

Securities and Exchange Commission Historical Society
Oral History Project
Interview with Frank Zarb
Conducted on March 1, 2011, by James Stocker

JS: This is an oral history interview for the SEC Historical Society's virtual archive on the history of financial regulation. I'm James Stocker. I'm talking today with Frank Zarb, who has had a distinguished career on and off Wall Street, as well as in Washington. Mr. Zarb, thank you very much for talking with us today.

FZ: Nice to be with you.

JS: Let's start from the beginning. Where were you born and where did you grow up?

FZ: I was born in Brooklyn, New York. That's where I grew up.

JS: Did you go to school in New York also?

FZ: I went to New York City schools, right through the end of high school, and then went on to Hofstra University in Hempstead, New York.

JS: I understand that after getting your degree at Hofstra, you joined the military?

FZ: Yes. I was ROTC in school, so I had to do active duty, which I did.

JS: Which branch of the service did you serve?

FZ: U.S. Army.

JS: Did your work there have to do with finance at all?

FZ: My work there had to do with running combat tanks.

JS: So quite a bit different, maybe good training for running a Wall Street firm.

FZ: Maybe. (Laughter.)

JS: After your military service, what did you do?

FZ: I was recruited by Cities Service Oil Company as a cadet engineer, which was an extensive training program that took me through the various parts of the oil business. Then I ended up training employees at the oil company.

JS: But you decided to go back and do your MBA?

FZ: I did that in the evening.

JS: So that was on the side. What drew you to the world of financial markets?

FZ: I was recruited while at Cities Service by a Wall Street firm that wanted someone to build and conduct a training program for back office employees. While I didn't know anything about Wall Street's back office, I knew something about training. That's the way it all started.

JS: Then in 1969, you began to work as a back office manager at CBWL Hayden-Stone?

FZ: That's correct. We built the new back office from scratch. We were a small firm, but we were able to acquire some bigger ones.

JS: Was that where you met Arthur Levitt?

FZ: Arthur Levitt was my partner, along with Sandy Weill.

JS: At this time you must have had a firsthand view of what they call the Back Office Crisis.

FZ: It was a paperwork crisis. It was a time when the marketplace became democratized. It moved from an elitist market to one which began to include the middle class. Mutual funds were born. I remember in those days Kentucky Fried Chicken went public and the middle class began to invest in the market.

So the marketplace grew in numbers of participants. But Wall Street was ill-equipped to handle that increased volume, thereby providing a clog of paperwork in back offices.

Some firms failed because of it.

JS: How did you deal with that at your firm?

FZ: Since we built that back office from nothing, after the peak of the crises, we were able to build state-of-the-art, and therefore, avoid the issue.

JS: Did you begin using computers at this time?

FZ: We did. It was the initial use of computers, which were big monsters.

JS: Now at the same time that you were working at CBWL, you also began to take on professional activities outside of your firm. I know that in 1969, you chaired a committee that studied the problems of securities theft.

FZ: The paperwork problem created an opportunity for organized crime to plant people and take advantage of the account differences that were created by the paperwork jam. It was a time when all of a sudden the Street noticed securities missing. The New York City police questioned some people who had them in their possession, which made us look further at the size of the problems. The New York Stock Exchange put together that task force, which evaluated the problem and made recommendations.

JS: How did you personally become involved with this committee?

FZ: Since it was primarily a back office issue and I had gotten to know the senior officials of the New York Stock Exchange and they asked me if I would lead it.

JS: So you spent a couple of years at CBWL Hayden-Stone and then you joined the Nixon administration.

FZ: That's correct.

JS: How did you come to join the Nixon administration?

FZ: Our offices were at the General Motors Building. One day I had a call from a man who said his name was Fred Malek. He said he worked for the President of the United States and asked would I consider going into government, which I considered not very likely. Who would be asking me, a kid from Brooklyn with no political background, to take a relatively high level job in government?

