

Securities and Exchange Commission Historical Society
Interview with Lewis Brothers
Conducted on October 6, 2008, by Kenneth Durr

KD: This is an interview with Lewis Brothers on October 6th, 2008 in Wicomico Church, Virginia, by Kenneth Durr. Are you a Virginia native?

LB: Yes, I graduated from the local high school in Gloucester, and enrolled in Richmond Professional Institute before it was Virginia Commonwealth.

I took courses at RPI and Smithdeal Massey Business College. The military draft interrupted, and I never did finish. I ended up serving a hitch in the Coast Guard. I always pursued an accounting career, and when I finished my active duty in the Coast Guard, I went back to school at RPI. It was then that I became interested in brokerage accounting, which was something unique at the time. I called the Securities and Exchange Commission and asked if they had any openings for examiners, and they said no, but they knew of an opening at the Securities Division of the Virginia State Corporation Commission, so I applied and went to work there. In those days, the states and the SEC were really very cooperative and shared the regulatory work load. When either agency issued a press release, we gave each other credit on any case we worked on together.

KD: When was this?

LB: I went to work at the Virginia State Corporation Commission in 1967. Brokerage accounting was not offered in school. You had to work for a firm or be a regulator to receive the training. I'm glad that I made the regulatory decision that I did because with the development of computers, most of the "back room" jobs at the firms were eliminated. I trained with the SEC examiners from the Washington Regional Office of the SEC.

KD: How did you do that? Was it a program that they had?

LB: The Washington Regional Administrator, Alex Brown, used to have semi-monthly meetings with all of the regulators so that we could coordinate our exams. Mr. Brown put me in the SEC Virginia audit program, and I spent a good year and a half going around with the SEC examiners auditing Virginia brokerage firms. That's basically how I learned the business. In 1971, I became director of the division.

KD: Who were you working for? Who was director before you?

LB: A man by the name of E.C. Frasier.

KD: It sounds like he was very close, then, with the SEC regional office.

LB: He was. The regional meetings used to include regulators from the SEC, New York Stock Exchange, Virginia, Maryland, West Virginia and Pennsylvania, and also the representatives from District 10 and District 11 of NASD. We met in Washington at the SEC headquarters. When I became director, I just continued this program.

KD: Were these week-long meetings? How did they work?

LB: The meetings lasted one day. Each regulator would present the cases they were working on. The states and the SEC did a lot of work together, and it was basically our time to share with the SRO's.

KD: So you were talking to the New York Stock Exchange people and the NASDAQ.

LB: The NASD. Everyone would share information on the firms being examined. This program started with the vision of the SEC Regional Administrator, Alex Brown, when a brokerage firm slipped into financial trouble. The firm has long been out of business and I would prefer not to mention its name.

KD: If it's long gone, we're probably safe.

LB: I remember going into the firm as an auditor, and found the SEC was there, the NYSE, the NASD and the State of Maryland. We agreed to pull out and form an audit group made up of representatives from each regulator to do the audit.

KD: You didn't need all those people.

LB: No. Mr. Brown made the comment, "This should never happen again." We were the first regulatory group to do the cooperative programs. When I became director of the division, obviously, I continued the programs and our staff did a lot of work with the SEC. I remember some of the investigations that we did jointly with the SEC and I can go over a few of them for you. One was a very large church in Virginia that sold church bonds. I remember the pastor of the church and the financial officer came to my office. We opened an investigation because of their advertising, and we also received complaints from residents of the Commonwealth.

KD: They complained to you?

LB: Yes. Our investigation disclosed a large public offering of securities with non-existent financial statements. The bonds were sold on the faith and credit at the church. I remember the pastor and his accountant during my meetings with them producing a balance sheet which they claimed as produced from the church books. I remember looking at it, and noticed they had listed \$100,000 in marketable securities as an account receivable. I asked what kind of securities they were; they stated all were listed on the stock exchange. I asked them where the stock certificates were located. The pastor said,

“Well, they actually belong to a church member who’s 93-years old and in bad health, and she’s mentioned us in her will.”

I tried to explain to them that, according to the generally-accepted accounting procedures, the securities could not be listed on the financial statement because the church did not own the securities. The SEC Washington Regional Office became involved, and decided to seek a temporary injunction to shut down the bond sales and appoint a receiver, because the church was teetering on financial problems.

