted to make sure everybody in the room heard what was going on.

I might mention that it was an unusual situation; usually when a new President comes into office and the political party has changed, the Chairmen of the various independent regulatory agencies will submit their resignation clearing the way for the new President to appoint his own Chairmen. However when Bill Cary was appointed Chairman there were one or two vacancies on the Commission so that either by pre-arrangement with Bill Cary, which I think was probably the case, Gadsby resigned as Chairman of the Commission but did not resign his seat as Commissioner and stayed for several months winding up his own personal affairs in Washington and I suspect being of assistance to Bill Cary in the transition from one Administration to another; and so that—as I mentioned Gadsby as an active participant as Commissioner during the disposition of the Re and Re case.

**KD:** Was this held in a Commission room? Is this the place where they would have done this?

**DS:** We're talking now of the old tarpaper shack at 2<sup>nd</sup> and E Street which had a Hearing Room and there was a table in front where the five Commissioners could sit but very rarely did the Commission sit on an enforcement matter as such and that room was mainly used, I suspect, for hearings with a single Hearing Examiner, as I said.

It was a fascinating building. It was steel construction, partly riveted and partly welded and it was I think three stories high. The Commissioners' offices were on the second floor and every time a truck passed by on 2<sup>nd</sup> Street the whole building would bounce up and down so you would be discussing a weighty matter with a Commissioner and suddenly the whole room was bouncing up and down.

It was clear from the Re and Re investigation that we were dealing with the tip of an iceberg, that the corruption had to extend much further than just the Res for a number of reasons.

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First many of their activities were just open [*Laughs*] and notorious on the floor of the Exchange; second they had stocks assigned to them which they already had formed close relationships with the management of the companies and there were just so many of their activities were so abhorrent from the point of view of specialist conduct that the Exchange could not have been unaware of what was going on, if not the full dimensions of it—but that there was something radically amiss with this operation.

So that it was quite clear that the Re case was only going to be step one in what had to be a second step and that is an investigation of the American Stock Exchange itself which the Commissioners authorized to pursue under the Exchange Act. And no sooner was the Re case disposed of and the Commission entered an order for that investigation. I might say that a couple of interesting observations that I made at that time—one wondered what kind of Chairman Bill Cary was going to turn out to be. In trying to decide whether to take the offer of the job at the Commission, I really knew very little about the SEC as such; I went to consult my old Professor at Harvard Law School, Professor Louis Loss who was one of the acknowledged securities laws experts in the country. He had written the Treatise on Securities Law.

I mention that because a friend of mine had said why are you going all the way up to Boston to see Louis Loss? I know a perfectly good law professor at Columbia; his name was Bill Cary who I had never heard of until he was appointed Chairman by President Kennedy and I kicked myself very hard in the rear-end for having missed the possibility of being on the inside track when Bill Cary arrived in Washington. But he was somewhat of an unknown quantity and his personal bearing was very, very gentlemanly, professorial, and unless you knew that he had, I think, parachuted behind the lines for the OSS in Yugoslavia during the Second World War you got a very wrong impression of what Bill Cary was like because beneath that surface—the surface was real; he was a very thoughtful man, but there was a backbone of steel.

And the first hint we got of that was in the argument of the Re case in which Gould was trying at best to blame everything on the old man as it were, the old pirate from prehistoric times who really just didn't understand a modern situation but who agreed that he had violated the law in very significant ways but that he was the totally dominant figure and his son was essentially a clerk in the operation. And as Milton Gould was waxing eloquent, Bill Cary leaned forward and his very soft voice said—tell me Mr. Gould how old did you

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say this kid was? And Gould said well you know I didn't characterize him as a kid and that was a witness in the investigation that I was simply quoting but for the record he's 38 years old. At which point Cary leaned back and I remember Ned Gadsby grinning as that came out.

One quick anecdote is that the Commission repaired to the Commission meeting room after the argument and because of Gould's stipulations what ordinarily would be a separation of functions between the staff and the Commission acting in a judicial capacity in the case that was waived and so the staff could consult with the Commission and the Commission could consult with the staff on the remedy.

And my second even more direct measure of Bill Cary came when he suddenly asked the Director of the SEC Opinion Writing Office, a long-standing career position held by Leonard Helfenstein, as to whether the Commission could act that day and not wait for an opinion to be written with respect to the remedy to be imposed. And of course there was the talk that this was irregular, etcetera, and that the better practice would be to wait for an opinion to be drafted by the Office but Cary pressed on and finally Leonard had to say that no, there was nothing in the law to prohibit this especially in the circumstances of this case where there was in essence a full confession on the record as long as opinion was written in a reasonable time thereafter. And Cary said that's very good; that's what I want to hear because I don't want these two wandering south of Canal Street tomorrow morning.

And so the Commission expelled the two of them from membership on the American Stock Exchange that afternoon. Milton Gould was in the process of flying back to New York; he was met by some reporters at LaGuardia who asked him about whether he had any comment on the speedy action of the SEC and they told him what it was and his comment was, "They might have waited until I got back to my office."

In any event, the situation then turned to the American Stock Exchange and the discussion at the Commission table was in that direction. Ralph expressed his concern that also since Bill Cary was new that there would be violent opposition to any investigation and that there was undoubtedly going to be various forms of political pressure brought on the Commission.

And Bill Cary made it clear that he was not going to be deterred on what he thought was indications of absolutely scandalous and outrageous conduct on the Exchange and gave I

think the first indication again that he was prepared to fight this publicly because in his determination to act against the Res that afternoon he asked the Secretary of the Commission, Orval DuBois -- who wore about eight hats as the Secretary of the Commission; he was also the Press Officer, he typed all the releases himself—quite a legendary figure in Commission history. He asked if anyone knew directed primarily at Orval as when the early edition of the *New York Times* closed. And [*Laughs*] it was a discussion in the Commission meeting room for those of us who may have known, thought we knew etcetera—but the general consensus was that it was probably around 7 o'clock, so it was plenty of time to get the Commission's action in the next day's newspapers.

It was also in our minds before the argument at the Commission that we were going to and already had been subjected to outside pressure and realized that the whole thing could begin and end with the Re case and that there had to be public reaction to the case in order for the Commission realistically to carry forward with a broader investigation. When I arrived at the Commission there was a reporter who was working on a story and his name was Frank Cormier; he was an AP Financial Reporter, later Chief White House Correspondent for AP, who had probably heard about the investigation through sources on the street because there were dozens and scores of witnesses called in the year or year and a half that the investigation had been pending. As I said before, the stipulation that Milton Gould had entered into also had the effect of making the investigatory file a public document.

So Cormier was busy that file. And we were quite surprised when the day before he was supposed to have the story carried on the AP Wire he called Ralph and told him not to look for the story—that it had been killed—that the AP wouldn't run it because he had of course asked for comment of the various people mentioned in the story and that the counsel for the American Stock Exchange had threatened the AP with a libel suit if the story was run and the AP backed away.

Another reporter came to our attention; a man by the name of Tom Ottened, who was I think the Chief Washington Correspondent for the *St. Louis Post Dispatch* who started to work on the story and I think I told him to watch out because somebody had already tried to do this story and had the story shot out from under him at the threat of a libel suit. And Tom Ottened said to me we've got to remember that the *Post Dispatch* is an old Pulitzer newspaper and we still have the crusading spirit out in St. Louis and I was therefore surprised when after he worked on the story for about a week to receive a call from him

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saying and I will quote to the best of my recollection, “I am nonplussed, shocked and chagrined but the paper refuses to carry the story—with the threat of a libel suit against the newspaper if we go forward.”

Thereafter through some mutual acquaintances, Tony Lewis of the *Times* became interested in the story of what had happened. He was not a financial reporter of course, but he brought the story to the Financial Desk at the *Times* and more importantly as I understood later he also brought the story to Clifton Daniels who was I think Managing Editor of the *Times* at that point and Daniels personally assigned a reporter, Bob Bedingfield to the matter. And one morning the SEC receptionist called back and said there’s a man by the name of Bob Bedingfield here to see you; he’s a reporter for the *New York Times*. Bedingfield was somewhat disoriented because he had been awakened at 2:00 in the morning by Daniels who told him to go down to Washington; there was an interesting story.