We had made some large acquisitions at CBWL and attracted publicity. My role in it was, from time to time, mentioned. Malek indicated that Nixon wanted a manager in each cabinet agency – not politically picked, but picked for management skills – because

he was going to reorganize the cabinet. There were probably five like me in the government, recruited the same way at that time.

JS: Had you been involved in politics at all?

FZ: No, not at all.

JS: So it was quite a surprise? What made you decide to go into government?

FZ: I was overwhelmed with the prospect of becoming the then-Assistant Secretary of Labor and to work in Washington. For someone with my background, it was a tremendous compliment.

JS: Was there a long confirmation process, as we often see with assistant secretaries today?

FZ: No, the confirmation process was not complicated at all. It became more complicated when I was confirmed to my subsequent job in government. But at that time, it was a pretty low level and easy process.

JS: You served in the Department of Labor. Then in 1973, there was some talk of your taking over at the Office of Petroleum Allocation?

FZ: I went back to New York prior to Nixon's reelection bid. Then after being back a little more than a year, Fred Malek, whom I mentioned earlier, called again and said that the administration was having some difficulties because of the Watergate scandal. They had some open slots at the top of the Office of Management and Budget. Would I be willing to go back and give them a year?

I did go back for what I planned to be one year. During that time, when the first oil embargo hit, I was seconded to head the Office of Petroleum Allocation, which allocated fuel during the acute shortage. I was also doing my work at OMB, so I was wearing two hats during that period. Through that process I came to know Gerry Ford, who was Vice President.

JS: So this resulted in your staying on during the Ford administration?

FZ: I was headed back to New York once again. Then-President Ford asked me if I would stay and head the nation's energy business, because it was a serious matter and he had this notion of creating important public policy to avoid oil shortages in the future.

JS: Energy policy was a very important area during this period, obviously a very sensitive political issue. Who else did you work with on forming energy policy?

FZ: All the cabinet agencies. The most important meetings were at Camp David. There were people like the Vice President, Nelson Rockefeller; Bill Simon, who headed Treasury;

Henry Kissinger, who was Secretary of State. The Secretaries of Transportation and Interior were there. It was an interagency effort to put together the first comprehensive energy package to go to the Congress. Unfortunately, it also became the last.

JS: It's interesting that it was a Republican administration pushing this energy policy and a Democratic Congress that was resisting it.

FZ: I teach a graduate class at Hofstra University and several weeks ago we studied the energy crisis of the 1970s and the public policy response. I had a student say to me, "I think it's impossible for our democracy to produce legislation that would reduce oil imports that you just described," because virtually all of the measures that were on the table were politically very difficult. We were trying to remove price controls and get prices up, and thereby have conservation and more capital to expand energy. The private sector is more likely to invest in alternative forms of energy, if it knew that prices of oil would continue to climb in the future.

Many of the Democrats in the Congress didn't want that. They were persuaded by the consumer groups that oil companies were making too much money, so they opposed this and they had the majority. The President offered legislation which would have tripled the number of nuclear power plants in this country, with very specific legislation.

And nuclear power then, as now, had an unpopular aspect to it. People were concerned about it and its safety. It was a great populist position to be anti-nuclear. So that was

defeated. Our proposal included an increase in the number of coal mines. Unless you came from West Virginia, that wasn't popular either, because people saw that as dirty old coal being taken out of holes in the ground. We had a number of mandatory conservation proposals which did not please the private sector, especially the auto industry. The plan called for lots of short term pain for the long term security of lower oil imports.

JS: You also dealt with a coal miners' strike while you were in the Nixon administration.

FZ: We dealt with a coal miners' strike and a truckers' strike during that period. One wag said during that period that if it's hunting season, there's going to be a coal miners' strike.

JS: Was there any possibility to stay on into the Carter administration? Would that have interested you?

FZ: No, they didn't ask me. We came from different worlds. I was free-market, get-rid-of-price-controls, and he was let's-keep-price-controls. We did a book for him, which was very balanced, that reviewed initiatives which were proposed, the arguments, pro and con, how much of it was passed, how much of it still needed to be done. We hoped that he would then pick up the fight. But he didn't, nor has any other subsequent president. So it was a bipartisan failure.