KD: So they were trying to get money just to survive, I guess.

LB: Yes. The case was heard in Federal District Court. I was a witness for the SEC in the Federal Court hearing. I remember the night before the hearing, I was with the SEC staff at the Federal Court House preparing for the hearing, when the pastor stated on his radio program that his church was in the grips of a battle with the devil disguised as the Virginia State Corporation Commission, and the United States Securities and Exchange Commission. He added that the heathens were staying at the motel out on the bypass. We received threatening calls at the motel. The next morning, I remember going to the Federal District Court, accompanied by U.S. Marshals. I told my story about my meeting with the pastor and the financial officer. The stage was dramatically set because everyone from the government came in wearing our dark suits, and the pastor and the attorney representing the church were dressed in white. The courtroom was packed with the members of the church and the judge had a rough time keeping order in the proceedings. The opening statement came from the church lawyer and when he finished, he received a standing ovation from the packed courtroom. When the SEC completed its opening statement, they were booed.

KD: It was a real show.

LB: I gave my testimony, and I remember the cross examination was very short. The lawyer asked me if I was a member of a church. I said, “Yes, in Richmond.” And he said, “Well, does your church have certified financial statements?” And I said, “No, but we don’t sell bonds.” And that was pretty much the end of my questions. The court listened to my testimony and several other people, and then the proceedings ended for the day. The federal judge called both sides in to his chambers, and advised, “My chambers are going to be open for the evening, and I expect all parties to agree on a reasonable settlement by tomorrow morning.” The settlement was completed that night. The SEC dropped the fraud charges, and instead of a receiver appointment, three businessmen from the community agreed to oversee the business affairs of the church. The church agreed not to sell any more bonds until they prepared the necessary prospectuses with financial statements. The next morning, while the SEC lawyers and church’s lawyers were in the chambers with the judge working out the final details for signatures, I was sitting on the bench outside with the pastor. The pastor said, “Mr. Brothers, I’ve learned a valuable lesson in this.” I said, “What’s that, Pastor?” He said, “I don’t have to sell bonds. People will give me money. And I don’t have to worry about the likes of the Federal and state government.”

KD: Not a good lesson to learn, I guess. Something that you said is interesting, there. At some point, this was in your lap, and then the SEC decided to come in. What was it that brought the SEC in?

LB: Investor complaints to the SEC, just like the ones we received, and through our quarterly meetings. The SEC knew about the case because I had presented it at the meeting and advised that we were working on it. The SEC decided they would not intervene until they received complaints. Once they received them, they contacted our agency. We were able to move fast. The state always had the ability to move quicker in the court than the SEC did on the Federal level.

We had subpoenaed many documents in the case and the SEC was concerned that any subpoenas they issued may be contested in Federal Court. The SEC would usually come to the states because the states could obtain documents in their court system faster. As an example, the Virginia State Corporation Commission is a court of record with direct appeal to the Supreme Court of the state. The three commissioners sit as judges, so any of the hearings by the staff of their agencies are brought directly to the Commission in their court. The SEC could obtain documents faster by doing joint investigations with our agency.

KD: So they can go to the Court of Appeals, and you know exactly where you stand.

LB: Well, interesting enough, from the Corporation Commission, the appeal is direct to the Supreme Court of the state. So you could do two appeals and be in the Supreme Court of the United States. That's quite quick.

KD: Other big cases from over the years—

LB: I remember a case that concerned a licensing case by discount brokers. They were contesting the state's authority to license the discount brokers because they were national firms. The case was not brought before our Corporation Commission. We were sued in Federal court. We were able to defend our state licensing authority. The Federal judge stated in his order that the national firms should register and be regulated at the state level. They appealed his decision. On the appellate level, the SEC intervened and supported our position. Stanley Sporkin, who was director of the SEC Division of Enforcement, made the argument. The Court of Appeals upheld the District Court's decision.

KD: Was this one of the big brokerage firms? The big national ones?

LB: There were several of them represented by a trade organization. The trade organization was the one that sued us.

KD: I suppose they probably had these issues with other states too. They just chose Virginia for some reason?

LB: Virginia was chosen because we had a very difficult registration requirement. In order to be registered in the state, you had to have a place of business. I thought it was an onerous provision, but it was in the state law, and we had to enforce it. This proceeding offered a great opportunity to have the Federal Court strike it down. The court's decision was a great compromise. The Federal Court determined the requirement of a place of business interfered with the commerce clause of the U.S. Constitution. The court also determined that the state had regulatory authority to require registration. When the SEC intervened at the appellate level, the only issue on appeal was the licensing provision because we never appeal the place of business requirement.