Bedingfield being a long-time financial reporter in New York was fully acquainted with all the names, all the local celebs that had been involved in the case because Jerry Re was a glad-hander and in the night-club circuit in New York, he would say I will put you in for 500 shares; I have this thing going; I can get you 1,000 shares, etcetera. And so there were a fair number of New Yorkers, some of whom really seemed that they had stepped out of a Damon Runyon story, involved in this case.

So Bob Bedingfield was very excited about it and to cut it short, the day before his story was to run he called and said that the *Times* had been threatened with a lawsuit and it was doubtful as to whether they were going to run the story—that it was in the hands of their counsel, and they were taking a very dim view of this. It occurred to me that our brief to the Commission was just about finished and we were going to file it in two or three days. One always waits to the deadline to file but we were ready. And Ralph who really had the laboring part in writing that brief really did a masterful job. My contribution was on the legal side—legal analysis.

But it occurred to me that my short stint at the law firm did give me some understanding of the law of libel—that if the *Times* were reporting what was in the brief of the Division of Trading and Exchanges filed with the Commission that this would provide some legal buffer, legal insulation against the libel suit and particularly would give comfort to the

lawyers for the *Times* who wouldn't be faced with a file cabinet full of documents that said God knows what, but if they could measure the story against the contents of a brief they might be satisfied, and that's exactly what happened. We received word that the story was going to run the next day and then we received a call that it wasn't going to run because *Times* printers had gone out on strike that afternoon and that there might not be an edition the next day.

And then we received a call that the printer strike had been settled and it was a very long story and it did run on Friday, April 28, 1961. And if you read the story you'll see that it expressly relies on the brief of the Division.

**KD:** And makes clear that it's doing that?

**DS:** Yes; it expressly said that. So that's sort of the [*Laughs*] back-stairs history of how the Re and Re case came to public attention.

**KD:** So the idea here was to build some support for going out there...?

**DS:** Making certain that the investigation would not be interfered with.

**KD:** Did it work?

**DS:** It worked. You can see I'm holding up to you a headline in the *New York Mirror* and if you notice—it's the kind of headline that I remember from the Second World War—*Germans Approach Moscow*.

**KD:** And it's a third of the page.

**DS:** And it says *Probe American Stock Exchange* and then the next line is *SEC Acts after Re Scandal*; you can see the Re case by that time had really passed into the public consciousness.

**KD:** So they put together a team to look into AMEX in general, do an investigation?

**DS:** Yes, of the whole exchange. It rapidly became very clear, as we had suspected, that the Re case was only the tip of an iceberg. I think as important as the AMEX investigation was and the Re case was in terms of integrity of the markets it also revealed that the Commission for a long time had been asleep at the switch with respect to its regulatory functions under the Exchange Act and its responsibilities for supervising the stock exchanges. I said to you earlier today that it's easy to understand how it happened back then because in my view it's really happened again at the SEC over the past several decades.

The Commission is really almost bifurcated in its responsibilities; on the one hand the Securities Act of 1933 is premised on full disclosure. It's a disclosure statute. The Exchange Act on the other hand is a regulatory statute that I think there is a much greater positive public consensus about regulation which is really aimed at transparency and disclosure—notwithstanding that George Stigler the economist and Henry Manne the law professor—harbor their extreme views that the free market whether transparent or not should dominate everything; that no regulation is the best regulation. I think that those views are really of outliers on this issue, but there is a general consensus across the spectrum that as a goal, transparency and full disclosure is a good thing.

Then one can argue—as we see with *Sarbanes-Oxley*—about the details of how one goes about ensuring transparency and disclosure, but there's no argument about the goal. On the other hand, when you get to regulatory decision-making and you're faced with a lot of issues which you arrive at the conclusion on sort of a 51/49 analysis and then try to write a regulation that splits the baby that way it's very difficult. And so you may end up with a kind of black and white resolution of a problem which is somewhat more complex than a black or white issue. And also it arouses much greater passion along the political spectrum; the consensus starts to disappear when you start regulating and you run into the free market philosophy which has really triumphed I think in the last several decades—so that the attempt to use the regulatory powers of the independent agencies are bound to arouse much more opposition and a lot more flack than disclosure and transparency.

**KD:** Right; so you need something big to happen in order to regulate to a greater extent than you had before? Something like AMEX or the corporate scandals recently?

**DS:** Yes, that's about it—and that once the Second World War intervened between the scandals of Wall Street in 1929 and 1960 memories had somewhat faded. I might say not wholly

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faded when I was at the SEC in 1960. You've got to remember that in 1960 we were a lot closer to 1929 than we are today to 1960 and the people who were 20 years old in 1929 were just about 50 in 1959—1960 and so that there were a lot of memories of the trials and tribulations of Wall Street, how the shenanigans of Wall Street really fit into the Great Depression, the economists can debate that endlessly, but nevertheless there was a general perception that the misbehavior of financial institutions had an awful lot to do with what happened in the country.

**KD:** Can you talk a little bit about your role in the AMEX investigation—what your job was?

**DS:** Well we had a number of investigative leads arising directly out of the Re case, so a lot of it was just pulling the strings as it were and seeing what came out. Also, I don't want to paint a picture totally black; there were people on the American Stock Exchange who were very disturbed about the misconduct of the Exchange officials and the floor members of the AMEX. But the AMEX—and to a certain extent the New York Stock Exchange, the fact that it was called the American Stock Exchange or called the New York Stock Exchange concealed the fact that there was really a whole bunch of different markets on the Exchange—that the specialists who might act as specialists in 40 or 50 or 60 stocks, each ran their own operation and their market-making activities—to some extent in disregard of what the overall rules might be of the Exchange and really looked upon the Exchange as being a landlord rather than someone who had any supervisory jurisdiction over them.

So what we did was simply on one level was to replicate the Re and Re case by investigating the activities of the largest specialist organization on the Exchange, a company called Gilligan and Will & Company. I also mentioned to you earlier today before we started that in a sense the activities of Gilligan and Will were already known to the Commission because in the late '50s, the specialist group had been involved in the distribution of securities on behalf of certain insiders of one of the companies in which they specialized which excited a lot of attention at the Commission under the Securities Act as to whether the securities had to be registered or not and there was a good deal of argument and back and forth and finally the Commission decided that the distribution was in violation of the Securities Act and essentially slapped them on the wrist and told them to go and sin no more.

**KD:** But that being an example of going after somebody under the '33 Act rather than the '34?

**DS:** And not seeing that the major wrongdoing that these fellows were engaged in was market manipulation and corruption of the marketplace itself and that the '33 Act violation on their part were purely secondary, so that what we did—and I was involved in this with Ralph directly, and the Lead Investigator of the Commission, Eddie Jaegerman, a man by the name of Tim Callahan and Ira Pierce who had done a lot of the investigatory work in the Re case and who had a nose for wrongdoing; he could almost smell it.

We just started with all the companies that Gilligan was a specialist for which looked like they were shaky, not well-known, which looked like promotions—started looking to them and found a pattern—that the one case that the Commission had uncovered about distribution of securities on behalf of insiders without registering those securities under the '33 Act was an established pattern; it was a service that Gilligan and Will provided for corporate insiders. So we took lots and lots of testimony of these corporate insiders who pretty much told it like it was. We took the testimony, usually the New York office of the SEC, and it was wonderful. We would schedule some witnesses, very often two witnesses almost back-to-back not involved in the same company; it might involve a different company and yet we observed they would meet each other in the anteroom and it would be like old home week with some of these guys telling each other their war stories and all the rest of it.

And it turned out, again just anecdotally, that a lot of these deals that were made were made at the Oak Room at the Plaza Hotel. That seemed to be the favorite watering hole of the sort of people balancing themselves on the razor's edge in New York finance.

