Securities and Exchange Commission Historical Society
Interview with Lee Pickard
Conducted on April 16, 2009, by Kenneth Durr

KD: Interview with Lee Pickard, April 16th, 2009, in Washington, D.C. by Kenneth Durr. I want to start out from the beginning, more or less, and get a little bit of your background and education, where you went to school and how you got into securities issues.

LP: Okay. Well, if you want to start with where I went to school, I went to Colgate University and graduated from there, and then I went on to Harvard Law School.

KD: Did you get any securities law when you were at Harvard Law School?

LP: I had a course with Louis Loss, who's one of the prime participants in the securities process, but I took a corporation course from him. I would not suggest, however, that that had much to do with my getting involved with securities.

KD: Well, take me to how you did get involved.

LP: Well, the way I got involved in securities is that after law school, of course, I needed a job. So I went to New York City and got a job in a law firm there that dealt in the banking and securities law matters, and I spent about eight years in Wall Street.

KD: Which firm was that?

LP: Well, there were two firms. The first one was Seward & Kissell. And then, after three years there, I moved over to a law firm called Nixon, Mudge, Rose, Guthrie, Alexander, & Mitchell. I worked in the corporate department, and I would be involved in various aspects of the securities profession, underwritings, acquisitions, mutual fund work, finance work. And there, of course, you're immersed in securities and you begin to learn a little bit about it. I say begin because it's a very complicated subject. And after some years there, as you probably might recall as a historian, Nixon was elected president of the United States, and Mitchell became the Attorney General. And I worked with both of these gentlemen, not on a shoulder-to-shoulder level, of course, but I was an associate at the firm.

So I was asked by one of the senior people at Mudge Rose if I was interested in going to work in Washington because the then-new chairman of the SEC, a gentleman by the name of William Casey, was looking for some expertise in his office in the securities field. So I was asked if I wanted to go down, and I went down and saw Bill Casey, interviewed with him. And Bill asked me at the time, you know, about my background, asked me how long I would be able to stay there, and I told him two years. He said "That's fine," because that's all he was planning to stay as well. And, of course, I was there six years, so events have a way of changing. So I came down, and I was Bill Casey's special assistant.

KD: What did he tell you your job was going to be as his special assistant?

LP: He told me, particularly, he needed support in the Investment Company Act area, the 40 Act area. We call it the 40 Act, the Investment Company Act. And I had some knowledge and some expertise in that area, and I said, "Fine, I'd be glad to do what I can." And from the moment I arrived, I never got even near that subject. I spent virtually all my time in the chairman's office dealing with matters relating to broker dealers and financial responsibility. That was the bulk of my work.

KD: Yes. I want to get a sense of why that was. What was happening at this point, about '72 I guess?

LP: Yes, that's right, '71, '72. That's a good question.

KD: What was coming together to create the overwhelming interest in this particular area?

LP: There were a number of events in the financial sector which were driving the SEC to have to draw its attention to this. Among them were these: they had a paperwork crisis which was unfolding, in effect, in the late 60s where the street was just unable to process the transactional activity because of the cumbersome nature in which it was done, because of the precipitous volume increases that were occurring, and the lack of systems to handle the transactional volume in an accurate and organized fashion. And there were examples of firms that had the papers piled up to the ceiling, unable to determine where a particular dividend was to be credited, or where the other side of a transaction was. Errors were prominent.

And as a consequence, the NYSE suspended trading one day a week, I think it was a Wednesday. And on that day, the back office was to do everything they could to try to unclog the system. It was terrible. And not only that, there were a lot of losses that arose as a result of that and other circumstances.

KD: And some firms went under as well.

LP: Approximately 85 to 90 firms failed in the street, a lot of them New York Stock Exchange member firms. And they were just unable to handle it. So the SEC was mandated and required to step in and to try to devise solutions to this problem.

KD: So that was the biggest driver behind the—

LP: Oh, I think so, yes. Another major event that I was involved in—and it's acknowledged in the study itself—is the *Study of Unsafe and Unsound Practices of Broker Dealers,* which was issued, I believe, in '71 or '72. I have a copy of it someplace. It was a heavily-involved study by the staff of the SEC of what was the precipitating causes of this financial debacle, because it was a very serious problem.

KD: Did you work with Market Regulation at all?

LP: Yes. Well, Market Regulation wasn't in existence then.

KD: Trading and markets.

LP: Well, it was Trading and Markets, which was a combination of Market Reg and enforcement. So, of course, I worked very closely and worked with Ezra Weiss and Stan Sporkin and Irv Pollack and others on this study. The study was highly visible and regarded study that came out, and it had a series of recommendations for what should be done to address the problem. So I spent a lot of my time on that study, and the study was well received, and most of the recommendations were eventually implemented by the SEC.

That was one of its great successes because out of that study came a new provision for net capital, a new provision for segregation and handling of customer funds by brokers, a reduction in elimination of a stock certificate as a recordation of ownership and transfer. In other words, the bookkeeping entry was embraced and pursued. Clearing and settlement systems were devised for the settlement of transactions. Transfer agents were regulated for the first time. That was another major part of my effort in the chairman's office and as director—the implementation of the transfer agent regulation. The transfer agent regulation was legislatively invoked. So in the process of doing all this, I kind of had a lot of dealings with the Hill and testimony on the Hill during these topics.