KD: Because you were glad to see that go.

LB: We were glad to see it go. Stanley Sporkin made the argument supporting the state on behalf of the SEC. That was the one of the last cases, I believe, he argued before leaving and becoming General Counsel of the CIA. He later left the CIA when he was appointed a Federal judge.

Another big case that we did in conjunction with the SEC was a finance company down in the Tidewater area that was selling notes in Virginia and other states. The offering was made in West Virginia, Maryland and Pennsylvania, in addition to Virginia. The finance company had set up each finance office as a separate corporation. They had about \$100,000 in cash and staggered the year-end accounting periods of each corporation so that the \$100,000 would be funneled from one office to the other. By doing this, they were able to produce solvent financial statements. I remember spending six months doing a joint audit with the SEC. Finally, the SEC moved successfully in Federal District Court to have a receiver appointed and to shut down the sale of the notes.

KD: How did you figure out that they had \$100,000 floating around?

LB: Before the SEC came into the case, the Corporation Commission started a routine audit of the company. I remember the first day we were there I asked the comptroller to let us review an organizational chart of the company and subsidiary corporations. The organizational chart contained over 17 corporations. I went to the top of the outline and asked to see the financial statement. It so happened that on the date they did the audit the \$100,000 was in another corporation and the holding company was insolvent.

KD: Odds were good you were going to pick one of the ones without the \$100,000.

LB: Exactly. And we didn't know that all of their cash funds totaled \$100,000 at that time, but I knew after reviewing the financial statement, the holding company was insolvent and the rest of the companies were ready to collapse financially. It took us about six months of tracing book entries and cash to prove that the financials of the companies were integrated.

On another occasion, the states with the assistance of the SEC, shut down an oil and gas fraud. The SEC had a procedure for small oil and gas offerings, which was referred to as Schedule D. Most of the Schedule D deals came out of the oil and gas states such as Texas and Oklahoma. A group of thieves and charlatans picked up on the process and began selling Schedule D offerings all over the country. I remember asking the Corporation Finance staff at the SEC to share Schedule D information with the states. They refused to honor our request. We spoke with Stanley Sporkin and Commissioner Irving Pollack and they had the division share the information. The State of Texas had one of the few computers at the state level. They transferred the data and sent each state regulator a listing of each Schedule D offering in each state where the offering was made. The states brought civil and criminal actions against the Schedule D filers. The SEC, through its Enforcement Division, also prosecuted some of the operators and discontinued the Schedule D program.

KD: Now why would Corp Fin tell you they didn't want you to see those—

LB: I'm not sure.

KD: Just turf, I guess.

LB: Turf, maybe. That was kind of a bad experience for the states with Corp Fin, but I can tell you a good one. Reg D filing requirements that exist today were drafted by the SEC staff and state regulators. Mickey Beach was the Corp Fin head, and when her division proposed rules that affected the states, she would work the state regulators right into the implementation process before the rule was ever published for comment. We worked together on Reg D and drafted the rule. It was then published and adopted by the SEC and the states.

KD: So did you meet in Washington a lot?

LB: There were 5 or 6 state people. I was one of them. We were sponsored by NASAA, and we probably met for a good six months on the rule before the SEC published it. The Corp Fin people would draft, and the state representatives would review it and come back with comments. There was much give and take by both sides. The states gave up some things, as did the SEC, and it was a good compromise. That was the way that rule was adopted.

KD: The oil and gas leasing sort of falls in the same category, at least to me, as the penny stock boom.

LB: Schedule D started out being utilized by legitimate industry; I'm not sure that penny stockbrokers were. It consisted of a small bunch of wildcatters who were drilling wells and raising money from a close-knit group of people that understood the oil and gas business. It totally changed when the people who were making the Schedule D offerings would solicit people all over the United States, without experience or knowledge of oil and gas drilling programs.

KD: Did you see your share of those mining stocks and earthworms and things like that back in the 70s?

