Securities and Exchange Commission Historical Society
Oral History Project
Interview with Donald Stone
Conducted on December 3, 2009, by Kenneth Durr

KD: Interview with Donald Stone, December 3rd, 2009, in Scarsdale, New York, by Kenneth Durr. Let's start with the back story. I noticed that you were in the military and served in World War II. Is that right?

DS: Yes, I did. My father was a poor boy from North Adams, Massachusetts, and he got a scholarship at Williams College in 1910. He volunteered in World War I. He went to Camp Devens, and they put him in officer's candidate school, and instead of coming out as a second lieutenant, he came out as a first lieutenant. He wrote letters to his mother and had a friend mail them so that she never knew that he went overseas. He was in the infantry in World War I. In World War II, he enlisted again. Fortunately, he didn't have the health to get what he wanted, but he ended up in Naval Officer Procurement; he was a lieutenant commander in the Navy.

I went and had lunch with him the day before I went overseas, and he was having lunch with all these admirals, and he had Army service medals on his chest—the Navy officers didn't know what they were, of course. I went to Deerfield Academy, and I graduated in '42 and went to Williams that summer. It was the first time they had people going to college in the summertime, and I enlisted that fall and got my father's permission, as did my brothers. My younger brother went into the Marines early on. My other brother went into the Air Force and won 8 air medals and the Distinguished Flying Cross. He was a lead bombardier at Iwo Jima. I also had two step-brothers, one who was in the Navy in the North Atlantic during that terrible time when the German submarines were picking everybody off, and he ended up in the Pacific; the other was a Marine. Three of them were at Iwo Jima at the same time and never knew that until the war was over. One was on a destroyer, one had flown over. I tried to get in the Air Force, and I didn't have good enough eyesight. They said I couldn't fly, but I could be an aerial gunner. I didn't figure that one out.

I transferred from the Air Force into something called the ASTP, the Army Specialized Training Program, which I thought was going to put me in the intelligence, and do something overseas. The intelligent thing they did was about the time of the Battle of the Bulge, they transferred me and a lot of others into the infantry. I went to the 1263rd Combat Engineer Battalion. We were all sent over for the Bulge—their wisdom. I got in that program because I was with people who spoke Italian, French, and German. I spoke schoolboy French, and I passed a test where I got a perfect score on a fictitious language test, so they assumed I knew something. I didn't know anything. After the war, I was in Paris. A fellow came up to me and he said, "Hey, Stoney, how you doing?" This fellow had been in the FBI and the ASTP, and he had parachuted into Paris during the war and spoke fluent French, and there he was as a civilian, but he wasn't a civilian. That was the organization I tried to be part of, but ended up in the Combat Engineers.

I was at the Battle of the Bulge. It was the first time I ever heard a gun go off in anger. I ended up going through Holland with the British Second Armor Division, and then I ended up crossing the Elbe River at the end of the war. We were the northernmost allied troops in Europe. And I went through three concentration camps. After the war, I was in occupation. I had enough points to come back, but I didn't feel like coming back right away. I eventually ended up coming back in the fall of '46. I called a fellow who had been a good friend of mine at Williams. I didn't know if he was alive or not. I hadn't seen my family or brothers or anyone I knew for three years.

I found it very difficult to be back in New York. My dad lived in New York then. He was on Wall Street, and he had resigned from his firm, and then he went back after the war. I went back to college—I went back in March, and then I went around the clock again – spring, summer, fall and winter - and I graduated in the fall of '47.

KD: You went into the bond business?

DS: Yes. I worked with my father, who was at Asiel & Company, and I became a bond trader. As I said, my dad was a poor boy from North Adams, Massachusetts, who got a scholarship at Williams at 16. He loved Williams College, and he eventually became a lifetime trustee of Williams. He was a governor of the New York Stock Exchange early on. He was a great role model. He always told us, "Your word is your bond."

KD: Did you think that you wanted to get onto the Stock Exchange because of this exposure through your father?