And we then turned to the more serious business of what was going on at the administration of the exchange and here it turned out that there was involvement one way or another at the highest level of the exchange and it also turned out that the President of the Exchange had a number of gambling debts paid for him by a well-known convicted securities felon.

**KD:** That led to a reorganization about then?

**DS:** That led to reorganization; I think the way Ralph handled it—here we had developed this record and what do you do with it, you know throw the rascals off the Exchange, you can put the really bad guys in jail but that left you with a problem. What Ralph did was set up a series of meetings in which he called some of the principals of the largest Wall Street firms

down to Washington for some heart to heart talks about what was coming and this led to the appointment on Wall Street of a Committee under Gus Levy, then I think Senior Partner of Goldman Sachs, to do a study of problems on the American Stock Exchange and that committee pretty much cleaned house at the exchange and brought in Ted Etherington who had been a partner at Pershing & Company as the new Chairman/President of the Exchange.

And he was a very bright and vigorous man whose career never saw its full fruition because he developed some heart difficulties and really had to retire after several years from active life—became President of Wesleyan College in Connecticut for a while and passed away about 10 years later. But in any event he was in prime condition when he became head of the AMEX and pretty much cleaned house from top to bottom.

**KD:** The AMEX investigation, would you say that it really was a pre-condition for the Special Study?

**DS:** Yes, because the AMEX investigation got started there were a lot of inquiries from the press and from the Hill as to what was going on at the SEC. How could these conditions as set forth in the Re and Re case and what was coming dribbling out about the AMEX because the reporters, the financial press was hot onto it, did it show the need for a broader investigation of Wall Street and perhaps the SEC itself? And two Congressmen in particular, Oren Harris, Chairman of the Interstate and Foreign Commerce Committee, and Peter Mack, Chairman of the Securities Subcommittee, thought it would be just a terrific idea to run a public investigation of Wall Street and the SEC. I think one or both of these gents who had been involved in the investigation of the FCC a year or two before but whose main activities were directed against the quiz shows...

**KD:** Oh yes.

**DS:** ...much to the chagrin of Sam Rayburn who had wanted a dispassionate look of how the alphabet New Deal agencies were functioning and what he got was a sideshow on Charlie Van Doren and the shenanigans of fixing quiz shows.

The Commission and Bill Cary of course was aware of the fact that they might be faced with a Congressional investigation, which would not have been really productive, and in

Washington, in dealing with political issues like this it's almost like quantum mechanics; you press over here and then something happens over there and you don't know what the connection was.

I can't pretend to know how this was diverted from a Congressional circus to the Special Study. I suspect that Bill Cary was making strong representations both up on the Hill and perhaps to the White House; I know what I was doing. I did know someone who worked for Congressman Bolling of Missouri, who at that time was Sam Rayburn's fair-haired boy and it looked like he was going to be Sam Rayburn's successor of Speaker of the House some day and I was able to get to him through the good offices of a classmate and I believe that's how Sam Rayburn was alerted to the fact that he was going to be possibly faced with another circus and he essentially as I understand it told Harris and Mack to get out of it the best way they could, and probably the best way they could was to authorize—because the matters were so technical that they called for a more technical investigation than the Congress could offer; therefore that was the genesis of the Special Study.

**KD:** So it goes to the SEC to do the study itself?

**DS:** Yes; it was very interesting the way it worked out that the study was in the SEC but not of the SEC. Milton Cohen took the job on the understanding that he was free to go wherever he wanted in the investigation and that let the chips fall where they may and that while he would keep the Commission acquainted with the progress of the investigation and acquainted with what the study was going to do that nevertheless he did not need Commission clearance to arrive at any particular conclusions.

**KD:** We were going to hit the Special Study but before that I want to talk about something that came up in my reading which is your meeting with a specialist named David Jackson at AMEX.

**DS:** I mentioned before I think that although there was a tremendous amount of corruption on the American Stock Exchange that I really didn't want to leave the impression that it was all black; it wasn't. And there were some people on the Exchange who were entirely honorable in their business dealings and deeply disturbed about what they had observed on the Exchange and foremost was David Jackson who had actually in earlier years been Chairman of the Exchange.

Jackson was particularly well-known and was the subject of a *New Yorker* article some years earlier when the tabloid radio broadcaster, Walter Winchell, had touted an oil stock called Pantepec. Jackson, a specialist in that stock, the next morning was faced with a huge, huge influx of buy orders which under ordinary circumstances would send the stock through the stratosphere. Jackson believed it to be his responsibility as a specialist and the obligation of the specialist to maintain a fair and orderly market. I think he went short something like 300,000 shares—I may be wrong, but he went short, a huge amount of shares to prevent the market from running away. This of course was an enormous financial risk to himself since if the stock went up he'd have to buy it back and cover. The old Wall Street jingle goes *he that sells what isn't his'n buys it back or goes to prison*.

**KD:** Right.

**DS:** Jackson was well-known for that and he lived up to his reputation the whole time I dealt with him. Unfortunately at the beginning of the AMEX investigation one of the investigators had really got into an unpleasant conversation with Jackson because he couldn't believe there was anybody honest on the American Stock Exchange and really hounded him and we got a call from Senator Javits' office to whom Jackson had complained of his treatment. Ralph got the call and was quite upset with it because we had really formed a view that Jackson was not only an honorable man but looked upon him as an ally in efforts to reform the Exchange. Ralph sent me up to New York and I spent an afternoon with Jackson and I managed to convince him that just as not everybody in the AMEX was bad, not everybody at the SEC was a bad guy.

**KD:** [*Laughs*] Some other things that ruffled feathers.

**DS:** Yes. We were quite, quite friendly thereafter.

**KD:** Well I want to move into the Special Study. You discussed the fact that it got this quasi-independent status. That was one of the ideas.

**DS:** Yes.

**KD:** And Milton Cohen, was he brought in from the outside to do that?

**DS:** Yes; Milton had been much earlier in his career Director of the Public Utility Division, the Division of Corporate Regulation when that had its moment in the sun. Now of course the statute has been repealed this last year [*Laughs*] I guess but the rationalizing of the Public Utility Holding Companies was considered a major operation of the SEC and I think Milton was the second Director of that Division.

I think that's where he first met Bill Cary; that's obviously in Milton's transcript of his oral history but in any event he was Bill Cary's choice as Director and he then selected staff. Ralph became an Associate Director of the Special Study. Milton divided the staff functionally. While there was a General Counsel, Dick Paul, right below that there were a series of Project Chiefs. I think there were seven or eight of us and we had various projects. The Study was divided into a series of projects. Mine were basically the New York Stock Exchange trading operations; the floor activities on the New York Stock Exchange and Commission rates fell under that.

**KD:** Were these assigned to you or was it the sort of thing where you sort of divvied things up depending on what your interest was?

**DS:** Well no. Milton made the assignments. Of the people that came from the Commission staff, Ralph knew what their interests and what their strong points were, and Milton pretty much just ratified it. We then each had some people working for us and some technical specialists working in common for opinion, economic or statistical assistance, etcetera.

**KD:** On-call as needed?

**DS:** Yes. And in my area I divided the Exchange operations into specialists odd-lot dealing, floor traders, Commission rates; those were the major sub-groups that I was responsible for. I ended up pretty much writing the specialist section and parts of the floor trading section, just a little bit of the odd-lot section and some but not much of the Commission rate section but they were all under my immediate supervision. And that's how we went about our duties.

At first I also had financial PR under my supervision because we had found in the AMEX investigation the first use of PR that we knew about to manipulate stock prices—put it that

way, there was a stock operator and businessman in New York who was also a quintessential New York character named Jerry Finkelstein and he had been a partner of Tex McCrary who was a publicist and engaged in some financial PR operations. Finkelstein later controlled four or five AMEX companies and which were then “clients” of Gilligan and Will and we became interested in what with us was new at how public relations were being used as part of the scheme to manipulate the prices of these stocks.