JS: So, you returned to the private sector. Now there were rumors in the press at this time that you were being considered to head up the American Stock Exchange. Did you have any exploratory talks about this?

FZ: I did, but it was not my kind of thing, particularly at that stage. There were other options.

JS: So what did you do instead?

FZ: I went to Lazard Frères and for ten years I was partner in charge of international operations out of New York. We were financial advisors to a number of governments, which was an interesting and fun job.

JS: Did you travel internationally for them?

FZ: I did. I was out of the country more than half the time. But it was a great learning experience.

JS: What areas of the world did you work on?

FZ: We were advisors to governments like Indonesia. I spent a lot of time in Turkey, Panama, Chile and China.

JS: Sounds like a fascinating job. Then in 1998, you took over as chairman and CEO of Smith Barney?

FZ: Correct. When I was at Lazard, my former partner, Sandy Weill, had bought Commercial Credit from Control Data and I went on his board. He then had an opportunity to buy Primerica from Jerry Tsai. Primerica owned Smith Barney and Sandy asked me to leave Lazard and head Smith Barney, which I did.

JS: What was the status of the firm at that time, financially?

FZ: It was in pretty difficult shape. It had gone through the crash of 1987 and had large positions in their arbitrage account. It was hurt pretty badly. Morale was not very good, because the parent company didn't like taking those kind of losses. So it was a distressed situation. However, the people in Smith Barney were uniquely professional and had a sense of integrity which I've never experienced anywhere else. It was clearly quite a good culture, so building on that base was not as difficult as some thought it was.

JS: What measures did you take to turn the firm around?

FZ: First, we did add some people and then secondly, put some real controls in place, in terms of spending. Actually, Jamie Dimon helped me with that, because he came over to be my CFO for a while, and did a great job in helping that happen.

While we added many good people, it was the existing folk at Smith Barney with regained confidence and new momentum who made the difference. Within two years we returned to profitability and became a very good organization.

JS: What year did you leave Smith Barney?

FZ: I left Travelers in 1993.

JS: What was your next challenge?

FZ: A year earlier I had left Smith Barney to become divisional chief executive officer at Travelers, the parent company. I moved to the headquarters with Sandy to run a bigger part of the firm. Then I had an opportunity to become chairman and CEO of Alexander & Alexander, which was a large public company, a global insurance agency and consulting company that also was in trouble. It was a turnaround, but it was a real opportunity, so I became chairman and CEO of that company.

JS: Now before you took over at the NASD, were you following the developments there closely?

FZ: I was, of course. The players were people I knew. Arthur Levitt, chairman of the SEC, was my former business partner and continued to be a friend. So yes, I was watching what was going on.

JS: Who initially approached you about taking over?

FZ: Dan Tully, the then-chairman and CEO of Merrill Lynch, who said he was talking for himself and Arthur Levitt. We had sold Alexander & Alexander, so I was then at the point of not having a job. We met and then I went to see Arthur Levitt and Arthur urged me to do it and then it took on a life of its own. I became chairman and CEO of the NASD.

JS: Did you hesitate before saying yes?

FZ: I did, because we would have to move, once again, to Washington. We had moved to Washington before because of my government assignments. It would've been lifting roots and doing it again.

Since its inception, the NASD had a President and CEO. The Chairman was a non-executive and came from the industry. There was no way I would take the job without being both Chairman and CEO.

JS: Did you still have children at home at that point?

FZ: At that particular point they were at school, but away from home. It was still an issue. In any case, I did agree to take it. We bought a home in Virginia and we went to work. It was an interesting time for that organization too.

JS: You said you already knew some of the principal players before you took over. Did you know Mary Schapiro then?

FZ: I had met Mary Schapiro, yes. I had met Rick Ketchum. I didn't really know them that well, but I knew who they were.

JS: How did you go about making personnel decisions?