KD: Is this during the years after this period?

LP: I guess this would be supportive of the Commission when I was in the chairman's office and, eventually, actually doing it myself as director, testifying before congress numerous times on this issue of transfer agent regulation. Because transfer agents, heretofore, had never been regulated.

A transfer agent is either an entity or an affiliate of a company which records the ownership interest in the company. Kind of important because you have to keep track of that. And that was an unregulated segment of the financial community. It is now regulated, and they have turnaround rules, they have rules on recordations and things of that kind which are on the books and which work very well. But, again, that's one more segment that came out of this process. It's only one of many, however.

KD: What was the response of the industry, of the New York Stock Exchange in particular, to some of these things?

LP: The New York Stock Exchange tended to be protective of its own jurisdiction and turf, as you would expect. But they knew that something had to be done. And, of course, we had other burning issues. The New York Stock Exchange had other burning issues at the time, among them fixed commissions. That's a major event that occurred under my watch, the unfixing or competitive rates. But the New York Stock Exchange knew that there had to be improvements, and they were helpful in the improvements. The Depository Trust Company was, in part, of their doing.

Depository Trust being the vehicle today which houses most of the ownership, so that if you walk into a Bernie Madoff, and you found that he says he has $25 million of IBM stock, you could confirm whether that stock is in DTC or not, and of course, that wasn't done by the regulators, but it gives you an idea what DTC is all about. In other words, the brokers deposit their ownership interest in positions in DTC, and DTC records them, holds them in bookkeeping fashion.

KD: So this was something that the SEC and the Exchange worked on together.

LP: That's right. Exactly.

KD: The reason I ask is because on a lot of these larger issues that clearly occupied your time later I have a pretty high profile, but some of the things you discuss here don't really show up that much. So the implication is that things went pretty well on this because it sounds like they were directly related to this back office crisis.

LP: Yes. Things went well, but they required a lot of attention, a lot of debate, public debate. The net capital rule, for instance, how it should be structured, what should be the charges for particular positions all were heavily debated.

KD: Where?

LP: Well, within the SEC and within the public because, normally, the process for adopting these rules is to publish them for public comment, and then for the financial community, and for public investors and the SEC to debate the efficacy of these positions and then come to a conclusion. So there was always enormous debate over this.

Just to give you one example of what I'm talking about, because of the financial crisis, a lot of investors lost money. If these firms went under, the New York Stock Exchange had a fund which was supposed to reimburse them. But that fund was soon dissipated, and this is sort of a forerunner to SIPC, which you've heard about. That was another major event during this period, the creation of SIPC which, as we know, insures customer funds and securities against defalcation and solvency up to approximately 500,000.

But one reaction within the SEC—and this is an inside story—there's some principle people in the SEC who advised that brokers should no longer be able to hold, directly, customer cash. Now I don't know whether I should name those people or not. Maybe I won't. I'm on the other side of the equation. But they wanted to take the cash away from the brokers and put it into banks so that brokers would leave that money in banks. Well, that has some serious implications to it. Because, if brokers had to move their money to banks, then, essentially, they would no longer have it available necessarily to lend out to their customers on margin. That is one example.

Without having that, the revenue streams would be cut significantly because you can look at the typical broker dealer. If you cut out his revenues on margin, he's, essentially, under water. So the question was, what could you do to address the issue of safety of customer funds, or the extreme of requiring them to put that money into banks where they would, essentially, lose some control over it. So we came to a compromise. And this is the forerunner of Rule 15c3-3, which is the customer fund and segregation rule, which I was very heavily involved in drafting, not only writing.

It was a task force that the chairman put together, Chairman Casey. The head of the task force was Jim Needham. And with Needham on the task force was myself, some people from the securities industry, I believe either Stan Sporkin or Irv Pollack from the enforcement division, and there may have been one or two others. And we finally came up with the Rule 15c3-3, which is a rule which permits the brokers to hold customer cash, but they have a strict accountability. It can be used for margin and maybe one or two other purposes, but it cannot be used in their trading activities. And that role today is on the books. It's worked very well over the last 25, 30 years, and very little customer cash in the broker-dealer industry has ever been lost.

KD: Was enforcement ever a problem with that?

LP: Yes. Enforcement wanted more strict measures. There would be a tension between Enforcement and Market Regulation. The same thing goes for the net capital rule. The net capital rule, they wanted more strict provisions. My own position on this is different. Well, my own position is, essentially, what the net capital rule is today.

KD: It sounds like there's a lot of tension going on between the idea of enforcing as much as practically possible and sort of letting the market work itself out.

LP: Yes. The enforcement division has as a primary goal, and it should, the protection of investors. And so they would want to make sure that they were comfortable with any provision, and that there was maximum protection. Well, you can give maximum protection to investors, and you should, but that has to be balanced against the regulatory cost and other factors. So that was a point of debate throughout my tenure. There would frequently be a different view by Enforcement.