LB: We saw mining stocks, earthworms, orange groves, anything that could be syndicated or offered. We did a criminal case on a worm farm. We had a traveling con artist from out of state come through and sell a young couple an interest in a worm farm in the western part of Virginia. They put their life savings in it, and the promoter stole their money. They complained to our agency and we investigated. We were able to get the Commonwealth Attorney to criminally indict the individual, who had fled the state.

But the nice thing about a criminal indictment is it stays on your record as an outstanding warrant. Several years later, the promoter was picked up on a speeding ticket in Ohio. We extradited him back to Virginia. He sat in the local jail all summer awaiting trial. The state required anyone in jail to work on the road gang. He spent the summer on the road gang with a guard standing over him with a 12-gauge shotgun, fighting the copperhead snakes, the chiggers and the heat. Mysteriously enough, by the next fall when he came to trial, the money became available.

KD: So he made restitution.

LB: He made restitution and the Commonwealth's attorney withdrew the complaint. We did a lot of criminal cases in addition to our regulatory actions when I was in Virginia. I had a great staff, and I'll tell you about them later. We were heavily involved in the registration review of public offerings. We were also very active in the registration of brokers, financial planners, investment advisor representatives and broker agents.

KD: Financial planners actually came in at some point in there, didn't they? Wasn't that an initiative?

LB: We were the first state to adopt the NASAA model program for investment advisors and investment advisor representatives. We adopted the program over the heavy objections of the industry, when we were able to prevail in the state legislature. I set up a program with the NASD to automate the registration of firms and investment advisors just like the CRD process for the brokerage firms. It was a very smooth transition. We adopted the model exam and the legitimate industry came right in and registered. We had some that refused to register, but after some administration proceedings with large fines by the Corporation Commission, more finally came in and registered.

One particular one that is memorable to me was a Finnish national who came into the Richmond area and claimed he had some sort of esoteric option strategy. He received customer funds to manage and ended up using the money for personal gain. When our investigation was completed, he was indicted, skipped jurisdiction and went back to Finland. I guess he would've been fine if he stayed there, but a year or so later, he went to Canada and started calling some of the Virginia investors. They immediately complained to us, and we were able to have the Royal Canadian Mounties pick him up.

We extradited him back to Virginia, criminally tried him and the result was 222 years in prison. The Richmond Commonwealth Attorney's Office was staffed to prosecute white collar crime cases and, working together with our investigations, they made a great team. The Finnish national who received the 222 year sentence was in jail about five years, and worked his way to a trustee position which allowed him to use the telephone. He opened an account from prison with a brokerage firm and starting trading options again. This time, it was with his cellmate's money.

The warden called me and advised, "This guy will come up for parole in another five years or so, and I'd like to make sure he doesn't get out." So we investigated this case, criminally prosecuted him again and tacked on another 10 years. As far as I know, he's still in jail.

KD: He just couldn't help himself.

LB: You asked about registration of public securities offerings. We received and registered many syndications.

KD: Explain that concept a little bit.

LB: Limited partnerships would be used to bring in investors for real estate, oil and gas, and movies. Most of these offerings were sold as tax shelters for high income investors.

KD: I know real estate limited partnerships were a problem.

LB: Some were and some were not. One of the last cases I did at the Commission was through NASAA as a task force in partnership with the SEC. Together we investigated and stopped one of the major brokerage firms from selling the partnership units. We were able to negotiate a good settlement for the investors. Irving Pollack, former SEC Commissioner, was appointed claims administrator under the terms of the settlement, and \$1.8 billion was returned to the investors.

KD: This was a big brokerage.

LB: They also paid a fine of \$500,000 to every state.

KD: This was a brokerage that was using unlicensed brokers?

LB: No. The firm and its brokers were all licensed. All the securities were registered. The way the partnerships were managed, many of them had no chance of any economic gain. There were sales practice violations and misrepresentations of the product.

KD: Got you.

LB: There were also many unqualified investors put into the programs.

KD: Now does this shade into tax shelters at some point?

LB: They were all tax shelters. If you are interested in more details, you may want to read the book *Serpent on the Rock*, written by *New York Times* business writer, Kurt Eichenwald. The role of the states and the SEC was outlined in the book.

KD: Excellent.

LB: There were other cases that we did when I was in Virginia during the 24 years that I was there. We did many but these are the ones I remember. There was a stockbroker at one of the major firms who was stealing money from customers by manufacturing account statements to hide the fact he was using customer funds. He would hand deliver customer checks by telling the brokerage firm that the customer had called and wanted a check for funds in his account. The firm would cut the check and allow him to hand deliver it. He would then forge the check and convert the funds to his own use. This went on for a long time with one brokerage firm, and then he moved to another one and continued stealing customer funds.