FZ: Well, first of all, I had the benefit of people like Mary Schapiro and Rick Ketchum in place. They were two stars. What we did could not have been done without them. If you remember, the NASD was under a consent decree. The SEC put NASD on probation. And so we had some real issues to face.

I talked earlier about the paperwork crisis and democratization. NASD was, in its day, a fine organization. But this democratization process that continued to grow, with more and more of the middle class getting involved in the marketplace, we needed a different look at the regulatory proposition. That's where the clash came. The NASD simply wasn't designed to do what needed to be done in this new world of investing – so major changes were needed.

We also had another important issue. We owned NASDAQ, which we wanted to grow. But growing NASDAQ and regulating it at the same time was very uncomfortable, and inconsistent with what made sense.

NASDAQ was hurt because of scandal, but it came back pretty quickly. Good listed companies like Microsoft, Starbucks and Intel hung in there. They stayed with us and we were able to turn things around. We changed the tone, the organization and the systems.

JS: You mentioned the settlement between the SEC and NASD. Before you took over, did you have discussions with the SEC about how that would be implemented?

FZ: I had discussions with Arthur Levitt about how it was going to be implemented. It had already been underway, before I got there. We had to report to an appointed monitor on steps to improve the substance and integrity of the regulatory process. It was more setting up new standards and major new processes to monitor the trading operations and to properly regulate them.

JS: Do you feel like when you got there, that the steps were already in place and underway? Or did you have to make some major changes?

FZ: We had to make some major changes. It was an uncomfortable process for the industry. It was difficult for the former leadership to bring the organization into a new generation

of change. The required changes were bold. Also, in its haste to do things differently, SEC required the NASD to set up three different boards of directors: an NASD board, a NASDAQ board, and an NASD regulation board. That made the job of leading the new NASD almost impossible.

JS: Would you have made that decision?

FZ: No. It was a bad decision. I can understand why it was made and people did it with good intentions. But the result was not a good one. I was going from board meeting to board meeting, and didn't have any time to do anything else. You can't run a company where boards are making policy in different parts of the same company that may not be consistent.

JS: Were all the boards based in Washington?

FZ: Yes. So I discussed the issue with Arthur Levitt and told him I wanted to change it. I reviewed the matter with Senator Warren Rudman, who had engineered the settlement for the NASD. Together we agreed that there would be one board. There could be two sub-boards, but those sub-boards would be made up of members from the parent board. Effectively, they would be committees of the board. That streamlined the operation. We were able then to get on with the job of more effective regulation.

But we were still stuck with the anomaly of owning the marketplace that we regulated. We began almost right away to look at demutualizing NASDAQ. That was a difficult process, because it was never clear who owned NASDAQ. The NASDAQ members paid dues for it, but they held no equity.

The membership wasn't keen on changes being made so easily. It took awhile, but we were able to get the pieces in place so that we were able to demutualize NASDAQ and it became a public company.

JS: Did you expect that that would happen before you started?

FZ: No, oh, no. It wasn't even a plan. The company was coping with more pressing issues, so demutualization was far from sight.

JS: Let's talk about another of the specific reforms that the SEC had demanded. They wanted changes in the way that orders were handled on Wall Street.

FZ: Order handling rules.

JS: How did you go about implementing this?

FZ: Actually, with a lot of help from people from the industry who knew how orders were processed, as well as Mary Schapiro and Rick Ketchum. Rick had very in-depth

knowledge and we were able to set out order handling rules, which gave guidance to the markets as to what they were going to do, when they were going to do it and more importantly, what kind of records needed to be maintained, so that we ended that process with a record of every trade, every time, everywhere throughout its life.

JS: How did this affect relations with NASD companies?

FZ: It was mixed. Some of the firms had been around a long time, particularly the small broker dealers, really did not like the change. I shared some of their concerns, because it put an expense on them that the bigger firms could afford and they couldn't afford. We formed a Smaller Broker Dealer Committee, which helped us with the change. We did our best to engineer our work to reflect size, but we needed to make the changes. We had to be as sensitive as we could, particularly to the small broker dealer community, and still get the job done.