KD: Where was Chairman Casey on this? Did he set the tone?

LP: I recall one day we were over there discussing, before the congress, this new rule, this new segregation cash rule. And one of the senators got up and said, "Mr. Casey, I'd like you to explain the way a Rule 15c3-3 works and what it does to protect investors." And I'm sitting behind him, of course, and suddenly, this gray-haired guy turns around, looking around the room, and I knew who he was looking at. "Mr. Pickard, would you mind responding to this question?" [Laughter].

Bill was, as you can imagine, and it's true today of these commissioners, they don't want to get into the nitty gritty of some of these financial protection rules because they're extremely complex, and they take an enormous amount of time, and you try to have confidence in the staff that they're doing the right thing at the right time. So I think Bill certainly wasn't resistant to any of this. I don't think he wanted to lock the money up into banks because I think he was getting pressure from the industry not to do that.

And I think we found a compromise that worked for everybody. So that was just a microcosm of one example of the battles that we would constantly have within the division as to the right balance, the right approach to regulation and how far we should go.

KD: Now you're working as an advisor to the chairman at this point. Who was in Market Regulation or Trading and Markets?

LP: Well, the head was Irv Pollack. At that time, I forgot what it's called, Ken, it might've been Trading and Markets, but he headed up both the regulation and the enforcement. And, of course, during my tenure up in his office, Casey reorganized the SEC, split the enforcement division and the regulation into two parts, which I think has some wisdom behind it because there's conflicting provisions on enforcement versus regulation.

I remember once, this is sort of superficial, but we had some provision up there on a rule which we were proposing before the SEC, which started out by saying, "The following practices should be adhered to by broker dealers." And Stan Sporkin got up and says, "I want it to read, 'It shall be unlawful to engage in this type of activity.'" And somebody says, "Well, why do you have to have it read that?" He says, "Because I want to tell the judge when the person hasn't been abiding by this provision that it's unlawful, and it's right in the law." [Laughter]. So there is this constant conflict between the enforcement division and—

KD: It sounds like the conflict was there within the one division when you had Enforcement and the Market Regulation together.

LP: Yes.

KD: Casey had, essentially, separated those out.

LP: Separated the two out, yes. And I think for better. And it's still that way today. Now maybe Chairman Shapiro will look at that again, but I don't think that that is in the cards.

KD: Then Brad Cook came in.

LP: Yes.

KD: Did you continue in an advisory role working directly with him?

LP: Well, what happened is Brad Cook was general counsel under Bill Casey. I think Brad Cook was appointed the first director of the Division of Market Regulation.

KD: That sounds right.

LP: And Bill asked me, the two years was up, and he said, "Can you drive with me to Baltimore?" He was going up there for something, to catch a plane. In the limousine, he wanted to talk to me, and he didn't have time to do it in the office. So I was supposed to ride up in the limousine with him and confer about my future, and then I get shuttled back, you know. My time was not as valuable as his. [Laughter]. And he said, "Lee, I want you to become associate director of Market Regulation in charge of financial responsibility. You've been doing it for two years, and you're right in the middle of this, and we think you're the ideal candidate."

And I said, "Okay," I would do it. And then he left sometime thereafter, and Brad Cook was my boss because Brad was director. And then when Casey left, Cook was appointed chairman of the Securities and Exchange Commission. And I was designated as director.

KD: So you were only associate director for a fairly short period of time.

LP: I would say seven to eight months, maybe a year. I can't remember.

KD: Okay. Some things that happened in this period. You had things like the future structure statement, the white paper on market structure. Tell me a little bit about those projects.

LP: Those projects, Ken, emanate out of the issue of fixed commissions, because there was a sense that the fixed commission structure, fixed rates of commissions which are set on the New York Stock Exchange and, indirectly, approved by the SEC, wasn't working. Institutional investors were finding ways to circumvent the fixed rate structure because it was not economical. Bigger trades just didn't cost that much more to do than small trades. And so economics was prevailing and the market was starting to fragment, at least in the perception of some, because institutions would go to regional exchanges, which could have a better method of trading at a lower cost, ultimately. Rebates were prevalent, give-ups were prevalent. It was a leaky sieve.

It wasn't working right, and economics were prevailing over regulation, which is, you know, regulatory dictating of the fixed rate commissions. So we started doing these studies of the markets and the fragmentation, whether or not fragmentation was detrimental to the markets. And one could argue that it is. I, personally, don't believe fragmentation is a serious issue. Never has; never will be. The SEC has spent an enormous amount of energy on an issue which I don't think amounts to a hill of beans.

KD: Yes. The question would be fragmentation, another way you could talk about that is competition. You've got different markets.

LP: Exactly. Almost in order to eliminate fragmentation, you've got to eliminate competition.

KD: Was the understanding, though, that you would seek to foster this unified market?

LP: That's right, exactly. There was, clearly, not only an understanding, but a mandate under the Securities Act Amendments of 1975 that you foster a situation in which every investor could get the best possible price available, wherever that price might be, whether it's in the third market, the fourth market, on an electronic system, whether it's on the Exchange floor. Highly unrealistic type things for the government to be involved in.