A customer complained and we opened the investigation. It was quite a big case and reported in the press for a long period of time. I remember one of the local folk artists, probably at VCU, wrote a ballad about his ill-fated deeds. It was played on some of the radio stations. As part of our settlement with the firms, we required all stolen funds be returned to the customers.

KD: Did you have to go after the firms?

LB: Yes. The first thing we wanted to do was make sure the customers were made whole. And to the brokerage firms' credit, there was no resistance. They stepped up and did the right thing. They paid the customers off. We criminally prosecuted the broker and he received 20 years. We started a failure-to-supervise case against both firms, because there was non-existent supervision over the broker. The conversion of funds should have been detected earlier for both firms. At one firm, the cage wasn't secure. The broker was going in the cage and stealing copies of the monthly statements so he could manufacture false ones. Both firms settled with us. Our settlement didn't require a fine of either firm, and we didn't complete any action against one of the branch managers. The SEC did settle with the other branch manager.

Our settlement agreement with both of the firms required them to hire, at the state's choosing, an independent accounting firm. We did the RFP, hired the accounting firm, and the brokerage firms paid for it. Under the terms of the settlement, on a six-month basis for two years, the brokerage firms had to audit each branch office in the state. The settlement required the accounting firm to do a peer review of the brokerage firms' internal auditors.

There were other firms in Virginia that allowed the process of hand delivery of checks. The legitimate broker would deliver the check, go over the customer's account and

probably end up with more business. However, for the charlatans and thieves, the money was too tempting and they would take it. In the end, the brokerage community decided to discontinue the hand delivery of checks to customers.

KD: Now was this the kind of thing that you would go to the other states and say, “You know, this worked out really well for us, why don’t you take a look at hand delivery?”

LB: Yes, we shared the information with other states and helped them with the RFP process for obtaining the independent accounting firms. Also we received help from states on the matter. I certainly don’t want to give any impression that I was the instigator of requiring the internal audit. That was something I picked up from the SEC because they did it. I do feel we were one of the first states to use it. As you can imagine, the firms objected to it strenuously. But they had no choice.

KD: It’s better than the alternative, I guess.

LB: Exactly.

KD: One thing we didn’t talk about is mergers and acquisitions and the regulation of those. Did you see a good bit of that in the late 70s and the earlier 80s?

LB: Virginia was one of the states that had the early takeover statutes. I remember having discussions with Stanley Sporkin, when he was the SEC Enforcement Director. I felt it was definitely a federal securities matter. In the earlier days, we referred to tender offers as “Saturday Night Specials” or “St. Valentine’s Day Massacres.” A raider would show up at a company’s Board meeting and announce that he owned a substantial portion of the stock and that they wanted to effect a buyout. I think the purpose of the state laws during this time served well. The target company would complain to the state.

The state would start proceeding and the tender offer would be announced to the public. During this time, the SEC did not have 13D requirements under the Federal Act. The raider did not have to disclose that the target company’s stock was being acquired.

In my discussions with Stanley Sporkin in the early days, he was of the opinion that the states should not be involved in cash tender offers. I felt the states should be involved until the public announcement of the tender offer. I remember giving him this example – we had a public company located in the western part of the state. There was a local factory in the area; everybody owned stock because it was a stock exchange traded company. I remember taking the statement from a farmer who said he came home for lunch one day and received a telephone call offering him \$20 a share more than the price of his stock. He sold the stock and came home that night to learn on the news that a tender offer had been made for \$40. After this example, Stanley agreed that something needed to be done to expose tender offers so that the investing public would have knowledge of the offer.

The SEC adopted the 13D requirements. The states were later preempted by the Federal Court from administering their tender offer statutes.

After 13D was adopted, I was not too concerned about the issue. But the law was there, and we had to enforce it. If we received a complaint from a company, we would go before the Commission and ask for a public hearing. The target company would poke holes in the disclosure document and eventually, the raider would ask the Federal District Court to enjoin the state. I remember we would always enter into an agreement with the Federal Court not to impose the provisions of the state tender offer and the lawsuit would be dismissed. The Federal District Judge would say, "Glad to see you here again, Mr. Brothers. The Virginia Legislature keeps tweaking the statute and changing it, and I keep striking it down. We'll see you with the next one."