JS: Was Bernie Madoff one of the active members of the NASD?

FZ: Bernie Madoff was an active member of the community. He was on committees at the NASD. He was on committees at the SEC. Frankly, he was a respected member of the community. Now we knew him, the Street knew him, as running a trading operation, which competed with the New York Stock Exchange. That was a neat business that made him a lot of money. It wasn't until this thing broke that I became aware that he had

a so-called money management business. So yes, he was, as I say, a respected member of the community.

JS: So he was an important market-maker at the time?

FZ: He was an important market-maker and he was a little bit of a rebel in that he took on the establishment.

JS: Now during this period which we might call the compliance period, were there any internal initiatives that had to go on hold, just because you had other priorities. In other words, were you forced to choose between initiatives that you wanted to do and those that you were forced to undertake?

FZ: Well, demutualization of NASDAQ was delayed because we had to get our house in order for people to give us the leeway needed to get this thing done. Remember now, I needed approval from the SEC, as well as others, to demutualize. It was also a difficult time because NASDAQ was considered a monopoly. It was continually under attack by the New York Stock Exchange. I mean competitive attack. They were formidable opponents. They had some political champions. And it was at a time when the Commission wanted NASDAQ to have competition, hence the ECNs, which gave NASD and NASDAQ a whole new set of issues to deal with. So yes, there was a lot going on. But there was a primary mission to demutualize. It probably took a year and a half for me to get there.

JS: When did you know that you had turned a corner with the company?

FZ: I think after the first year, Floyd Norris of the *New York Times* wrote his column and it was called "Comeback Player of 1997," and wrote, "Here's a regulator that has gone from where it was to something that's a respectable regulator," which was stunning. I still have that piece somewhere in my archives.

JS: Let's talk a bit about the role of technology during this period. As you mentioned, the ECNs were a major challenger to the NASDAQ at this point. Before you started at the NASD, did you expect that they would pose a major challenge?

FZ: No. It was there, but I just did not know it and didn't understand it. They grew very quickly. We had to scramble and do some other things. We also had the New York Stock Exchange that we were continually in a fight with. After we demutualized NASDAQ, we did try to acquire the London Stock Exchange, with Deutsche Börse as our partner. We were right, we were just fifteen years too early. We also formed an NASDAQ in Japan.

We built the MarketSite in New York City in competition with the New York Stock Exchange. It frustrated us that they could bang a gavel and we had nothing to bang.

JS: What was the goal of MarketSite?

FZ: To compete with the New York Stock Exchange. It would be a physical symbol of the NASDAQ. It's a place to open the market and to close the market. I had to go see the CEO of CNBC, Bill Bolster. I remember telling him that it was unfair that they showed the New York Stock Exchange open and close every day and never showed NASDAQ open and close. By God, Bill changed it, over the objection of the NYSE. It was a time when we had some momentum, but we had to get competitive. The MarketSite was designed to do that and it's held up remarkably well over the years.

JS: So at this time, you also began to put together an electronic limits order book.

FZ: Correct.

JS: Why did it take until 2002 to get that launched? I'm talking about SuperMontage, here.

FZ: First of all, the technology needed to be built from zero. It just took a lot of work and a lot of time, with everything else going on. People at the NASD, NASDAQ were first-class and they worked flat out. I still am convinced that without Rick Ketchum and Mary Schapiro, I wouldn't have gotten these things done at all.

JS: This is an issue that may be forgotten today, but this time was the era of the Y2K problem. Was this is a significant issue?

FZ: It was more a fear than what turned out to be reality. We thought the change was going to be so sizeable. There were so many programs out there operating with the old clock. The concern was real and the industry was right to worry about the possible chaos.

JS: Was it a significant drain on the resources of the organization?

FZ: A huge drain on resources and I have to admit, I was one of those people that told the Congress that we may have to slow things up. Since couldn't slow the calendar up, we may have to slow other things to make way for this. It turned out to be a non-event.

JS: You weren't the only person who said that. The NASD also embraced the idea of a website portal for financial information for investors. Where did that idea come from?