The leading columnist in finance in New York was a columnist on the *Journal American*, the old Hearst newspaper of New York, Bennie Gould, no relationship to Milton Gould the lawyer, and he wrote a financial column for years and years and years which was very Wall Street oriented. My classmate on the staff, Norm Poser, and I, during the course of the AMEX investigation, went to the morgue of the *Journal American* and identified ourselves and asked for columns that had to do with specific companies on the American Stock Exchange. The fellow that ran the morgue of the *Journal American* who had obviously been there for many, many years and had a very rich brogue I recall, smiled and said to us, “Oh after old Jerry Finkelstein are you?” [*Laughs*]

**KD:** [*Laughs*] It wasn't a big secret I guess.

**DS:** [*Laughs*] Not when he had the names of the companies; he knew just what we were up to. In any event, since I had more on my plate than I could handle that was broken off and Norm ran that project.

**KD:** So your job was essentially to keep these four different investigations?

**DS:** Yes; I headed up these four investigations.

**KD:** Okay.

**DS:** Probably under other circumstances the odd-lot investigation would have gotten much more [*Laughs*] publicity both on what was uncovered and what happened as a result of this Special Study investigation. Without going into any details, the odd-lot system can only be described as bizarre. There were two firms, Carlisle and Jacqueline and De Coppet and Doremus who essentially split the odd-lot business between them.

And just to take a minute—it becomes important for other reasons; the way it worked was if you bought an odd-lot of stock it did not get subjected to the normal Exchange market-making process; it didn't go through the Specialist Post where you know there'd be a broker at the buy and a broker to sell. The order went to one of these two firms and they had what they called associate brokers who were members of the Exchange who stood at the Specialist Post and when AT&T sold at \$40 or whatever price they would have all these odd-lot orders and they would execute the odd-lot orders at \$40 plus or minus and the plus or minus would be I think; \$40 is a bad number—let's say the stock sold at \$41; if you were selling an odd-lot, you were selling your 50 shares of American Telephone, what you would get would be \$40—\$39.75; they would charge you \$.25. If you were buying an odd-lot you would pay \$41.75 or \$41.50—because \$40 was the breakpoint because over \$40 the charge was a half I believe and under \$40 the charge was a quarter. I may be wrong but it's in the report.

And of course with the flow of odd-lots being on both the sell and buy sides, the firms really did not have to take any large positions because they were essentially matching the buy and sell order that they had. Now theoretically these two firms were in competition with each other, but yet it was a very structured and very mannered competition that the major brokerage firms would switch from one to the other on pre-arranged times and when Merrill Lynch switched one to the other, six firms had to switch the other way to keep the business relatively even.

By the way, the odd-lot customer not only paid this odd-lot differential but you paid a normal stock exchange commission to the broker to whom you were giving your order. We found that in fact what was going on was the odd lot differential being charged was arrived at in an agreement between the two firms; the activity was totally collusive between them and that as far as the reasonableness of the charges, what was going on is that these firms were financing all kinds of other services for Exchange members. If you wanted to open a branch office in Oshkosh you would go to one of these firms and they would provide the architect, the architectural plans, construction management, etcetera; they were busy providing all kinds of services to these other Stock Exchange firms, financed by small odd lot investors.

As we got further and further into the activity it became more and more sort of *Alice and Wonderland*; anyone with their head screwed on right knew that the function being

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performed by these giant firms was essentially mechanical. And the risks being taken by these firms were minimal; as a matter of fact they pretty much would end each day with a zero position in every stock, because they would buy or sell enough at the very end of the day just to be able to go home and sleep in a neutral position.

We got wind very early and when I say got wind, let me again diverge for a couple of seconds and make another point. A lot of what we did in the Special Study was a result of creating relationships with many people on Wall Street. And I think over the years that's what the Commission on the regulatory side has failed to do; you can't do it all based on Reports that are being filed with the Commission. (A) you lose a feel for what's going on and (b) you really lose tremendous opportunity to get ahead of the curve because there are people on the Street who can see developing problems or changes which the Commission should be aware of. And I think that one of the legacies we tried to leave was to kind of institutionalize that among our successors but it atrophied. Why I don't know; but it was a tremendous tool for us in the Special Study—it was just a web of connections which we made on the street.

**KD:** How hard was it?

**DS:** David Jackson was one of them for example.

**KD:** How hard would it have been to make these connections because after all there's something of a wall or a no-man's land between the SEC and the industry.

**DS:** Well not really as hard as you think because after all a lot of what you're doing is not controversial. I mean if there's no problem there's nothing at all that inhibits you from just talking about what's going on the Street. People like to talk about their businesses.

**KD:** Right.

**DS:** And so the contacts can be conducted on a highly informal basis. Again you have to obviously know when you're wandering into an area that may involve some conflicts of interest or you don't want to mislead the fellow you're talking to that he may be in trouble, so you don't pursue that kind of thing. But everybody on Wall Street knows everybody else's business; as a matter of fact I mentioned the architectural services that the firms

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provided. In one of my Q&As with one of the elder statesmen on Wall Street, I asked him if he thought it was appropriate for the odd-lot firms to be financing these activities essentially on the backs of odd-lot customers. And he looked at me and said, “I’ve been on Wall Street for 50 years and one thing I know is that you never know who the hell is paying for what.” *[Laughs]*

**KD:** *[Laughs]* Well the odd-lots investigation, interesting as it is with clear collusion, I guess as far as proportion of business that still is something on the side.

**DS:** Well yes. It is off to the side a little bit but they controlled 10 percent of the seats on the Stock Exchanges.

**KD:** That’s a pretty respectable number.

**DS:** And just to complete it what we found was in the files of the firm’s documents which show that in 1957 the Exchange had retained the consulting firm of Ebasco and Company to study the floor operations of the Exchange from a space point of view. They were running out of space; the first thing Ebasco recommended was do you really need all these odd-lot fellows standing around on the floor of the Exchange? Why not get rid of them and put in an adding machine? You didn’t even need a computer; a lot of this could have been done with the adding machines of the day. Well the campaign that the odd-lot firms ran against the Ebasco Report was very, very illuminating, and it’s all in the Special Study Report for example—let’s spread a rumor that if the Ebasco Report is adopted there will be 100 seats dumped on the Exchange.

**KD:** The value of yours will go down...

**DS:** Exactly; anyway but the conclusion of it was that at the end of the Study it was clear that the odd-lot business was going to be eliminated in the way it was done. I think it was one of the few times that the Commission had ever actually terminated an activity on Wall Street that was a significant part of business of the Street.

**KD:** Did you recommend that odd-lots be terminated?

**DS:** Pretty much. I don't remember what the exact language was but it was pretty clear; by setting out essentially the Ebasco Report, there was really nothing left to say. We met with the Anti-Trust Division on the Justice Department when the Study was completed; they wanted to go over all of our recommendations to see if there were any anti-trust implications that they should be concerned about and when we came to the odd-lot dealers one of them simply said, "well, who is going to take care of that—you or us?" And in the meeting, we just went onto something else. It was absolutely clear that was going to come to an end.

**KD:** Well speaking of getting rid of things, is it correct that you recommended that floor trading be...?

**DS:** That's a much more complicated matter. The traditional view at the Commission among the staff going all the way back is that the floor trading served no useful purpose; it was really a kind of insider trading situation because of time and place geography. Floor traders could see trends of the market in particular stocks that the public wasn't privy to and make a quick quarter etcetera—when they made an eighth, it was a zero sum gain—what they made some member of the public wasn't making.

As a matter of fact, as I said earlier, the Special Study was a wonderful time for frustrated academics. We had subpoena power and had time to read and reflect etcetera and I found out that the pejorative use of the word "chisel"—"chiseling" came from the Exchange activities -- floor traders who could chisel between the bid and the offer and make some money by coming between—the bid is \$40 and the offer is \$41; they come in at \$40 and an eighth and dump at \$40 and seven-eighths so they were called chiselers and that's how the pejorative use of the word of chiseling came about.

We found that, aside from this sort of species of insider trading that one might say, the problems broke down into two discernable groups of floor traders. Any member of the Exchange if he wasn't otherwise occupied could wander over to a post, see where the action was and as I said, get in between the bid and the offer. One of the specialists we had on the record, described them at the basketball players because he always seemed to be able to reach in [*Laughs*] and get between everybody else.