DS: Yes, but I was thinking of leaving Wall Street, frankly. I didn't like the bond trading. I understood it, I had worked on the floor as a clerk, and I knew the action was on the floor. I didn't want to end up in his firm, because I had said to him, "If I'm successful, it'll be because I'm your son, and I don't want that." So he bought a seat on the Exchange for $53,000, and he said, "You owe the money to your brothers." So I owed them each a third of the fifty-three. It took me many years to pay it off, but I did as soon as I could. I started out as a $2 commission broker on the floor where I made a living. I figured that what I ought to do is something that other people didn't do.

So I started doing arbitrage on the floor of convertible preferreds. And in those days, financing was done by rights. Say American Telephone would have an offering, a rights offering to raise capital. You'd buy the rights, you'd sell the stock short, and make the spread. When I started doing that, there were very few people doing any of it. I had no capital, so I did it as an agent.

KD: You went from being a $2 broker to doing arbitrage.

DS: No, that's what I did as a $2 broker too. But then I found that I could make more money doing the arbitrage, but getting a commission on both sides. I did that, and I realized that if I ever left the floor, I was out of business. My best days were Saturdays because many members went off to see the football games and so on, and I'd pick up commission orders at that time. Saturday was my big day. I could get a lot more $2 business then. Of course, when you think back on it, the daily volume was something like 300,000 shares. And a big order would be 500 shares. A thousand shares—wow! It was fixed commissions, obviously, then. I knew how lucky I was. Having been on the floor for a while, I realized that the best business there was the specialist business.

KD: Why?

DS: Because the orders were brought to you. If I ended up, say, the specialist in Johnson & Johnson or Coca-Cola, wherever you wanted to buy Johnson & Johnson or sell Coca-Cola, there was one spot, and that was where the specialist was. I knew that was a good thing to do, and I was asked by some specialists who had an existing joint account if I would like to join them, and I said, "Yes." At the same time, I was asked by E.H. Stern & Company—Eddie Stern and Bunny Lasker—if I'd like to join them. I didn't have any capital, and I knew you needed capital. I think I had $30,000, but I owed my brothers.

I decided if I joined E.H. Stern & Company, which they asked me to do, my contribution will be what I make as a specialist, that's how I can help. I knew Eddie Stern, I think, was the richest and best trader on the Exchange. He had capital, and that was vitally important to my being a specialist. They didn't ask me for capital. And, eventually, I ended up running that specialist business.

KD: So, ordinarily, a specialist, to get into the business, needs money to put up?

DS: The firm must have capital. A lot of the people who became specialists, who were former clerks of the specialists, and they'd bring them out in front. I did that. I trained a whole bunch of guys. I'd get a seat for them, lease a seat for them, and then taught them how to specialize. I eventually ended up running the specialist unit, and brought other men into our firm.

KD: So you're working with E.H. Stern & Company.

DS: Yes, that's right. I was the lowest animal on the totem pole. It took me a long time to realize that I was terribly fortunate to be a specialist, and I worked very hard. I tried to figure out how to do it differently than some. When Eddie Stern died, and Bunny Lasker and I changed the name of the firm to Lasker, Stone & Stern, I realized that capital was vital for the running of a specialist operation. As a specialist, your job is to maintain a fair and orderly market under all conditions, and the companies are very concerned, when the market goes down, how you participate. They aren't too interested how you participate on the way up, but they wanted you to be there on the way down.

I was very conscious also of my relationship with the companies in which I was registered. Before I was done, it was over a hundred companies, because I merged the firm with Merrill Lynch. That's down the road. As I was doing the specializing, I realized that I could create capital if I was short the market. In other words, I was credited, not debited, and so I would try to go home every night with a short position in dollars—not that I thought the stocks should be shorted or anything, I just wanted to have a balance. The market originally closed at 3:00, and then closed at 3:30, and then closed at 4:00. I would check positions an hour before the close, and I always was very conscious of our exposure and try to get short —I graded the specialist not how they made money, but how they lost it.

I was very concerned that they didn't let losses run, and I thought that a good trader, because he's not an investor, would take a loss. And I tried to teach them that, though I knew that they thought the more money they made for the firm, they more they'd get paid. That is a factor, but I considered the less money they lost as more important.

In a bull market, you buy something, and it goes up. We had plenty of bull markets. But also, stocks each have different qualities. I was always conscious of the illiquidity of the market outside of our own trades—the real illiquidity of the market. I knew that the corporations mark you well as how you participated in a declining market, or in their stock declining. I kept close contact with the companies. I, personally, did it in a great number of our companies, and then tried to teach guys to keep contact with the company management. If there was any aberration in the trading of the stocks, be sure to call them at the close and tell them what happened, who's doing what.