KD: Right. We haven't gotten to the '75 Act amendments.

LP: No, but we're getting there.

KD: I'm just wondering where the guiding hand came during this period, this '72, '73 period. One year, you're issuing these statements. The assumption is that you want to have a non-fragmented market.

LP: That's the assumption. That is the assumption. Whether it's a proper assumption or not, we can debate that.

KD: Was it something the chairman was interested in, in particular? Was there a sense that this was what congress wanted?

LP: I think there were people at the SEC who felt that that was a proper approach, that fragmentation was detrimental to some investors. Where else would it come from? That's a good question. It came from the New York Stock Exchange because it's in their economic interest to make sure that they maintain order flow on the floor. I think that's a primary thrust. And the Stock Exchange was able to convince some people at the Commission that this was a primary goal of our nation to have unified markets.

KD: How much input did they have in your deliberations when you're putting together these papers?

LP: There were hearings that we had, these papers were exposed for public comment. So, obviously, they had tremendous input. And they spent a lot of their energy. You can imagine the amount of energy the New York Stock Exchange spent on this issue. Why wouldn't they. You know, they're specialists on the floor. We had a committee that I was involved in, a central market committee, and we had the SEC's National Advisory Committee on the Implementation of a Central Market System.

KD: National Market Advisory Board, or whatever it is?

LP: It was called the National Advisory Committee on the Implementation of a Central Market System. I was a member of that committee, and so were senior people on the street. By senior people, I'm talking about Felix Rohaytn and people of that type, all of whom had, in my opinion, a vested interest in this process. It was not directly apparent, but they spent their life with people who were in the financial community and who were instrumental in the specialists on the floor and things like that.

So the notion was the SEC, in combination with the industry, was to be the architect of a central market system, where there would be integration of quotations, integration of clearing systems, and that was a goal that was promulgated and eventually evolved from the '75 Act amendments. Was it a useful exercise? I'm of the opinion it was not, but I was overruled in many cases on that.

KD: By the Commission, I guess.

LP: Yes, the Commission, course of events, yes. I was not a regulatory type. Somebody once said to me, "Lee, you're sitting in that chair as director, but you're not a firm believer in regulation." I said, "That's true. All the more reason for me to be here." But, you know, in come areas, I was more vigorous. In the financial area, I wanted a strong financial base, and I did what I could.

KD: Things like the net capital rule.

LP: The net capital rule, the segregation rule, clearing and settlement. We eventually ended up with systems which are extremely efficient in terms of the clearing settlement. We don't have these paperwork debacles that we had before.

KD: Something that popped up is some controversy—you talked about institutional investors. There was a Rule 19b-2, and there was some question as to whether institutional investors could have seats on the Exchange.

LP: Right.

KD: Can you tell me a little bit about where that controversy came from and how it was dealt with?

LP: Sure. These institutions seeking seats on the Exchange would be an indirect way of recapturing some of these fixed commissions. Again, that's an issue relating to fixed commissions. If they had seats on the Exchange, presumably, they could trade for their managed accounts, and they could rebate back some of the commissions because they would have, essentially, captured them. So there was this notion they shouldn't have seats on exchanges, which is kind of crazy, but again, it's to patch up and to hold in place that fixed commission rate. Now 19b-2 was the rule which related to, if you're a member, having to trade on the floor of the Exchange. I'm trying to reconstruct that. It was, I think at one point, referred to as Rule 394. And that rule required that a member of an exchange bring the trades to the floor.

KD: Right. That's the New York Stock Exchange rule.

LP: Yes. Well, 19b-2 eroded that and started to cut away and say you can no longer compel your membership to bring the trades to the floor. There was an exception. There's always an exception they can go to a regional exchange. But they couldn't trade upstairs in their own trading department. And, eventually, the 394 rule was deemed to be anti-competitive. And I think Rule 19b-2 was a rule which decided that to be the case, and that made lots of sense. We've always thought that the New York Stock Exchange should not have a rule which compelled its membership not to be able to trade upstairs if it so chose. So that rule, they were compelled to eliminate this anti-competitive rule.

KD: It took a long time, though.

LP: It took a long time. Well, it's because the New York Stock Exchange put up a serious stiff fight on this issue. They thought it was central to their survival, which it turned out to be not. It's another example of a rule of the NYC which turned out to be unnecessary for their wellbeing. And fixed commissions would be another example of that.

KD: Before we get deeply into some of those things surrounding the '75 Act, one other area I want to touch on is the rise of options trading, and how your office in particular, because you're right there at the point at which this is emerging, and how you responded to that.

LP: Well, the Enforcement Division was always very skeptical about option trading. We looked at it for a number of years, and we slowly but surely phased it in. And we were convinced by the option exchanges that what they were doing had financial safety behind it, and we had no reason to believe that it wasn't permissible.

KD: Why was Enforcement concerned about it?

LP: I think they were worried about the manipulative intent that could occur because of option trading. But I think it was a process that took some time, but we were eventually convinced, or satisfied, I should say, I don't want to use convinced, that the process was not anathema to investors, and was a process which investors wanted desperately for their hedging purposes and for other economic reasons.