FZ: Actually, it was built on an existing program that gave investors the opportunity to look at the record of their investment advisor, their stock broker. If he had been disciplined, and we had some rules about that. That built the concept. Technology was getting to a point where it became a no-brainer to have that kind of a portal and it just got better and better and better.

JS: During this period, the NASD seems to have made an effort to portray itself as on the cutting edge of technology. Was this a conscious effort?

FZ: Yes. Partly it was our great companies, the Intels and the Microsofts, even Starbucks, which was on the cutting edge of what they did. We were able to benefit from the fact that the people who listed on our exchange came from that world, so we were going to join the same world. We became a cutting edge technology exchange.

JS: Did you consider yourself a technology guru or did you have someone on your staff who was an expert in that?

FZ: I, in no way, considered myself anywhere near a technology guru and I certainly don't today. But yes, we had very, very top IT people that we recruited after I got there. The team was outstanding. We had core operations in Connecticut. One of the big issues in Connecticut was that over the years we didn't pay any attention to security, but it became quite clear that that had to change because of events in the world. The major physical changes, in addition to the new computers, technology and back-up system, made NASDAQ world class.

JS: Let's talk a little bit about the changes in NASD's regulatory role. At this time, Mary Schapiro was already the head of the NASDR. How did you go about forming a common vision for a new regulatory organization?

FZ: Well, it was really not hard. We included the thinking of investors and broker dealers. We had come to the conclusion that we were going to be a leader in the regulatory world, and that we had to work as partners with the SEC and not be in combat with the SEC.

There were things that needed to be done simply to protect the investor. We were convinced, and I certainly was, that good regulation was supporting the growth of the marketplace. The better we did our job, the more confidence we gave investors, the more investors there would be. It turned out to be correct.

JS: Did you see the NASDR playing a role in regulating organizations outside of the NASDAQ at this time, too?

FZ: There were some non-U.S. regulators that wanted to study our model. The New York Stock Exchange regulatory unit was still at the New York Stock Exchange. When I ran Smith Barney, we would have the New York Stock Exchange come in. SEC would come in. NASD would come in. It was a little duplicative.

JS: Was there any resistance to these initiatives to increase regulation?

FZ: Oh, sure, sure. I mean, when I was a young assistant Secretary of Labor, I had the job of running the audits of the old Johnson programs, the Great Society manpower programs, which were put lots and lots of money out to not-for-profits and it became complicated and, some of it, scandalous.

I went to see Elmer Staats. Elmer Staats was Comptroller General, who ran GAO for years and years and had a great reputation. I went with my hat in my hand, because he audited me. I audited the D.O.L. programs and the G.A.O. audited me. I pre-empted the

process and went to see him and said, "I need your advice. I'm new to this town." And he was very helpful. I'll never forget, he said, "There are two great lies in this town. One is when my guy comes into your shop and says, 'I'm here to help you,' and the second is when your guy says, 'We're glad to see you.'" So there's a normal stress between the regulator and the regulatee.

JS: Was this also manifested in regards to the measures to detect violations of rules? I know that you instituted computer systems to track trades at this time. Were people hesitant to do that?

FZ: Yes. People are hesitant to change their ways. The larger firms saw the need. They weren't particularly pleased with making the investments required to do it. The smaller guys, it was a little onerous. I mean, they had to do things differently that cost them money to do. So you had to respect that. But in the end, it got done.

JS: Let's talk a little about the merger with the American Stock Exchange. How did this come about?

FZ: Chairman of the American Stock Exchange, Dick Syron, came to see me and he was concerned about the future of the American Stock Exchange. He thought the model was one that could not survive long-term as it was. We looked at it and determined that it would be neat if listing companies could have the choice of being on the electronic marketplace or on a floor-based marketplace.

Some of us thought that the world was upside down. It seemed to me that the bigger listed companies should trade electronic, and the small cap companies, many of which didn't have any research following, needed the love and hugs of a specialist. We studied it and moved in that direction and of course, we paid very little for the American Stock Exchange. It cost us something to spruce it up. I still think it was a good move. The cultures were different. The concept was good then and still is.