KD: It's your job to buy when it's going down.

DS: It sure is. You have to supply stock when it was going up. I thought one time, for a specific example, I thought it would be right for Buffett to list. I became very active in the Exchange. I was a floor official, then a floor governor, and then a director, and then vice chairman. I was the vice chairman twice, which I guess is the only one who has a six-year term, and then you're out. I guess I didn't learn how to do it, so they brought me back, and I did it again. We were very aware of when companies complained around the Exchange. We would have governors going in to speak to the specialists and see what was happening and what they were doing and talk them, if necessary, into participating more maybe than they had.

But in my own case, I was short stock on an ongoing basis, great stocks, we had Reynolds Tobacco, Coca-Cola, Johnson & Johnson. Before long, we eventually had U.S. Steel, Blockbuster, Metro Goldwyn-Mayer, which split into Loews Theaters, that's how I got to know Larry Tisch very well. We had Blockbuster, we had Enron. We had Chemical Bank, which became Manufacturer's Trust, which became eventually J.P. Morgan. So we had a wide spectrum—Celanese, St. Regis Papers, Standard Packaging, RJR - I can't remember them all off the top of my head.

KD: Back in the ‘50s when you were younger, how many of those would you handle?

DS: Physically handle, I would probably handle three or four. I handled Johnson & Johnson. I got very close to the company. I cared a lot about them—those people were terrific with me. During the Tylenol crisis, at the end of it, Jim Burke called me up and asked would I have lunch with him. I said, “Sure.” He said, "I'm coming down to see you." And he did. I thought he was going to bring his son down or something to see the Exchange, but he said, "I came down to thank you for what you did for us during the Tylenol problem." That was a hell of a nice thing to do.

Obviously, I remember when I left there, when I stopped—I sold the business to Merrill Lynch and I merged the two units. Before I did that, I called the chairmen of most of the companies that we were specializing in and told them what was happening, and what I thought it was very good for their company because they had permanent capital, they had the biggest and best public firm in Wall Street, and it would be good for the company. I would tell the CEOs, “You have here a top company whose customers will get to know your company better than they would've if you weren't there.”

But more important, you have permanent capital there which will have longevity. Whatever happens with the specialist firm, it'll be good for you. And it was at Coca-Cola Roberto Goizueta said to me, "Donny, if it's good for you, it's good for us." The same thing, I called Don Keough, he was overseas, “If it's good for you, it's good for us.” At Johnson & Johnson, they were terrific. When I retired, they gave me a party down there with the executive committee.

KD: So it paid to stay in close touch with the companies you were working with.

DS: It was important to service the companies about trading in their stock. They had stock holder relations and appreciated information available to all. I had other people who were the heads of companies, which say every time you want to see a block of stock, "Let me know, Don, let me know. And, by the way, what's your position?" And one CEO was always wondering, what was my position, what's my position? After the crash, we lost over a million and a half dollars in his stock.

KD: Which crash?

DS: Back in '87. That was a lot of money to me and to our firm. It was the most we lost in any stock. He had said to me, "Anytime you see a block of stock, call me." I called him three times those two days, and I'd offer him stock a point below the last sale. He said, "Who's the seller?" I said, "I am." "Oh, that's nice of you to call me, Don. I'm not interested." You got to know your players. One time I said to him, "Would you have lunch with me?" He came down. I said, "I want to show you something." The Exchange evaluates each specialist, shows how much stock they bought in what sort of a range, how it compares with other units, that same price stock with the same capitalization, and I said, "I want to show you what we've done for you over the years."

Obviously, I was showing him a very good picture, and I said, "And I've arranged something that's going to make you very happy." He said, "What's that?" I said, "You're going to get a lovely new specialist, someone you'll get along with very well, and you won't have the problem to have to call him and ask him daily like you do with me how much I bought and what my position is, and they're much wealthier than we are, and you'll do much better." I could not resist teasing him and we remained friends. [Laughter].

KD: Gave him no choice.

DS: You had all kinds of people.

KD: You were paying close attention to the companies you were serving.