KD: Do you remember having discussions with the people in Chicago?

LP: Oh, yes. We had extensive discussions.

KD: AMEX, I guess, was—

LP: Yes, AMEX. What happened, of course, CBOE got in first, and they were very successful, and then other exchanges wanted to rapidly follow. So there was constant pressure on us to approve this as quickly as possible. I remember that being a prominent part of the equation.

KD: What would you say back? If you're going to impose conditions, what were they?

LP: Well, I can't recall exactly what conditions. I mean, we did impose conditions. As I say, it was a phase-in process, and we watched it carefully before we would permit full expansion. But I can't recall. There were conditions about financial safety, things of that type.

KD: In the time you were there, definitely AMEX had started with options. Had the New York Stock Exchange begun?

LP: No. I think that came after. But the other exchanges came in. Philadelphia came in, of course, and others.

KD: And later on, there was a freeze for a while, after your time as well, I think.

LP: Could have been. I don't remember. And then, of course, another major program that was launched in my tenure was the oversight of municipal securities firms.

KD: Talk about that a little bit.

LP: Municipals have largely been exempt, and they are exempt, even as we speak today, from the '33 Act provisions, but it was thought that there should be some regulatory oversight of municipal securities broker dealers. So they were required to register, and they were required to adhere to a series of standards.

And because municipals are not only dealt with by broker dealers, but ultimately banks, the municipal securities rule-making board was put into effect, which is an amalgam of broker dealers and banks, and it sets standards subject to SEC approval. It's like a FINRA, like a self-regulatory organization. And so that whole program was unfolded, and it set standards for municipal transactional activities.

There was markup provisions, there was confirmation provisions, record-keeping provisions, the same type of standards and measures applicable to broker dealers dealing in equities and debt were set forth for broker dealers to deal with municipals, with the public.

KD: I would assume there would be some push back from them on that.

LP: There was some, but it worked out fine. Of course, there would always be push back. That was a kind of a theme among securities firms. And rightly so. They should be. It's like today with the investment advisors, you know, this notion that they should be under FINRA. Well, they're going to push back because regulation is a costly affair.

KD: With the municipal securities, did economics, the problems that cities were facing in the 70s, did that have anything to do with it?

LP: I think it did. Yes, it did. That had something to do with the regulation of that industry.

KD: Because when things get in stress, that's when the problems show up.

LP: Exactly. Stress tends to create more regulation. It never reduces regulation.

KD: Well, let's get into commission rates then.

LP: All right. That was probably one of the biggest events on my watch.

KD: Yes. And under Casey and Brad Cook, there was something that someone dubbed prudent gradualism, i.e., you're going to unfix the rates on transactions above $500,000, things like that. Do you remember that decision being made, or was that ad hoc?

LP: It was systematically made. I think we reduced it, you know. One of the reasons for the gradualism was to see what occurs when you have at least some measure of competition among transactional activity. What are the results? So it wasn't a bad idea.

KD: Did you see what occurred?

LP: Yes. What occurred was a relatively smooth operation, not anything of any significance. Now commission rates eventually came down tremendously, but the profitability of the street wasn't reduced commensurate with the reduction in commission rates. In fact, profitability eventually went to even higher levels. There was a tremendous increase in volume throughout this period, trading volume. And that trading volume had an impact on profitability.

KD: So you saw this even in this period when the rates were unfixed only for the very large transactions.

LP: That's right. We didn't see any negative consequences that were predicted by the New York Stock Exchange and others. The unfixing commission rates is probably one of the major acts of deregulation the government has ever been involved in, other than maybe the civil aeronautics board.

KD: Was the intention to continue working that way, to continue gradually going down?

LP: Yes.

KD: What happened? Because it seems like it stopped in the Brad Cook years.

LP: Well, it didn't stop. Well, in May of '75, we did.

KD: Right, until '75 when all the reins were off.

LP: Well, you're saying there was a period of time when it was quiescent?

KD: Yes, that's my understanding.

LP: The issue was prominent and debated intensively during all this period. The Commission did it. The Commissions convened—I think it was under Ray Garrett, because I had five chairmen when I was director. Casey, Cook, Garrett, Rod Hills and then finally Harold Williams. I had five of them. You're saying my tenure was short at the SEC.

KD: Yes. Compared to what?

LP: I had five chairmen while I was director.

KD: It's true. Was it clear that Garrett was committed to unfixing commission rates?

LP: I think Garrett was a very prudent and conservative type chairman, but he became convinced, as I did, that fixing commission rates was not only unjustified, but the SEC didn't have the capacity to determine whether the rates were reasonable. Periodically, the NYSE would come in with a new schedule of rates, usually higher of course, and we would get out our Ouija boards and try to figure out what to do, and usually come up with an approval process, but not having any verifiable, dependable way of doing it, because there wasn't any. I mean, it's a service that's rendered. There used to be notions that institutions were subsidizing individuals, or individuals were subsidizing institutions, but you couldn't establish that, and I'm not sure it was relevant to anything.