There were others who dealt in large blocks of securities; they were not specialists but they bought large blocks and it was recognizing the growing institutional business on the

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Exchange which was one of the big contributions of the Special Study. The first Study of the institutionalization of the markets took place within the Special Study. And the argument was that these fellows who dealt in blocks served a useful public purpose. In any event we, the staff, were not persuaded by that argument.

**KD:** Did you try to test it and see if made sense?

**DS:** It was difficult. There wasn't enough of it to be able to use the same kind of testing that we did with specialist position taking because the block traders weren't doing this on a consistent basis. When they'd take a position and then some institutional buyer would want to come along—they would sell and of course -- the trick to making money as usual is buying low and selling high. I mean that's it, so they could do well while doing good; that's what the argument was.

I think that the recommendation of the Study was not a clear-cut recommendation; it did talk in terms of abolition of and it also talked in terms of removing the excesses of floor trading. I haven't looked at it in a number of years. However, it became clear to me that there was not a majority on the Commission who was willing to take the plunge and abolish floor trading and it proved to be the issue that the Exchange decided to dig in their heels and fight. How and why I don't know, but it was the issue that they decided to do or die. And we were prepared—now I'm going to the implementation phase of the Study after the Study was completed. We discovered that consultants that the Exchange had retained, Cresap McCormick and Paget, ostensibly to do an independent study, but that the Exchange management was trying to dictate the results of that independent Study. A man by the name of Jim Dowd, who was a professional working on that Study, was deeply disturbed, came to the SEC and told us about it, and I think resigned from the firm.

**KD:** Before we head completely into the implementation phase there's one more subject that you dealt with that becomes very important, which is commission rates. Was there any thought to unfixing commission rates at this point?

**DS:** No; at the beginning of the Study—and this has to do with what I mentioned a moment ago—the institutionalization of the market -- it was as clear as crystal from the very beginning that the commission rate which was applied on a round lot basis, so if you bought 10 round lots your commission was 10 times as high, if you bought one round lot, if you

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bought 1,000 round lots your commission was 1,000 times—that was a wildly unfair structure when you dealt with institutions. So we started with the view of examining that problem and probably coming to a solution which would call for a steep volume discount.

**KD:** Okay.

**DS:** This is what first got me into the mutual fund area because as we investigated how the commission rates worked it struck me as very strange that institutions and particularly mutual funds, although a small segment of the institutional market in terms of assets at that time nevertheless, a much more important segment because it traded a lot more than bank trusts traded who usually lived on a buy and hold forever strategy when they bought equities at all. It struck me as very strange that the mutual funds that the files did not show any activity by mutual fund companies about the lack of some form of volume discount.

It struck me as very, very strange and odd that the files of the Exchange, the press, the periodicals contained absolutely nothing from mutual funds pointing to the fact that the commission rates that they were paying were wildly excessive. And so we looked into what was sort of an interesting byway and we discovered the entire “give-up” situation which takes a little explaining. While the Exchange commission rate schedule had an anti-rebate rule, a broker could not rebate any portion of your commission—it was the death-penalty to rebate commissions to customers. However, it was considered perfectly appropriate for a customer to direct and with the agreement of their broker for a customer to direct the broker, the Exchange member broker to split a commission with another Exchange member.

Now allegedly historically this got started when—as they used to call brokers in the old days—your customers’ man would go on a vacation to Europe and you had to give your personal order to a colleague of his. (Or, conversely, if you, the customer, were traveling and you could not contact your regular broker.) As a courtesy you would direct a split of the commission to your broker who was on vacation because of the wonderful service that he had provided to you over the years. That was supposedly the genesis of give-ups.

What it was being used for in 1960 by large segments of the mutual funds industry was to supplement sales compensation for the sale of mutual fund shares by member firms who did not execute portfolio orders of the mutual fund. Now the traders for the mutual fund knew who they wanted to execute orders; they would go to people with particular skill and

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ability that they liked, but it could well be that that firm really didn't have retail capacity and weren't selling mutual fund shares to the public. Some other firms were and so you would direct the executing firm to split the commission with the people who were selling the shares of your mutual fund to the public as extra compensation.

This answered the question to us why the fund industry wasn't pressuring the Exchange to reduce the commission because they were using portions of the commission to supplement the sales charges being charged for mutual funds.

**KD:** So this came up in the Special Study?

**DS:** Oh yes.

**KD:** That's amazing.

**DS:** Then in an epiphany—I think one of these things that several of us had at the same time—I realized that we could get a handle on the amount of excess over the true cost of execution, by how much the executing firms would be willing to give up to other firms at the direction of the customer. So in other words, we found that within the umbrella of the minimum commission rate schedule there was a lively free market operating and that the mutual funds were pushing the executing brokers to give up large portions to the people selling their shares.

And so that in studying commission rates, which we thought had actually had to be left to another day in the sense that the Special Study didn't have the time or the resources to do a cost analysis of expenses and profitability of member firms, it struck us that we had stumbled on a tremendous shortcut or substitute to a cost analysis because we could now demonstrate what the free market would charge for pure execution of mutual fund orders and that this would outflank all of the years of argumentation that you would get into with the Exchange and with the cost studies which would be done by them and costs studies done by consultants and third parties. Commission rates would become a fertile ground for employment by economists and accountants for a decade, but by measuring "give ups" here, we had an actual demonstration of what the approximate costs of execution actually were.

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Now let me switch to the implementation phase for a moment on this. We continued to study the operation of the commission rate schedule as part of the implementation and followed—followed the money as it was [*Laughs*] and discovered along the way that practices on the regional exchanges differed somewhat from the New York Stock Exchange.

Now one of the problems that the fund industry seemed to have with the give-up system is that while the New York Stock Exchange was quite happy with the situation where commission dollars could be split, as long as they stayed within the New York Stock Exchange community, this left the fund industry with no ability to give extra rewards to non-members of the New York Stock Exchange, so-called NASD-only brokers and at that time the small brokers, non-members of the New York Stock Exchange, were actually the backbone of mutual fund shared distribution.

And so the managers of the mutual funds were quite unhappy that the New York Stock Exchange prohibited a split of commissions with non-members. Well it's part of the genius of American entrepreneurship that somebody else thought of a way of doing this but at the same time it ended up bringing down the temple in the process. And that was the Detroit Stock Exchange.

Nobody would really dream that you could get institutional sized executions of orders on the Detroit Stock Exchange. So if you wanted to for whatever reason got an order executed on the Detroit Stock Exchange or any other regional exchange—I'm talking about a large institutional order—the execution had to be put together in New York essentially on the New York Stock Exchange, so now you had Fund X selling to Institution B 20,000 shares of IBM and in fact they negotiated a price and that price could be a purely negotiated price or a price off the exchange ticker for IBM depending on the negotiation—an eighth of a point one way or a quarter of a point the other way. Then you could call the member that put together the trade on the New York Stock Exchange, who was likely to be a dual member not only of the New York Stock Exchange but most of all of the regional exchanges.

So that member could call his floor member on the Detroit Stock Exchange and say I have 50,000 shares for execution at X and X price, executed at the next New York Stock Exchange print a quarter off one way or the other and bang there's an exchange trade—now the execution of that order has taken place on the Detroit Stock Exchange. Now the killer

was that the Detroit Stock Exchange, which wanted to be very helpful and naturally attract business to the Exchange, adopted a rule that you could split your commission; 60 percent had to stay within the umbrella of the Detroit Stock Exchange membership; 40 percent could be given to any NASD member around the country.

And that's what ultimately brought the temple down because this meant that if you could direct a give-up to a non-member broker of an Exchange every mutual fund organization has an underwriter, part of the same corporate family as the fund's investment advisor in 99.9 percent of the cases, who is a member of the NASD; you could then direct to give-up back to the fund's underwriter and therefore offset part of your advisory fee that you're charging fund investors against the receipt of the give-up off the Detroit Stock Exchange.