DS: Yes, sir.

KD: When did you start paying close attention to the Exchange and really getting tied in to the policy discussions that they were having?

DS: That's a good question. The Exchange has a lot of dedicated professional regulators. First, you become a floor official, and then you become a governor. We had sixteen governors.

KD: What does a floor official do?

DS: A floor official—we had seventy-two floor officials who are positioned all around the floor. If there's an imbalance in a stock, news that affected the stock or market, they're over there to see what's going on, what they can do. They also want to make sure that the rules are observed. If there's an imbalance, you have to get a floor official's permission—or in those days you had to get a floor official's permission to trade off the current price.

KD: Is this the kind of thing that the regulators took over?

DS: That's one of the problems I want to talk to you about.

KD: Okay, great.

DS: We had the floor officials, and then over them, we had governors. There were sixteen governors. It was an honor to be a floor official, it was an honor to be a governor. The governors were all around the floor, and they had more clout than a floor official in determining openings. If anything went wrong, before long, the floor officials would bring in a floor governor. Above them, there were four directors. I was one of those directors. Between the directors, we divided up areas in the Exchange, and we'd meet every week for lunch to discuss what we could see was happening. We also had something called the market performance committee. And on the market performance committee were the floor governors. And upstairs governors were also on that committee.

KD: Is this the Board of Governors?

DS: No. It was called the Market Performance Committee. It consisted of four directors and sixteen governors from the floor, and four governors from upstairs firms – two from the buy side and two from the sell side. The Board of Directors represented listed corporations, large and small member firms and the public. I served as one of two vice-chairmen with Bill Schreyer from Merrill Lynch; George Shinn, Chairman of First of Boston; John Gutfreund, Chairman of Solomon Brothers; and John Chalsty, Chairman of Donaldson Lufkin, and Jenrette

KD: You're moving up over time, but your first involvement would've been as a floor official?

DS: That's correct. I was asked to be a director early on, and I came up to my partners and said they'd asked me to be a director, and they said, "Well, we don't think you should get it because if you get it, one of us can't." I didn't have any money, and I wanted to be part of that firm. So I turned it down, and I won't go into it. That's what happened. Then they came back to me later in the game.

KD: Bunny Lasker must've been moving up as well.

DS: Well he was the one. He was my partner, and he wanted it. So I went to the nominating committee and suggested him at his request.

KD: Well, you got plenty of chances later on anyway.

DS: Yes, I did. The Exchange was probably better off that I didn't get it then because I had a lot more experience later on.

KD: Some big policy issues—this would've been in the early '50s, and might've been too early for you to worry about, but there was a lot of discussion of off-floor trading of the Exchange.

DS: I spent a lot of time in Washington. I was the fellow who was on all four market structure committees, so I knew that very well.

KD: Did you start with the institutional investors? Was that the first one?

DS: First institutional investor study. That's correct.

KD: What was driving that? Why was that one started?

DS: As I remember it, John Whitehead was the chairman of that committee, and there were rumblings about the institutions and their relationship with the investment banks. It ended up, if I remember correctly, as a study of floor trading. [Laughter].

KD: This leads to the issue of fixed commission rates?

DS: No, not yet. That was a little later.

KD: I know the institutions are trading very large blocks of shares, and they're wondering why they have to pay.

DS: Right, and it's always money on every one of these things, as you know, as to why we're all down at the SEC. It's turf for the people who are running the market. The New York Stock Exchange was the biggest market in the world, and there were always people who were in the over-the-counter market, Gordon Macklin, those fellows all wanted to trade the listed stocks, and there were the block traders who were trading listed stocks. There was a whole network of people, and the Exchange was a big regulator. The member firms had to hire legal help to make sure they complied. They had the NASD looking at them, they had the SEC looking at them, and the New York Stock Exchange looking at them.

Oh joy of joys, if you didn't have that, you'd save a lot of money and you'd make a lot more money. Over a period of years, I was on all these committees. I started out with the normal bias that the New York Stock Exchange is a great regulator and we didn't need another regulator. But I came away with the knowledge that the SEC was the best thing—that SEC, that time, was a great regulator. They kept everybody's toes to the fire, and on the line to see that they were doing it correctly. I've learned to greatly respect what they were doing. They had very bright people working at the SEC. I got to know the staff very well because I was down there all those years.