KD: And the sense is that the New York Stock Exchange is going to, basically, resist all of this.

LP: Yes.

KD: But Robert Haack, for one at least, seemed to have a sense that this was going to happen in one way or another. Did you work with him much or talk to him much on this?

LP: Yes. He, I think, had a broad perspective on this and realized that the inevitable result would be the unfixing of commission rates. And he was one of the enlightened regulators that we worked with, and I think he did a credible job.

KD: In what way would you have worked with him?

LP: Well, he would be down to chat with us and talk with us about what he saw the implications of our action of unfixing commission rates. We would debate the issue with him and discuss it. We had a lot of meetings and hearings on this topic.

KD: And at some point, the meetings and hearings started to go to Capitol Hill when you start talking about the '75 Act amendments, right?

LP: That's right. It's interesting that the '75 Act amendments have a provision in the fact that commission rates on exchanges should be competitive. Well, that was enacted by the congress two or three months after the SEC officially unfixed rates. [Laughter].

KD: Locking the door.

LP: Yes. I guess locking the door, but on the other hand, maybe the horse got out of the barn. I don't know. A little late in the equation. Their courageous act, which was already done.

KD: What was your role in this? May 1st, '75, I guess?

LP: Right.

KD: Was it just another day, or was there a lot of work leading up to this to watch closely what happened?

LP: Well, as I recall, we had had hearings again on market structure and commission rates. And it became a topic which was on the SEC's agenda, and we went up there on this particular time, I think the actual official SEC act was before May 1st. I think we set it for May 1st. I can't remember how much earlier it was, but the Commission met, and we debated the issue for a very short period of time, and all five commissioners voted to unfix commission rates. And I went downstairs after that and talked with the Division of Enforcement and told them that that had occurred, because I knew that they were pushing that themselves for some period of time.

And I think I spoke with maybe even Irv Pollack about it because Irv had had so much to do with the hearings and with the debate on this before he lost part of his division to Brad Cook. He was interested in hearing about that because he had had so much involvement in the process.

KD: During this period, who were your key people in the Division of Market Regulation? Who were you working with?

LP: Well, the key people, in addition to myself, were Sheldon Rappaport, Tony Snodgrass, who was my associate director. So was Sheldon. Dan Polaro, who's deceased. Well, so is Sheldon. And Tony Nuland, who was sort of in charge of clearing and settlement, under my direction, and John Liftin. I don't know whether you've heard of those names or not.

KD: Yes. I've actually talked to John Liftin. You hinted that—Tony Nuland, for example, you gave him one particular thing.

LP: That's right.

KD: Is that how this worked—you would say, "Here's your portfolio. Take this and deal with it."?

LP: Yes. Each one has a subject matter that he concentrates in. That's right.

KD: Was that pretty much standard procedure at the SEC?

LP: Yes. Enforcement, I don't know how they carved up the pie, but in market regulation, you normally have an area. Marty Moskowitz was another key player here. Marty was in charge of the oversight of the CBOE rule changes and the options. Marty's deceased as well, I think. It's amazing.

KD: Again, it gets back to your point that these are extremely complicated subjects.

LP: Yes.

KD: And nobody is going to master all of them.

LP: No. They're extremely complex.

KD: Okay. Well, the last big subject matter I have is the whole central market thing, and we've talked a bit about that. But, of course, it seems like that is central to what the '75 Act amendments were about, at least one of the big themes. It's a major theme that's carried forth for years and years to come, you know, is trying to integrate the transactional process.

KD: You had earlier talked about this advisory committee on the central market system. It was run by somebody named Yearly?

LP: Yeah, Alexander Yearly, Sandy Yearly.

KD: Okay. Was he in the Commission?

LP: No. He was the head of Robinson-Humphrey, which is a regional broker dealer firm. We were trying to come to a conclusion as to what should be done in terms of market structure. How do the players fit in? How do the specialists fit in? How do the third market firms fit in? And how do the institutional players, the institutional money managers who are coming on the street. You got to remember, Ken, these institutional money managers were expanding and becoming more prominent as the years gone on. And you can see, they dominate today. You know, the advisors.

There weren't so many hedge funds then, but there were investment advisors with large amounts of money under their management. Fidelity was there then, Putnam was there. All the big firms. Here they were moving this money around, and in a sense, you know, providing the same kind of liquidity, the same sort of participation that a Goldman Sachs or a Morgan Stanley might participate.

So the question is, how did these players get integrated, and where are the problems? We met repeatedly on these issues. And as I say, the fundamental defects in this whole deliberative process, first of all, whether or not you needed it; and secondly, can you bring a bunch of competitors into a room, specialists, and then expect them to really come out with anything that's subjectively useful.

KD: Could you?

LP: No. The answer is, I think not. Nobody's ever done a story on this, but I think the thing was a failure. I think the subsequent action of the SEC has been, largely, a failure. The markets today are strong, and are vibrant and are efficient, but not because of what the SEC has done—at least not in the area of structuring. The SEC is most successful, has been in the area of policing and the area of confidence and honesty in the markets, the area of insider trading. There they shine. But the SEC, in my opinion, does not shine when it tries to tell members that they've got to take an order and expose it to six other markets before they can do the transaction. I don't think that's necessary.