This then led to the famous or infamous depending upon which side you were on—the case *Moses against Burgin*, the suit against Fidelity which held that Fidelity had violated its fiduciary duty by not seeking to recapture brokerage on behalf of its fund shareholders or rather using it to promote sales. So when I say it was the Detroit Stock Exchange that brought the temple down that's what I meant because now it broke the alignment between the fund industry and the brokerage community in New York and it was no longer a system in which everybody profited except the customers [*Laughs*] —the fund shareholders.

**KD:** About when would this have been?

**DS:** Well I can give it to you exactly; probably the most important single document I've ever written in my career was a one-page document—this is during the implementation phase when I was asked by the SEC Division of Corporation Regulation for my views on a pending registration statement they had from a mutual fund organization which said that it was impossible for them to recapture brokerage on behalf of fund shareholders and I sent back a one-page memorandum saying it was possible and the registration statement as drafted was inaccurate. And as I said that broke the alignment between the fund industry and the Exchange and it was sort of all downhill for fixed rates after that. Gene Rotberg and Walter Werner picked up the investigation which went on and really made public essentially all of the stuff we are now talking about.

**KD:** That's the investigation that was finished up in '66?

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**DS:** Yes and led to May Day abolition of fixed commissions or whatever.

**KD:** We were talking a little bit about commission rates and how you got interested in mutual funds. But I also wanted to talk a little bit about process in addition to the content here. It seems like this was a pretty complicated study, a lot of people authoring different pieces and then all coming together. How did this process work? Were you just set loose to do your thing and check back with me in six months or did you talk all the time?

**DS:** Yes; constant informal contact and very, very structured formal contact—Milton Cohen set down some ground rules at the very beginning that from the time you started the study you should be thinking about writing the report—that it wasn't going to be anything that was going to be left to the last couple of months to put something together. So the process of outlines and refined outlines went from almost a second or third week of the study. Second, there were weekly meetings of all the project heads—Wednesday mornings I think it was, lasting for several hours where you would present where you were, what you were doing and had a chance to interact with each other as well as with Milton and Ralph.

Then Milton at least once a week would have dinner with Ralph and Dick Paul, the Chief Counsel and occasionally I was invited to those dinners where again he would badger us to think in terms of completing the study and where we were going. I've never met anybody who could work harder than Milton Cohen. He read every word in that report and he was keen not only on the intellectual integrity of the report but also very, very conscious—and this must be some experience in his own background—that reports could become disproportionate in that depending upon the circumstances, some people were prolific and aggressive, could write 200 pages on how many angels could dance on the head of a pin while some other very important matter in the report might get eight or nine pages, and so he was very, very keen on that the report had to remain proportionate and aside from giving his intellectual reactions to the work we were doing he had a major part of his concern was that the report would again as I put it—proportionate.

And then he brought in near the end—the last couple months a fellow by the name of Roy Schotland essentially as an editor of the report. Part of Roy's warrant I think was also to read as he was reading for style the whole report—he's a law professor now—was to see if there was anything just contradictory or not. And quite the opposite also. If there was

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anything complementary that we weren't seeing ourselves that could be cross-referenced or contrasted and compared etcetera.

So but basically it comes down to Milton Cohen himself who, as I said, read every word of that report [*Laughs*] and every word bears his imprint one way or another.

**KD:** Was there ever a sense that he was really influencing what some people would write so that it might become as much this is Milton Cohen's section as so and so's?

**DS:** [*Sighs*] Not really; when it came to the intellectual content of the report Milton operated as one among equals. He expressed his views, we argued with him [*Laughs*], etcetera and we'd go our own merry way. The one issue that I mentioned before on which he had very strong views was that he was against any centralizing tendency of the report—that might lead of the creation of one single national marketplace and the end of competition between marketplaces.

**KD:** Is this when you had the discussion about Keith Funston?

**DS:** Yes. Milton's comment, when I was taking the position then that we should go for centralization, was, "Would you like Keith Funston to bestride the world like a colossus?"

Going back to the organization of the Study, Ralph Saul was no slouch when it came to hard work and speed reading. And so it was a very fortuitous combination of people. I should also mention one person that I left out and that was Sid Robbins who was an economist who was Chief Economist of the Study. Some of the other points—I don't remember whether we went through this before on the record or off; on the Specialist Study that we did the first computer analysis of specialist trading activities on a trade by trade basis which had not been possible in the 1930s. The last time the Commission had looked at this was in 1936. Ray Vernon, a distinguished economist then who went onto even greater things, wrote a little book called the *Regulation of Stock Exchange Specialists* based on the work he had done at the SEC but he could only look at the daily totals of specialists' trading activities—in other words that they ended the day with more or less shares than they started the day with, as against the price movement of the security during the day.

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He recognized that was not the best way of going about it because prices will tend to go—even of a single security—on an ordinary day will both go up and go down, so depending upon when the specialists bought and sold the securities at various times in the day you could determine where the specialist was acting to maintain a fair and orderly market as the expression goes or whether he was engaged in speculative trading of his own.

**KD:** But you were able to do that?

**DS:** We were able to do that; we looked into it. A younger man on the staff by the name of Bernard Israel was delegated that job and he came back and said the Weather Bureau had some big computers and they were willing to do the study that he had spec-ed out for \$18,000. Milton took it to Bill Cary, because the Study's budget was fully committed, and Bill Cary came up with the \$18,000 out of the Commission's budget.

The Study was an interesting study; it was inconclusive in the sense that it showed that some specialists were doing what they were supposed to do and some weren't. The trading of the specialists doing their job was essentially against the trend of the market and thus one can say performed a stabilizing function while other specialists didn't seem to have trading which performed any stabilizing function and would call into question as to whether those trades were necessary to maintain a fair and orderly market.

Basically just one further comment on the specialist system. If you break it all down you'll find that many stocks on the New York Stock Exchange and even to an extent today really don't have that many trades during the course of the day. The crowd that the New York Stock Exchange likes to talk about—the crowd of brokers and this continuous auction market some bidding \$40, others offering at \$41, and finally striking a deal. The specialist may intervene at \$40.50; that is the ideal and like a lot of ideals somewhat mythical. With many stocks on the Exchange, an order would come in at 10:05 and the next order on the other side wouldn't turn up until 10:06; no broker waits around for a minute to trade 200-shares, so essentially he's going to trade with the specialist.

Either he trades with the specialist book - the limit price orders from the public – or the specialist for his own account; this function of the specialist is really to act like an arbitrageur, an arbitrageur through time, not geographical arbitrage between markets, but he links buyers and sellers who show up at different times, and if you do the arithmetic that's

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in the Special Study you will find that for most stocks I'm really understating the absence of "a crowd." And so the specialist essentially—the specialist doing the best job -- simulates what the market would be like if there was a whole bunch of willing sellers and willing buyers standing around and haggling with each other.

**KD:** Why is that an important function?

**DS:** The question is, what is the alternative? Before the continuous auction market, and we go into this in the introduction of the Exchange markets, there was a call system on the Exchanges and the Clerk or Secretary, or whatever they called him, of the Exchange would call a stock's name and brokers who then were holding buy and sell orders would engage in an auction process right then and all the orders would be executed at that point in time, and go through the whole roll of Exchange stocks. They might do this; I'm not sure—once, twice, three times a day.

So under the call system a stock might trade only three or four or five times a day. The advantage of that system is that it marshaled buying interest and selling interest through time to be executed at a single point in time, but once you went to a continuous auction system then you couldn't let orders fall on the floor; that isn't what you were representing to the public as a continuous auction market. There had to be some mechanism by which you didn't have to wait for an hour for your order to be executed. Now today I see the institutions which today seem to be synonymous with hedge funds think it's a tragedy if they have to wait two milliseconds to get an order executed.

**KD:** [*Laughs*] Right.

**DS:** I wonder what difference does it make to the world if security transactions take place four times a day rather than every two milliseconds, but of course you see what became clear, as we studied the trading processes, is that the tape was the greatest advertising gimmick that was really ever invented in the financial markets because the movement of the tape itself stimulated interest—people sitting around the brokers' offices trading stimulated volume. We found one very interesting thing when the tape was invented; the Governors of the Philadelphia Stock Exchange thought it was wonderful that brokers in their offices in Philadelphia would have access to what was going on at the Exchange and they passed a rule that only brokers in Philadelphia could have a tape in their office.