KD: It was a tricky situation because the SEC was very often going along with the corporate raiders and wanting to give stockholders the opportunity to—

LB: I didn't really have problems with that philosophy myself because as long as full disclosure was made, the tender offer was announced, and the shareholders were given notice, many of these companies were targets because the management was lax. The company was worth on the books a lot more than the stock was traded for. The management of the company wouldn't do anything to encourage the marketplace to increase the value of the stock. In the early days, I think the SEC was behind the curtain and the states were out front. However, once the public shareholders received full disclosure, I felt that the state tender offer statutes were outdated.

KD: Let's back up a little bit. In talking with other state regulators, there's discussion of merit states, there's New York, and then there's everybody else. Would Virginia qualify as a merit state?

LB: Virginia was almost merit, and mostly disclosure. The merit states were located in the mid-West.

KD: Right.

LB: They came up with model guidelines to review the programs. In those states, the Commissioner literally had the authority to look at an offering, and determine whether it was fair, just and equitable. Many other states only had disclosure standards, and Virginia and others were in the middle. I certainly didn't have the authority under the Virginia statute to declare that an offering was not fair, just or equitable.

However, if we adopted guidelines adopting standards for review and the offering didn't meet the guidelines, then we could deny it. We published the guidelines on oil, gas and real estate syndication and others. Most of these guidelines were developed by the Midwest Securities Commissioners.

We attended Midwest meetings to learn what the problems were, to review their guidelines and to participate in writing them. Virginia was in between full merit regulation and full disclosure.

KD: Yes, it sounds like you could do pretty much the same thing, but you were deciding, in general terms rather than on a case-by-case basis.

LB: Yes. Our statute required that the guidelines had to be published and the offerings had to meet those standards. I don't think the Midwest Commissioners or the total fair, just and equitable states were arbitrary or capricious. They had their own standards of reviews in their states, but a lot of the rules were not published. The Midwest Commissioners had their own association, and were also members of NASAA. Both groups were under funded. Eventually, NASAA implemented the Uniform Exam and had enough money in its treasury to fund many of the Midwest programs. The Midwest Commissioners decided it would be more appropriate to dissolve their association and accomplish their work through NASAA.

KD: Well, let's walk through that a little bit. You became involved with NASAA sometime in the early 70s as treasurer? Is that right?

LB: I became treasurer of NASAA in the early 70s, and went through the progression of the offices in the association, serving as president in 1976. That was my first term. With my presidency, we started the first uniform registration programs and CRD.

KD: Where did the impetus for that—let's start with the registration.

LB: The Central Registration Depository?

KD: Right. That's the second thing. I'm thinking of the uniform securities exam as being an important initiative.

LB: It was and came later.

KD: Is that a little later?

LB: Yes. The first uniform initiative was done in 1976. And it was the standardization of all the registration forms. NASAA had a small treasury and I appointed Hugh Makens from Michigan to lead that project for the states. NASAA financed some of his trips to Washington to meet with the other regulators. Hugh was quite a statesman, an excellent lawyer and a great securities commissioner. He probably would never say he was, but he was a good politician in that he could lead people to reach an agreement.

KD: And I suppose that everybody thought that their forms were the best.

LB: Yes. And everybody had one. All 50 states, the SEC, stock exchange, NASD. Hugh was able to, in a year's time, with the help of the other regulators to come up with a

standardized U4, U5 and form BD. The states, for instance, gave up a lot of requirements to make the form uniform. Like individual license, most states required a license, like a driver's permit, pictures of applicants, references, staggering renewal dates, just to name a few. Once the forms are put together, shortly thereafter, NASAA developed the state uniform exam. That was kind of the second item because so many states had different exams. And I remember, for instance, we used to proctor exams for other states. If a broker wanted to be registered in Texas, Texas would send us the exam, hard copy. We would bring the person in the conference room. They would take the exam, and we'd monitor the process, and then we'd send it back to Texas, and they'd grade it and tell the person whether they passed or failed. You can imagine the time that that took to get into the industry. Well, the states decided to move forward and put together a uniform exam which would basically work in tandem with the Series 7. And it was adopted by the states.

KD: In tandem with Series 7?