KD: And this was in the '70s.

DS: Yes. And then forward. I was on the National Advisory Board.

KD: There was the Yearly committee in the early '70s.

DS: I was on the Yearly committee, and I was on –

KD: The National Market Advisory Board.

DS: I was on all of them, and I got to know the staff well. I realized the commissioners, bless their hearts, were there for a short period of time, but the staff was highly knowledgeable, or wanted to be highly knowledgeable, and I thought it was the NYSE's job to see that they were. John Phelan was very good at that. I got to know the commissioners and the chairman, the chairman being much more powerful than the commissioners, the commissioners each having their own interests. Over a period of time, we figured out—John really did this—that in academia, it was much easier to attack the Exchange than to understand what was happening.

Jim Jacobson followed me as Vice Chairman, and was highly knowledgeable of the NYSE rules and public values of the auction market, and had deserved creditability at the SEC and in the industry. He was an effective and strong leader. He decided to have an advisory committee of academic people coming into the Exchange and learning about it.

Bob Rubin and I taught over at NYU. Gus Levy had a program, and one time he asked us to come over and take over for him, and I talked about the Exchange, Bob talked about arbitrage. Then I, for five years, taught at NYU business school. It was more educational for me than it was the kids—although they weren't kids because most of the people at NYU came in from the banks and brokerage firms and so on. It was a great experience, and then I got too busy doing Stock Exchange stuff, I couldn't do it.

At that time, Don Weeden was a very effective voice for the third market. He and I became friends. I was friendly with his brother Alan, and I am with both of them today. Don and I could sit across the table from each other and Indian wrestle, but at the end of the day we'd go out and play tennis, and were friends, and are friends to this day. And he was a passionate, successful David against the Goliath of the Exchange, and he did very well. The net is that what he fought for exists today in the Exchange, and doesn't exist today like I knew it. That's something I'd like to talk about a little bit.

KD: Absolutely. You worked with him on the National Market Advisory Board. You're really looking at the idea of what the future market should look like. You talk about academics sort of wanting to invent something brand new.

DS: That's correct. The SEC had a bias towards supporting competition. We put into place the Intermarket Trading System where you could look on the screen and you'd see the Pacific Coast Exchange, the Chicago Exchange, and could, through electronics, trade. If their market was better, you could trade with them. There were only a couple people in the system who really competed with New York. One was Bill Lupien.

That was a transitional period, and it was very interesting. They wanted to put in a CLOB, a Consolidated Limit Order Book, and that never happened. The Exchange kept upgrading its electronics, and Phelan was the one who really got that going, and then we ended with DOT, Superdot, and the volume was such that we couldn't exist without it.

KD: How did that affect the way specialists, for example, were doing their job?

DS: It meant that you had to have very good clerks behind you to be able to handle the volume as it came in. When the clerks made a mistake, which they did on occasion, and they overlooked orders or put things on the buy side when they should've been on the sell side, we had to stand up to it. It could cost you hundreds of thousands of dollars if they didn't do it right.

KD: When you say we had to stand up to it, you had to make good on the mistake.

DS: Absolutely, and we did. Over a period of time, I got such respect for the system. I was an usher for people who would come in from the outside. I had some wonderful people from Washington and I remember a general who defended Stalingrad came in from Russia. And I had Khrushchev and Gorbachev. You'd get to see them all. I said to the interpreter, "Tell the general that a Russian soldier saved my life," and I told them a war story, and all of a sudden, he gives me a great big hug, and then we're buddies. I would always start my spiel with people who came into the market as "I and my peers are the most regulated businessman in the world. Every transaction I make is real time in a computer, and the computer's watching the computer, and there are humans watching the computer, and there's an audit trail on everything we do real time."

It makes imperfect people like me level. None of us are perfect, but you can't make a mistake here because you're being watched. I say that's good. It forces this market to be a very valuable honest public market.

KD: Was it always the case, even in the '50s?

DS: Oh, no. We didn't have the electronics, but we got it in the '80s. And yes, we were honest!

KD: Were there manual audit trails or things like that, though, in the '60s or '70s?

DS: But not like this.

KD: Not nearly as effective.