The SEC is also strong in the areas of disclosure. And what they've done with the markets and the disclosure area has been very successful. For instance, the last sale information, that was all done on our watch. That is, any transaction in an equity security of any magnitude has to be recorded on the tape within ninety seconds. It doesn't matter whether it's traded on the New York Stock Exchange, Philadelphia Exchange, over-the-counter, upstairs at Merrill Lynch's trading desk, it has to be reported.

There's the integration you're looking for. The same thing goes with quotations. If you're doing a bid or an offer, which is different from a last sale, and you're doing that in one location or another, and it has to be integrated into a composite form.

KD: Composite tape?

LP: Well, a composite screen. Not a tape. A tape is for the last sale information. In the other deliberative process that the central market system committee did, I don't think, honestly, we accomplished a great deal. You had specialists fighting with Don Weeden, who's a third market firm, as to what should be the regulation? You can imagine what the regulation of each of them was. It depended upon what was in their back pocket. And that's only natural.

KD: Supposedly, the idea was to get everybody together and come up with a vision of what this central market would look like.

LP: Well, you know, one of them was it ought to be a black box. And somebody said, "Well, why is it called black? Why isn't it red, white and blue with starts on it?" [Laughter]. But, you know, we don't have black boxes, and I don't think we ever will because we do have competitive markets. So you have inconsistencies in the '75 Act amendments.

KD: So that's the idea of a Hard CLOB.

LP: Yes, a Hard CLOB. Yes. You've got the terminology.

KD: I guess you've got lots and lots of ideas people telling you what this thing ought to look like.

LP: Exactly. That's right.

KD: What did you do with those ideas?

LP: We distilled them and we came up with the last sale transaction reporting.

KD: Did that come out of these discussions?

LP: I think it was in the process of being invoked and done as we do. We came up with the notion that if you're going to be disseminating bids and offers, they ought to be consolidated, and they ought to be available so that anyone can readily get this information. We came up with clearing systems, central clearing systems, to settle these transactions. And we came up with strong financial responsibility roles for participants, which is something under my watch that we did, so that those who were participating in the process, those professionals, are not going to default on the transactions. Those are the fundamental tenets for a good market. And, of course, you know, we've got the enforcement division trying to make sure that the manipulations and the insider trading are reduced to minimal.

KD: These things you talked about, do these fall under the category of quote rules?

LP: Yes, quote rules, last sale transaction rules. That's right.

KD: Okay. Things like that, again, it would strike me that they would have been less controversial because they're not challenging anybody's turf. Was that the case?

LP: Well, there would be discussions about that, particularly the quote rules. You know, some would say why should the quotes on our system be available for an outsider who hasn't paid for them? Things of that kind. There would be fundamental issues.

KD: Like the New York Stock Exchange wouldn't want NASDQ to get –

LP: That's right.

KD: But you were able to just step in and say, "Well, this is how it's going to be."

LP: Yes, that's right. In certain ways, that's right.

KD: How much time and energy was consumed during this period when congress is studying and thinking about the '75 Act amendments?

LP: Enormous amounts of time. Our division was fully occupied with the '75 Act amendments. They took up months of time, and there was tremendous controversy. Just to give you an example, one of the things in the fixed commission rate area, the industry as a quid pro quo, wanted Section 28E, which is an area that I deal with a lot involving soft dollars. So that law had to be argued and debated. That is, it gave fiduciaries the right to pay up for research without violating ERISA.

In other words, use commissions to obtain research which, otherwise, they might not have been able to do. That was a compromise, or a quid pro quo for the repercussions or the consequences of unfixing commission rates. But there were a lot of things like that that had to be dealt with as measures, as the markets changed and evolved.

KD: Did you get into discussions with particular senators and congressmen or anything like that?

LP: Yes.

KD: Harrison Williams, for example.

LP: Yes. Harrison Williams used to ask us to come over and testify all the time. He would always ask us to raise our hands and swear under oath that we were telling the truth. In the meantime, he was in the back office taking money from the Arabs. That's another story. I was always somewhat amused by his strong sense of integrity. We had to raise our hands. Of course, you know, when you testify before these congressional groups, you're, more or less, under oath whether you know it or not. And if you tell an untruth, you're subject to a liability. So you don't have to raise your hand, but he dramatized it by asking us to raise our hands and say we were under oath. I guess he didn't trust the staff at the SEC or something like that [laughter].

KD: So you said that most of your staff was involved in this. Would the legislators come and say, you know, "We want you to develop some ideas around this. Give it to us, and we'll do something with it." How did that work?

LP: Yes. There were people over on the Hill, a lot of them actually SEC staffers who were drafting this kind of legislation. And they would want support from our staff in drafting, and we would. We would supply them with statutory provisions. In fact, I'd say 75 percent of the laws which were passed in 1975 were probably codified in our division because we presumably have the resources and the skill to do that, subject to the review, of course. So we would constantly get requests for drafting pieces of legislation.