JS: At one point there were also plans to merge with the Philadelphia Stock Exchange.

FZ: We were in serious negotiations with Philadelphia. The economics didn't work out, because there were no synergies in that transaction. Philadelphia being Philadelphia, with the same overhead and we'd be in New York with the same overhead. You couldn't put two markets together and create savings.

JS: What was the draw of the Philadelphia Stock Exchange?

FZ: Options. We thought options in electronic exchange were natural and they were also going through some upheaval, so the price would've been right. But when we ran the numbers, it didn't work out.

JS: A little earlier you talked briefly about the company's international strategy. At this time the NASD was reaching out to many different countries. Was this something you guys were thinking about before you took over or did it evolve later?

FZ: It evolved as I moved around the world and met exchange heads. Joe Ackerman, now chair of Deutsche Bank, was key to the Deutsche Exchange. We talked about the way the world was headed and we created this vision – which is happening now. We saw a time when the MarketSite in New York would be open twenty-four hours a day. From New York, it would go to Asia, Asia to Europe, then back to New York, because the marketplace is global.

The larger firms had already gotten there. I mean, they were part of the international landscape. With all these other money centers, why shouldn't the electronic exchange be there? The reasoning was sound. We knew it was going to be a long haul, but when you have a long-term plan like that, the markets go up and go down, and the economics of the overall enterprise change. We got to a point where we couldn't support this new venture. So it was temporarily withdrawn. Now it's a reality.

JS: Did NASDAQ open up a branch in Europe?

FZ: We opened up a branch in Europe. We bought the software from a company called EASDAQ, which I think is still in use in the NASDAQ operation. It was small, but I

thought it would be the forerunner to buying the London Stock Exchange. If we could've bought the London Stock Exchange, then it all would've come together.

JS: Sometimes it takes time. What about NASDAQ Japan? Can you tell the story of that?

FZ: It was an idea created and brought to us by a guy by the name of Masayoshi Son, who was the chairman of Softbank, a big company in Japan. Masa was young, aggressive, and a very successful business guy. He came and made a pitch as to why we could operate in Japan and we were intrigued, because he had produced the Osaka Stock Exchange to partner with us. The Tokyo Stock Exchange didn't want any part of us. Tokyo had the New York Stock Exchange mentality. They had their own franchise and they didn't want anybody touching it.

In the end, we began to impose our regulatory standards. The Japanese trading community didn't particularly appreciate that, so that didn't work. It was a good initiative. It was there when I left the company, but it was clear even at that stage that they were going to have a challenge to make this thing really go. Unless it was embraced by the Japanese government, it wasn't going to happen. But it was a worthwhile effort.

JS: So in a way, the world was coming to NASDAQ as much as NASDAQ was going to the world?

FZ: Oh yes, I sat in the MarketSite with the Prime Minister of China, who wanted to talk to me about an entrepreneurial class, how you build one, an inventive class, and how you go about creating venture capital. They wanted to talk about a Chinese NASDAQ. They were thinking about that a long time ago and it's now happening.

JS: So why did NASDAQ decide to file to become an exchange officially?

FZ: Simple. Our ability to trade and to get into markets we weren't in depended on our being an exchange. The way we were regulated depended on our being an exchange. And the thing that kept us from being an exchange for years was politics. The successful New York Stock Exchange had political leaders to support them and not us. Senator Phil Graham told me once that he thought the New York Stock Exchange was on sacred ground. I knew I was in trouble when the Senate Finance Committee chairman told me how sacred my biggest competitor was.

JS: Let's talk a minute about that, about the relationship between the New York Stock Exchange and the NASDAQ. It was pretty heated during this period, wasn't it?

FZ: It was very heated. It was heated and unique. Dick Grasso and I would go at each other all the time. Then two or three times a year the two of us would sneak out and have dinner together. That didn't mean the next morning we weren't going to go right back at it. But that time was more responsible than almost anything for NASDAQ's success.