DS: You'd have to go backwards. In the early days we used to write the orders by pen or pencil into a paper book. That was the audit trail. Now everything was in computers.

The volume kept increasing, and the efficacy of the electronic book had to be upgraded. One of the places I think we fell down—we always had in our crowd reporters who were Exchange employees, and they put a mark on a card—the transactions to go into a computer. I thought it was a mistake to lose them because I thought it was almost a little regulatory arm, but they couldn't keep up with it—humans couldn't keep up with the volume, receiving computerized orders directly from computers.

It had to be done by the clerk, and the clerks had to get the orders, then turn to the specialist and say, you've got 12,000 to buy, 6,000 to sell, and the price, and you trade. It was good for the Exchange to have those reporters, but it put the burden of reporting accuracy on the specialist himself. I'm not saying that people didn't do it well. Some people did it better than others, but the volume got humongous. It was important that the Exchange continue to update its systems. When I was first down there, volume was 300,000 shares, 1,000 shares—woo, man—you got an order!

KD: Things were really changing in the ‘60s. You could see it happening, I'm sure.

DS: Right. And I was there in the ‘50s.

KD: Yes. It got so bad in the ‘60s you had your back office crisis. Was there any sense of—

DS: I was on every one of those damn committees too.

KD: What did you do? What was the discussion like on those committees?

DS: Let me tell you about the market performance committee, for example. The market performance committee met every Wednesday, and it had some traders from institutions as well as block traders. We would talk about what had happened that week and any problems people ran into. When the committee first met in the early part of the year, we would say, "We're going to have an executive committee meeting here."

The staff would come in and sit there and then leave. Then the members were the regulators more than the staff. The chairman of the committee said, "Everybody's going to get three minutes to talk. Figure out what we ought to do in the coming year to make this a better market." We took down what that was, and then we would vote on it, in terms of what should be the priority. We would do it. When they'd come up from the floor—and we learned how to get 100 percent presence at the meeting—we would call the meeting at 4:15. If the market closed at 4, then you're out of here, mid-sentence, at 5:30. But it's going to be run like that, so people came.

They liked the opportunity to tell you what went wrong on the desk upstairs. “The specialist did that,” or “we should've been doing this,” or “no one told me.” It was real self-regulation.

KD: Did you draw members of this committee from all over the place, different functions in the Exchange?

DS: They were the floor governors. The floor governors were chosen by the floor directors, and also we had elections on the floor, people who wanted those governors. It was, oddly enough, democratic.

KD: They had their ear to the ground.

DS: You bet. They were dedicated. That was terrific. Later, the Exchange changed dramatically, and brought in John Reed. I think it was Paulson who picked Reed when he left Citibank and he came in for a dollar a year. At the end of the year, he retired. I asked him if we could prevail him to stay if I got the compensation committee to double his salary.

They put me back on the board then with three other floor members. On that board at the time were Paulson and Stan O'Neal from Merrill Lynch, and the head of Morgan Stanley—Phil Purcell. That was an interesting board—the public directors who were interested in the public, and then there's the industry board. At that time, I had said to John Reed, "How's the market performance committee doing?" He said, "What?" I said, "The market performance committee." I turned to one of the former directors, who said, "What's it doing?" "Oh, they met five times last year." They lost their teeth.

KD: There wasn't the level of input from the people down there.

DS: No, on the floor.

KD: One of the questions that gets to is your description of a kind of self-governing exchange—

DS: That's what it was.

KD: —where the decisions are being made through these democratic channels. During your time, you saw a lot of different chairman and different styles, I imagine.

DS: Yes, I did.

KD: How much could they move the Exchange? How much could they change direction?

DS: It depended who they were. The one who moved the change the most was John Phelan because he had worked on the Exchange as a specialist, and he knew more about it than, say, Mil Batten who came in from J.C. Penney. John understood it. John was replaced by Bill Donaldson. Bill Donaldson was an industry fellow, but he didn't know the Exchange as well as John Phelan. And Dick Grasso certainly knew the Exchange very well.

When Mil Batten was there, he relied on John Phelan, and Bill Donaldson relied a lot on Dick Grasso. In the interim period, all the time the market performance committee had a lot to do, John Phelan was president of the Exchange under Batten, so Batten had the protection of seeing that the floor worked correctly, and the Exchange worked correctly under his aegis.