At the same time, the New York Stock Exchange looked at the invention of the tape and immediately subsidized bringing the tape all around the country to brokers' offices and we see what's happened to the Philadelphia Stock Exchange and now we see what's happened to the New York Stock Exchange. [*Laughs*]

**KD:** Well on the Special Study you talked about the process a little bit. How about the overall findings and the reception? You put all this work into it—was it 18 months; is that right?

**DS:** Yes.

**KD:** What was the sense of people on the team when it was ready to be released? Did you know that you had produced this landmark study?

**DS:** Yes, we certainly had a sense that we had put together something which had never been really done before. Perhaps in the latter days of the New Deal when there was something called the Temporary National Economic Commission which did a lot of the studies of the American economy, something like that had been done. But here, as I said before, here were a bunch of would-be academics who had subpoena power and had not much time but some time to look into a lot of questions which in the working day world you would not have had time to look at.

Milton was a hard task-master; I remember working in the office seven consecutive weekends—Saturday and Sunday [*Laughs*] but there was an intellectual stimulation to what we were doing which I think very few of us have felt that had ever been matched in our subsequent careers. There were all kinds of internal disputations that went on continuously; I suppose in one sense my intellectual *bete noir* was Gene Rotberg who was in charge of the over the counter section of the reports. Gene developed a great affection for automation and thought that the securities markets could essentially be replaced by a black box; and that gave rise to NASDAQ. That was another tremendous business change directly attributable to a government agency—the archaic system of pink sheets and telephone calls and blackboards gave way to NASDAQ.

**KD:** One other thing about the Special Study—did you have a sense of the overall theme? Was there an overriding point to it all?

**DS:** I don't want to be too general and certainly cavalier about it but I think what you really ought to take as our mission are the words that appear over and over in the Securities Laws, "the protection of investors and the public interest." And so the question was were the securities markets functioning in that way and was the Commission's oversight, and the whole regulatory apparatus including self-regulation, working the way the Congress that had fashioned these laws would have expected it to be done? You know because so many other things were, on the face of it, disconnected with one another—capital rules, the Exchange members on the face had very little to do with odd-lots.

**KD:** Right; but it's all linked back to the market?

**DS:** It's all linked back to the market.

**KD:** How was it received?

**DS:** Well I'm going through some of the newspapers. The three segments of the report were received with banner headlines in both the regional press and the national press.

**KD:** *SEC's Grave Market Abuses but No Broad Power to Fraud*—is that...?

**DS:** *SEC Study says Stock Exchange is Remiss Regarding Investors*. And there was a general page one orientation to the way the press received the report, and after the press the public. And then of course came the nasty part—trying to implement sections of the report which were more controversial. Bill Cary left the Commission to go back to Columbia; I have no reason to think that his departure had to do with anything other than what he said—he wanted to go back and teach. He had been away from it long enough. He had achieved quite a legacy with the report and some other things that he did.

Manny Cohen got named Chairman by Lyndon Johnson. I think all told, without attributing any ill-will to anyone, the change had a negative influence on the implementation of the recommendations of the report.

**KD:** Cary leaving?

**DS:** Cary leaving and you'll find in this collection of the newspapers that I have and the clips that it was remarked in the press and in some of the periodicals that would the implementation of the Special Study's reforms be inhibited by Cary's departure, no matter who became Chairman thereafter? And just a normal human—you don't want to raise somebody else's baby kind of syndrome and Manny Cohen didn't really regard the Special Study as his baby; it was Bill Cary's and certainly a number of recommendations went forward and most importantly the Commission Rate Study that Gene Rotberg conducted building on what we had started in the Special Study leading to the abolition of the fixed commission was certainly...

**KD:** For mutual funds do you mean?

**DS:** No. I'm talking about the New York Stock Exchange.

**KD:** The New York Stock Exchange.

**DS:** The commission rate schedule was abolished and certainly Manny was not only influential but brought his unique forcefulness to having that come to a successful conclusion. However as to the rest of the Special Study's recommendations I don't think that Manny really strayed far from his 1933 Act disclosure orientation. I don't know if he ever really convinced himself that the regulatory mission of the Commission under the '34 Act was as important. Now it could well be that he saw that the tasks were in the long run perhaps impossible of achievement, that the recommendations were too controversial for the Commission to be able to effectively steer clear of the shoals of opposition with a too vigorous promulgation of rules under the Exchange Act.

And then of course Manny found his own white whale which was the mutual fund industry which we will get to a little later. I think some of us felt that Manny just didn't push as hard as Bill Cary would have pushed. Even though Manny was a Commissioner during the Study, Cary lived the Special Study much more than Manny did, and so there was no total immersion for Manny in the outcome of the Special Study.

**KD:** Would this Study by itself have created enough pressure from the public to do this implementation? We've seen over and over and we've talked about how something big has to happen to create these major regulatory changes?

**DS:** Well one of the problems here is that once you get past the more dramatic recommendations of the Study there are a whole bunch of recommendations that appear technical and are technical and very difficult for anyone outside the game to follow. And therefore there is no sense of public accountability for a lot of those recommendations.

**KD:** And on the other hand there's going to be a lot of pressure against changing and by those who are specifically...?

**DS:** Yes; who have a lot of staying power—they're there.

**KD:** Right.

**DS:** Sooner or later the staff of the Special Study was dispersed to the four winds, so to speak. Milton in some of his last meetings with us when it was becoming fairly clear that implementation was going to be a very rocky road, used to say—don't be too depressed if your pet recommendations aren't adopted; this Study is going to have a haunting quality that will last a long, long time. He really did feel that the intellectual stature of what had been produced was so high that it would have to be for decades coped with one way or another by people entering those areas.

**KD:** It turns out he was right about that.

**DS:** I think he was; I think he was.

**KD:** You covered a lot of ground in this Study and you were just hinting at this thing going on for a long time afterwards. In retrospect, either now or in previous decades, did it become apparent that there was something really big that you all missed that you didn't bother to study that you really should have?

**DS:** [*Sighs*] Yes. There's one thing that really just in recent years that has come home to me—I have not discussed this with any of my former colleagues but one of the things that was probably barely mentioned in the Special Study Report, if at all, which was going on at the same time as the Special Study was a push headed by Merrill Lynch to permit public ownership of Stock Exchange firms. Before that all Stock Exchange firms had to be

partnerships and so capital formation for the purpose of conducting broad-range of Securities activities was very, very difficult to come by. Some firms had sort of quasi-capital in the form of subordinated debt and very cumbersome arrangements. But there was no public ownership of Stock Exchange firms permitted.

Merrill Lynch kept on raising this with the Special Study and I don't remember what's in the Report about it but I can tell you that most of the special students looked upon this as a positive development, in that it was one way of having the necessary winds of change blow through Wall Street was to permit public ownership of firms. The Stock Exchange firms had remained relatively unchanged since before the Crash and as a matter of fact there were huge generation gaps within the membership of the Exchange—people that were held over from before 1929 and people that didn't come in until well after the Second World War.

A lot of people just didn't want to have anything to do with Wall Street; you couldn't get the Exchange firms to automate at all their back-office procedures. (A) They insisted they didn't have the capital and (b) they all knew another bust was going to come someday like 1929 and what are they going to do with all these machines? And again this is the mindset; as I tried to say earlier today, we were a lot closer to 1929 in 1960 than we are today and people's mindset was very different then than it is today.

As a matter of fact, one point just to stray again into another area: I've always felt legal historians love to look at trends in the law and the way cases come out; I don't think they spend nearly enough time on what you might call anthropological or sociological research—the judges that were deciding the cases that arose under the Securities Law in the '60s—had all lived through the Depression. They might not have agreed with the analysis of why and how the Depression was caused and what the role of Wall Street was but it was part of their life experience and of their perception of the world. I think that the SEC and the SEC's interpretation of the securities laws received much more friendly treatment from that generation of judges as against a later generation of judges who are now imbued with the free market philosophy which is in the ascendancy.