JS: In which way?

FZ: Once we got to the point where we were head-to-head with the great New York Stock Exchange and we were being compared as an equal to the New York Stock Exchange, we all of a sudden had stature that NASDAQ never, ever had. People thought differently of us. We thought differently of us. It was a remarkable transition.

JS: Of course, you were putting up statistics during this period that were in strong competition with the New York Stock Exchange, in terms of trading volume and listed companies.

FZ: We did compete with them every way we could. We talked also about consolidating the New York Stock Exchange with NASDAQ. I actually talked to the Justice Department at one point to tell them that Dick Grasso and I were in conversations. I didn't know whether it was going to go anywhere, but we didn't want to do it without their knowledge. They had no problem with us talking, but they didn't give us a green light.

JS: Was this before talks with AMEX began?

FZ: Yes, yes, it was before that.

JS: So in this hypothetical deal, the New York Stock Exchange would have served the role that AMEX later did in the relationship?

FZ: Right, only because of our relative sizes, they'd be a more important component in the universe than was the American Stock Exchange. I always thought that was a great idea, because again, the users could decide in which format they wanted their securities traded.

JS: One of the reasons that NASDAQ was doing so well during this period was the rise in technology stocks. Was there any concern during this period that the index might be overheating? Perhaps that the reforms had been too successful?

FZ: Yes. As we got closer to 2000, I took ads out in the *Wall Street Journal* on the editorial page asking investors to be careful. I was worried about soccer moms taking the kids to school, going home and logging on and doing day trading. It was clearly building into a high that could not be sustained.

I had talks with Dick Grasso and with Alan Greenspan about raising House Margin Requirements. Alan did not want to raise Initial Requirements. But I thought Dick Grasso and I could send a signal by raising House Requirements. It was a difference of opinion. I thought we should do it, Grasso did not and we couldn't do it without him. But yes, it concerned me a lot. You could feel the rise in what I call the Ambient Risk Attitude and what Alan Greenspan calls "irrational exuberance."

JS: So once the bubble began to burst, what measures did you take in terms of damage control?

FZ: I was then retiring. I don't really know what NASDAQ did. There wasn't much they could do once the bubble burst. NASD had to intensify regulation at NASD, we always worried about market breaks, because that's when the problems surface.

JS: What factors brought about your departure from NASD?

FZ: I was getting to that age. I was past sixty-five and really wanted to have a different pace. That job was day and night. Anywhere in the world, you were on duty. I thought it was time, so I decided to step down. I had a couple of offers from private equity firms to become what effectively amounted to a senior advisor. Of the three, I picked Hellman & Friedman.

JS: Did you make any recommendations as to your successor?

FZ: I did. I knew my successor. He was with us back in the CBWL days and I thought he'd be good. I introduced him to Warren Hellman, who was on the board of NASDAQ at that time. Everybody thought he had all the characteristics to be the right CEO. He'd been in the business all his life. He worked with Sandy Weill most of that time, and had all the needed skills to do that job. Sandy also thought he was a great candidate.

JS: You left your position just a few months before the September 11th attacks?

FZ: Yes, correct. That's exactly right.

JS: So after leaving, you eventually joined the board of directors at AIG?

FZ: I did. I've been on nine public boards now in my lifetime. I'm getting off my last one, which is Kraft Foods, in May. Hank Greenberg, whom I'd gotten to know since I was back at Lazard, asked me if I'd go on the board of AIG, which I did and then ultimately became lead director. I was not on the board at the time it was bailed out by the government, but that's a sad story.

JS: Were any of the symptoms already manifest at the time when you were on the board of directors?

FZ: Not that we were aware of. Matter of fact, if anything, all of the signals that were received from both inside and outside advisors were that it was strong as strong could be.

JS: Well, Mr. Zarb, do you have any final thoughts before we wrap up?

FZ: Looks like you did a good job. You covered a lot of ground in a short period of time. Good work.

JS: Well, thank you very much, sir. We really appreciate you talking with us today.

[End of Interview]