KD: Unfixing commission rates, we didn't talk about that. We talked about all the committees in the '70s. And that was the big to-do.

DS: Right.

KD: What was the effect, from your perspective, from the floor's perspective?

DS: It was inevitable that, with competition like it was, rates should come down. The only mistake in the coming down of rates, in my opinion, is when they went to trading in pennies. Because in trading in pennies, you've lost the transparency of the market. You don't know—you couldn't see the market. In those days, you could see. Of course, you can't see the market anyway any more because there're these dark pools, and there is no regulation any more.

The rates came down, and the industry learned how to live with the rates coming down, and they made their money trading in derivatives, which is something I'd like to talk about quickly if I could. It concerns me that the market is unregulated today. I don't think it's in the public interest today. The transparency of the market doesn't exist.

KD: The derivatives market.

DS: With derivatives and people trading, the Exchange only does about 20 or 25 percent of the listed trading volume today. Before, it was all out there for everybody to see. Now you'd have to go to the major firms. You see up there the bid and offer, but they're pennies. They hide what the real market is. The real market isn't on the floor of the exchange anymore. It's fragmented around the country, and things are happening in fractions of seconds as orders are diced, and computers can go into the system and play games finding out, trading against the bid, raise it a penny, raise it a penny, the other guy comes up, raise it a penny, raise it a penny. Then someone's working an order, people can trade against that order very clearly today, and do.

I have a friend who's a big trader, a big money manager, who said, "I had a small order, $25 million, and it cost me $50,000 to execute it because they're playing the slicing game, and before I could get the order executed, I got executed."

What bothers me is the short-selling rule which had great effect on the decline of AIG, Fannie Mae, Bear Stearns, Lehman Brothers and nearly Morgan Stanley and Goldman Sachs, which miraculously became banks overnight so you couldn't get them. And they nearly did Merrill Lynch. And I wondered, how does that happen? Where did all of that selling come from? Did it come from hedge funds, did it come from trading desks? How could they sell short?

Well, the short-selling rule when I was around was a plus tick or a zero plus tick. And you have to borrow stock. Even today, the rule says you have to borrow stock if you sell it short. There's been absolutely zero regulation to find out who borrowed the stock, how did they get all that Bear Stearns stock? Do you think the fellows who ran Bear Stearns would lend them the stock, who had the big blocks of stock? Of course, they wouldn't. I think it was naked selling, illegally, without borrowing stock. Have the regulators done anything about it? No. And the Exchange—it didn't take place on the Exchange. It took place elsewhere.

KD: So formerly, that kind of thing would've shown up on the Exchange.

DS: It would've shown up immediately, and it wouldn't have been done because they wouldn't dare do it. But I have a strong gut feeling, having lived in markets as long as I have, and understanding the short side very well, that there was no short-selling rule. And I might add, there's none now. Nine months ago, the SEC started talking about a short-selling rule, and they had it out for a ninety-day commentary period. There's no short-selling rule now, and there's nobody checking if they're borrowing stock when they do. There's no reason to. The market acts so well. But it won't. These fellows still have the opportunity.

If I read the papers well, there were a group of people who came out saying there's no need for a short-selling rule now, and obviously, the SEC has done absolutely nothing about it. I believe that market structure is vitally important as the green leaves that everybody is seeing, the green that's growing and the real estate market is coming back. Well, maybe it's going to be 2010 or 2011, but it'll come back. Our system is set up just like it was before to have this happen again because the short sellers are the ones who really made a great deal of money and knocked the market off. I'm sure there's some that did it very honorably, but when the faucet got turned on, it would be very interesting to see who did what.

KD: That's very important with the fact that the Exchange is, essentially, so decentralized at this point there is no Exchange.

DS: The Exchange is just another trading system. It's not a regulator like it used to be. It hasn't got the teeth that it once had.

KD: I don't want to end before we cover the other big splash, and that's '87. I know there was some press attention to that at the time, and I was wondering if you'd tell me a little bit. Did you have a sense that that could happen? Were people saying something like this may happen?