In any event, to get back to my main point—we on the staff of the Special Study were highly sympathetic to the idea of public ownership of Stock Exchange firms and indeed, the Commission finally gave the green light a couple of years after the Study finished.

What we didn't see is the diversity of businesses within the securities industry broadly defined that Stock Exchange member firms would go into. That laid the foundation for all kinds of conflicts of interest which the Commission was ill-equipped to deal with and I think this still haunts us today that we never fully have come to grips with the relationship between the investment banking scandals and doing a public business on the stock brokerage side. I think one small example of that—I was looking over a speech that I made a couple of years ago on this whole late trading in mutual fund shares where the existing rule—Rule 22c-1 under the Investment Company Act essentially said that an order to buy mutual fund shares in the hands of the broker was in the hands of the fund organization and therefore the timestamp at the brokerage firm level determined what day the order had come in on. And that's where all the abuses took place.

Now I, on behalf of the fund industry, negotiated that rule with Sol Freedman and Syd Mendelsohn, the Director and Associate Director of the Division of Corporate Regulation back in 1968 or so and no tougher cops were ever on the beat than Sol and Syd. We all recognized that there would probably be some low-level cheating by some unscrupulous person who would say to this customer—I can get you in today even though it's 5:15; we'll back-stamp this and we'll sneak it through and get you today's closing price. But we thought that a) branch office inspections would uncover and keep a lid on that kind of thing and b) it wouldn't affect the funds very much or at all; the volume of distorting trades would be so small as to not dilute the fund. We never could possibly have foreseen that there'd be hedge funds with the ability to mobilize billions of dollars and many millions of dollars. As I put in my speech, throw those millions against a rather fragile rule never designed to cope with that kind of motivation to evade the law and you can end up with major problems.

**KD:** Right.

**DS:** It was unimaginable that you would have that accumulation of capital and the ability to finance an operation where you were gambling on making two cents a share but if you put a billion dollars against those two cents you made a lot of money at that especially if it's a sure thing, and that's the kind of thing I'm talking about. We never realized the accumulation of capital in the securities industry that would take place and the activities both licit and illicit that might present problems thereafter.

**KD:** In many ways it's the technology that made that possible?

**DS:** True, but also I say the normal workaday conflict of interest of being underwriters of securities and distributors of securities and investment advisors and everything and dealing in commodities became more difficult with the onset of large financial conglomerates.

**KD:** The securitization of everything?

**DS:** And people—one man's synergy is another man's conflict of interest. [*Laughs*]

**KD:** Well something I want to touch on—is it seems like you left the SEC pretty shortly after the Special Study.

**DS:** Yes.

**KD:** Did that have to do with concern about implementation or disappointment?

**DS:** I would have to say was a factor. I was personally attacked by Keith Funston in a call to Manny Cohen and had to defend myself. I'll give you a copy of that memorandum which no one has ever seen before. Now I did and certainly would have survived it had I stayed but it just detracted from the joy of my work so to speak. I was a big boy and I played pretty rough and expected it on the other side.

I mentioned David Jackson before; along the way when we were involved in this floor trading fight, Funston and Walter Frank who was then Chairman of the Exchange made an appointment to go see President Johnson, and David Jackson called me at home to tell me that this happened. And I figured one way of killing that was to let the press know about it and I did and the press duly reported it and they had a wonderful discussion about the weather with the President. And it's memorialized because that was the day that Lyndon Johnson took the two of them out to the lawn of the White House and decided to lift a beagle by the ears and if you look in the near background you'll see Walter Frank and Keith Funston—so you know.

**KD:** [*Laughs*] That's an accomplishment.

**DS:** [*Laughs*] We can play tough.

**KD:** You gave history a great photograph.

**DS:** [*Laughs*]

**KD:** I was interested to notice that you went to work after you left the SEC for a company that represented IOS?

**DS:** Yes for a subsidiary of IOS in the United States.

**KD:** Did you ever get to meet Bernie Cornfeld?

**DS:** Oh yes; yes, indeed. He was rapidly getting into trouble with the Commission staff and I was the only one on the scene including his outside counsel who knew anything about the Exchange Act, so I was called upon to give some advice with respect to that and I met Bernie a couple of times. He was quite a character; of course there was a big difference between Cornfeld and Robert Vesco who came later. Bernie was very adept at clipping the corners off dollars that passed by him while Vesco just stole the whole thing.

**KD:** Including Cornfeld's company right?

**DS:** Yes; the whole thing and ran off with it. What Cornfeld's genius was seeing that there was a market for American mutual funds in Europe and forgetting all the fun and games in his difficulties with the Commission and his own shortcomings and derelictions he showed the first time that there could be sales of mutual funds in Europe by non-bankers. Thirty years later, German bankers would still stand around and have a ritualistic cursing out of Bernie Cornfeld and of course very self-righteous because Bernie turned out to be a crook, but he really scared the pants off the German bankers because before Cornfeld, 100 percent of mutual fund distribution in Germany took place through German banks. All of a sudden, Cornfeld came in and built up a sales force, and I think it was accounting for 10 or 15 percent of distribution—overstating that a little, but certainly built up an independent distribution system of the mutual fund shares before the German banks knew what was happening.

**KD:** This subsidiary you went to work for—had you decided to become involved in the mutual fund industry at this point?

**DS:** Yes; I was pretty well deciding that mutual funds were the future for most investors and Bernie's operation certainly seemed to have its attractions. I did the best I could to check them out; they seemed to be okay. But after one year I decided that it was time to go elsewhere and I then got to the Investment Company Institute. And the reason that they were interested in me and I was interested in the Institute it was clear that there was a shaping up of a drive on the SEC's part for additional regulation of mutual fund shares. The Institute was a rather small organization located in New York City which barely knew the address of the SEC. And so they wanted someone familiar with the SEC and to work in this area.

**KD:** Was this drive stemming from what you discussed before, Rotberg's study of the industry?

**DS:** That provided one rather small aspect because that was really the New York Stock Exchange commission rate problem but it did bring out into the full glare of the noonday sun how mutual fund shares were being distributed etcetera. And what really fueled the SEC's attention to the fund area was a report done by the Wharton School for the Commission in the late '50s.

**KD:** Right.

**DS:** The genesis of that study was that the Investment Company Act of 1940 contained a section authorizing the Commission to do studies related to the size and growth of the mutual fund industry and the genesis of that in [*Laughs*]*—*that provision was a feeling back in 1940 and the '30s that open-end mutual funds could wreck the stock markets if there was ever a run on the funds by investors wanting to redeem their shares. Again this is the feelings about Wall Street that went back and there were, I think, proposals in early drafts of the Investment Company Act that would have limited the size of a mutual fund to \$100 million—instead, a provision authorizing periodic studies based on their growth and size, and I think it was Commissioner Barney Woodside, again sort of encapsulating some of the pre-bust concerns, who was concerned about the growth of mutual funds and pushed for the Wharton School Study in the '50s.

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I think the Wharton School Study was then held in abeyance during the Special Study. There are a couple of chapters in the Special Study on selling practices of so-called contractual plans I think, but no investigation of structure or structural issues with respect to mutual funds and Manny then picked that up after the conclusion of the Special Study and pursued it.

I think there was general disappointment with the Wharton School Report because it was heavily statistical in nature without an adequate exploration of the issues or problems that might underlie the statistics that they were gathering. So what Manny did was get a small group together, namely Dick Phillips and Mike Eisenberg, to mine the Wharton School data and do some further studies and come up with some conclusions and that gave rise to a Study that was published under the title of *Public Policy Implications of Investment Company Growth*.

**KD:** So it's more than a coincidence that that came out in '66 and that's the year that you came to ICI?

**DS:** Right; it was very well known because the ICI was asked to comment on various aspects of these studies that the staff was making.

**KD:** Well that's a good place to wrap up for today.