KD: Was there ever any chance that Rule 394 would be wrapped into that?

LP: There was serious thought given to that, but the NYSE may have managed to dodge that bullet for the moment. Eventually, they lost the battle, but they kept the 394 in place for some period of time.

KD: Why? Was it just the Stock Exchange adding—

LP: No, they had a compelling argument. If you don't bring it all onto the floor, you're bringing it to the floor and 85 percent of all the transactional activities in these listed securities are occurring on the floor, why shouldn't you bring it to the floor where it gets exposure to the best trading activity possible? It's a compelling argument. And the argument against it would be, well, you're a private organization. Why should you be able to force any of your members to bring their business to the floor? Why can't they bring it any place they want? So these two were in tension. And it's another example of something that isn't clear on its face, but eventually it became obvious that the 394 was antiquated, unnecessary. So we got rid of it. But it took some debate and some time.

KD: Were you mostly involved in the last couple of years of your tenure as director of market regulation, were you mostly involved in dealing with the repercussions of this legislation?

LP: Yes, we were.

KD: What were some of those?

LP: Well, I think one of the things they wanted us to do is to look at all SRO rules, Self-Regulatory Organization rules, and determine whether they were any competitive in the best interest of investors. So we had an enormous number of studies we had to do on that score. I mean, the last couple years, I was only director for three and a half years, so a lot of things occurred after the '75 Act amendments that became more intense of trying to figure out what the market structure should look like. So that became a heavier burden on us as well. Not that we made great progress, but that was a heavy burden.

KD: Right. Were there any studies that were carried on that were as ambitious as the one you did just before this advisor committee?

LP: I don't remember, Ken, whether we had any other studies. We're always doing studies, but I can't remember. I don't recall during the last stages that we had any, other than this mess of review we had of the Self-Regulatory Organization rules.

KD: Did you have the staff to do all this, or were you ever stretched?

LP: I'm always a great believer in not having too much staff. I remember Rod Hills would have Monday morning 8:00 meetings in his office, and the directors were all there, and he said, "What are the staffing needs?" And I remember Stan Sporkin saying, "Well, we're understaffed. We've got so many, 1,500 people working here." He says, "What we've got to do is have a program where we go from every year a 20 percent increase so that at the end of four, five years, we double the size of our organization so we can handle the volume." And Rod turned to me, said, "What do you think, Lee?" I said, "I think we've got to have a program similar to that, only going in the other direction." [Laughter]. So, no. I think there were enough staff people there to handle the process. I mean, there was a lot of hard work to do, but I'm not a great believer in spending public money. So I don't subscribe to the notion that we're under staffed.

KD: You talked about some of these initiatives that took place under your watch. In these last couple of years, '76, '77, did any of those initiatives take place, or were you mostly catching up with all these studies and things? Sounds like most of the changes you made came a little earlier. Some of the quote rules, perhaps, came out after the '75 Act.

LP: They did. The quote rules came out. I'm not sure they came out on my watch. And then what we did have is a lot of activity in terms of the transfer agent regulation, which is somewhat prosaic. We had a lot of rules relating to municipal securities regulation, which kept us extremely busy. Then the option markets kept us very busy. So you combine that with the reviews we had, the SRO, we had a heavy-duty plate of activities.

KD: Well, by this time, you'd outstayed your two years.

LP: That's right.

KD: What was behind your decision to move on from there?

LP: Well, I think what happened is that I'd been director for about three years. And Carter got elected president, and he appointed Harold Williams, and there was a notion that they wanted to, perhaps, have somebody else as director of the division.

KD: Did you get the message from someone, or was there just a sense that you weren't going to fit in in the new structure?

LP: Well, you know, the chairman and I talked about it, the new chairman, and he decided he was going to go ahead and try to find somebody else. I said, "Fine."

KD: Which is his prerogative, I guess.

LP: That's right.

KD: So did you go right into private practice after that?

LP: Well, yes, essentially. Started my own law firm. Yes.

KD: And so you've been working in the securities area.

LP: Yes. Represent about 150 broker dealers.

KD: Okay. Anything that we haven't talked about that we should get out?

LP: Probably. [Laughter].

KD: Well, there's probably a lot that should be in the record, things that stand out in your mind as having been colorful, instructive or just interesting.

LP: It's a very challenging position, being the head of that division, because the issues are very complex, and the people you deal with, you know, there's a highly-educated, informed group over at the SEC. They attract good talent, and the constituents, the outside group, are also highly-informed intelligent people. So there's never a day when you don't have a challenging and provocative type experience, you know. So I was very fortunate to be a director at that time because there were so many major events that occurred. It was just industry-wide tumultuous things that were occurring.

KD: Right. One of those deals when the years seem to go by faster than they really do.

LP: They really went by quickly, yes. And I was fortunate to have a lot of very strong people in my division. We had some extremely talented people. And, you know, you can't do it alone. It's an impossible task. You need people that give you guidance and support.

KD: Well, terrific. I really appreciate your taking some time and giving me a little guidance on this.

LP: Good.

[End of Interview]