DS: Yes. John Phelan, early on, got very concerned about program trading and the portfolio insurance. I had the same concern that John did. We talked about it a lot. We had those fellows in who were doing the block trading, the computer trading, and talked to them about it. They didn't want a short-selling rule either. I remember we had a meeting with maybe the ten biggest computer traders, and they all said, "We have the stock, you know, we have these packages."

We wondered if they had the packages, and they traded it. John said, "Well, what if we held you to a short-selling rule on it?" We couldn't do it. We couldn't do it. I was sitting by one of the big players, and I said to him, "Could you do it?" He said, "Yeah. We could do it with a short-selling rule." I said, "Will you stand up and tell him?" He said, "Nope." So we never had it. Not even close. The program trading and portfolio insurance absolutely crucified the market. There was one time during the day in '87, I think it was, on that Monday, where the futures market was down a hundred points more with the averages than the market was. The professionals kept moving more and more interest in trading to do the kind of trading that Bernie Madoff did. Not by cheating, but by having electronic systems. And they got very good at it, and very sophisticated at it. When Greenwich Long Term Capital had the blow up, they had great systems, and they were hypothecating tremendous amounts of money.

Maybe the Commission or someone should make sure that it does not happen again. But I have a very uncomfortable feeling that everything we worried about that went down the tube is in place to do it again.

KD: How long after '87 were you still trying to fix the structure so that wouldn't happen again? Were you working on this for months, years?

KD: All this stuff came out of Chicago. It didn't come out of New York. It came out of the trading and the volatility of the trading in stock futures, options and program trading. That's where the big axes were made. I recollect we had a meeting with some of them at the Exchange after the crash, and they had, one of the fellows, one of the big economists who won the Pulitzer prize in mathematics or economics was brought in by Chicago as one of their witnesses, and fortunately hadn't won the prize by that time, he won it about four weeks later. What they would say was, "Hey, listen, these are markets for sophisticated people. We don't deal with the public."

KD: You did some things as well, like the circuit breakers, things like that, in the aftermath.

DS: Yes, we did. And that worked. But there are no circuit breakers anymore. There's nothing any more. There's no short-selling rule anymore. The short-selling rule, just a simplistic little thing prevented the kind of crash that we had last year, but it's not in place now, and the markets are in place now, and there's no transparency. I don't think there ever will be again. How one can raid a stock could be prevented with the short-selling rule being put back, if regulators went and took a look and see who sold AIG, who sold the stock that knocked Bear Stearns down. And there's ways they could do that.

KD: One of the focuses in all this is the whole idea of self-regulation. Was the New York Stock Exchange successful at self-regulation, or was there always the mismatch because you've got the market and the regulators in the same house? You made a big point that a lot of the self-regulation was really coming out of these committees. It wasn't coming out of the regulation side of the Exchange, per se.

KD: The regulation part of the Exchange was very effectively supportive of what the committees did, and they had the computers to see who was doing what. But we, on the floor, knew what was happening on the floor. If someone was trading without orders, for example, that would have to be picked up upstairs, couldn't be done by us. People were found to be doing that. We would report, "We think so-and-so was doing it, but the muscle was upstairs."

KD: So there were things you could see, and things they could see.

DS: Correct.

KD: Did the regulation side of the Exchange become more powerful over time, and more influential?

DS: Yes. It became more influential after the crash.

KD: After '87.

DS: There was no doubt about it. And should've been. A number of specialists lost stocks because they hadn't performed as well as they should have, and that's the ultimate punishment. Although the SEC picked up a number of specialists, and specialists firms, that'll never happen again.

KD: Now they're market makers.

DS: Yes, there are no longer specialists. There are no such things.

KD: Is there anything that we haven't talked about that you think is important to cover here in your career or how the Exchange works?

DS: I always thought the Exchange would live for a hundred more years. The Exchange was the envy of all other exchanges around the world. It had credibility; it was an honor to be listed on the New York Stock Exchange. You had to meet criteria that no one else had to meet, and there still must be a feeling that the Exchange has credibility or no one would pay listing fees to be there. My hope is that the Exchange will, once again, have integrity by regulation that will make it the primary market that it once was. My hope, but I won't be around to realize this. I always thought it was one of the great national assets, and it is no more, as I see it, to my mine and many others' great disappointment. But the public was well served. Thank you for doing this.

KD: Terrific. Thank you.

[End of Interview]