LB: The Stock Exchange and the NASD both required applicants entering the securities business to pass the Series 7 exam. The state exam contained the information on state law. The states through NASAA entered into a contract with the NASD to administer the state exam (Series 63). The NASD had offices located all over the country and they also administered exams for the Stock Exchange as well as their own. All exams were on line and applicants could come into these offices, take the exam, and they would know if they passed or failed as soon as the exam was completed.

The states entered into a contract with the NASD to administer the Series 63 exam. The states owned the exam and developed the question bank. The exam was unique because it was hard to compromise, as the computer made each test individual.

The pass rate on the state exams before the Series 63 was very high. The 63 was not implemented with the idea of "Gotcha" for the industry. NASAA wanted a pass rate of 75 to 80 percent. If the pass rate went above that percentile, NASAA reworked the question bank. If it went below, NASAA also reworked the questions in the bank. The computer would provide a print out on which questions were missed and which were answered correctly. That was the way NASAA continued to review and monitor the exam. The Series 63 exam was the start of funding for NASAA through the exam fee paid by the applicants. The NASD received an administration fee, but the bulk of the funds went to NASAA.

KD: This sounds like a lot of work putting together these questions, and monitoring them. Was this a committee that did this?

LB: The NASAA Committee did that. The state regulators on the NASAA Committee would always meet on the weekend after working a full week in their agency. I was not involved in the original group and I can't remember who they were that put the original exam together. However, I remember they spent many hours working on the question bank.

KD: Yes. I'm sure.

LB: After the exams and after the forms, it was just a matter of time before the CRD system. The states through NASAA initiated that process. Several state Commissioners and staff worked on the original project. The Commissioner from Arkansas was Harvey Bell. His staff person, who contributed so much to the project, was Nancy Jones. Mary Alice Brophy, the Commissioner from Minnesota, and Ray Cochi, the Commissioner from Massachusetts, I remember these people and others meeting as a NASAA committee. There were others that I'm sure I've left out, possibly Tom Krebs from Alabama. They spent countless hours meeting with the NASD, working toward the program and a contract.

KD: So we were talking about the CRD.

LB: Yes. The Central Registration Depository.

KD: And the origins of that.

LB: The origin. Well, as I said, right after the forms were done, Hugh Maken and I talked a lot about the idea of automating the forms into some type of registration process. However, Harvey Bell was the person who actually started to move the CRD project. The original committee consisted of Ray Cochi, Tom Krebs and Mary Alice Brophy and several others. They would report on their progress at NASAA meetings. NASAA by that time had the funding to take on this project and the first working CRD committee was formed.

After the CRD was a working prototype, it had to be administered by the NASD or the Stock Exchange. Both of these SROs had the technology to run CRD.

A contingent of the NASAA Board and the state administrators presented the program to the Stock Exchange and they turned it down. The NASD agreed to contract with NASAA and put the technology together. NASAA entered into a contract with the NASD, requiring the NASD to supply a terminal to every state. In some states, this was the first piece of hardware computer equipment that they had to use in their offices.

KD: This is '87, or something like that?

LB: No. Late 70s. The NASAA-NASD CRD system came up in 1980, and by 1984, all the states and the District of Columbia were on the system. Ray Cochi, the Massachusetts Commissioner, left the state and went to work for the NASD as their state liaison. The firms, the New York Stock Exchange and the SEC were included in the CRD development process. Many years after the states, the NASD and the SEC adopted the CRD forms and registration process, the New York Stock Exchange still required their applicants to file a separate U4 with the NYSE. After a number of years and a lot of

pressure from the industry, the New York Stock Exchange accepted the requirements of the CRD system and discontinued its separate filing requirements.

KD: They just had to have that extra little leverage.

LB: I remember the state agencies kept a supply of the forms and they had the New York Stock Exchange stamped on them. The brokers would call to get the forms because they were NYSE members. They had to file online with the CRD and mail a hard copy of the form to the NYSE. Sometimes old procedures die hard, I guess.

KD: So it sounds like you had pretty good relationship with the NASD at this point.

LB: Yes.

KD: Even have somebody in there who—

LB: Very close. The NASD sent Ray Cochi and a team of people around to set up the CRD hardware and help each state convert their database into the system. There was a period of time that the CRD and the state individual systems had to run parallel. But in 1980, it all shifted to the CRD.

KD: Seeing as how this was computerized, it probably made more sense to work with the NASD on this than with the New York Stock Exchange.

LB: It probably did. But I'm not sure. I think the stock exchange may have wished they had tried to work with the states and develop the CRD at the NYSE.

KD: They were always a little behind the curve when it came to the technology.

LB: I'll give you an interesting piece of history. The registration of brokers in states increased markedly with the implementation of the CRD. I know in Virginia, ours jumped from about 3,000 to 10,000 inside of six months. That probably indicated there were a lot of unregistered brokers in the states before CRD, but the states had no way of locating them. The firms really didn't keep track of in which state their brokers transacted business because they didn't have to. When the CRD system came in, the industry really stepped up and started registering people. The Series 63 estate exam had to be taken and that increased the NASAA treasury. A lot of duplication for the industry at the state level was eliminated and the speed of the registration and renewal process was improved. Before CRD, each state manually renewed agents each year. In Virginia, we shut our entire office down to process the annual renewal in a week and through the weekend. The CRD system processed the renewal in a day. In my opinion, the CRD was the most uniform process the states have ever accomplished. The CRD was a process that made it easy for the industry to meet the state requirements.

I believe that if the states had not implemented CRD, Congress would have pre-empted the states in this area long ago. The states would not be licensing brokers today other

than the ones located in their state. States have the authority to license any broker who does business with residents of their state. My discount broker case upheld state authority in this area. Before the CRD, the license process was a burden on the industry and I think the states should take pride in the fact that they developed the CRD.

KD: Which gets to the question of the reason for this. Obviously it was a pretty high priority thing.

LB: It was. NASAA spent its money to develop the CRD and many hours were spent by state Commissioners and their staffs. To this day, there's a CRD committee in NASAA and it still functions today to maintain the CRD's efficient process.

KD: I'm interested in the process of moving through the 80s. You were president of NASAA in '75, or '76 the first time.

LB: Yes, 1976.

KD: And you're looking at a group that's fairly small, not a lot of budget.

LB: Exactly.

KD: How was NASAA changing in the years after the CRD goes in? Was it almost too much growth to sort of get your hands around?

LB: No. Through NASAA's money, the states really stepped up uniform regulation and enforcement. The action that I told you about with the brokerage firm, that was all funded by NASAA.

Training started at the state level, which NASAA sponsored. Broker-dealer examiners, lawyers and enforcement personnel were trained. The registration modules for the products that we spoke about was all funded by NASAA.

KD: Has NASAA started to bring on staff at this point?

LB: At that point in time, yes, NASAA started to bring on staff in the Kansas office. NASAA hired Bruce and Linda Burditt. I think a lot of that was in Jeff Bartell's interview with you.

KD: Right.

LB: So we won't go into that.

KD: That's fine.

LB: NASAA, of course, eventually moved its office from Kansas to Washington, D.C. and increased its staff.

KD: Right. Was the move to Washington something that was anticipated for quite a long time, or was there controversy over it?

LB: No. I think the states always felt that the organization would eventually be moved to Washington because so many of the other associations were there, including the SIA and Attorney Generals, to name a few. The Burditts did a super, super job for the organization. They spent many hours each day with several other staff members on NASAA business. How they did it, I don't know, but they were always there to take the calls, and they catered to the members' requests. Fortunately for NASAA, Bruce's background was in accounting. He set up the bookkeeping systems and the audit processes for NASAA to manage its funds. If the funds had been mismanaged, it would have been a black eye to state regulation. It never happened on Bruce's watch or anyone else's.

KD: He set up the foundation.

LB: Yes.

KD: What was later taken to Washington.

LB: Bruce Burditt was responsible for the efficient management of NASAA funds. When NASAA went to Washington, I remember the first executive director was a former member of Congress. I can't remember his name. NASAA down through the years has played a big role on Capitol Hill and it has always devoted a lot of time of Federal legislation. The state Commissioners testify on the Hill often. NASAA doesn't lobby because its charter prohibits it. The association only testifies when asked. NASAA can't contribute through a PAC. However, NASAA has been very successful in Washington because of the staff representing the association.

KD: Right. They got somebody else a few years after that, I guess.

LB: NASAA has hired a number of people over the years, some of them from the states, as well as others from outside state regulation. The person that's there now, Russ Iuculano, has a consumer background and does an excellent job for them.

KD: Well, let's wrap up with NASAA a little bit. You have the very unusual experience of having been there relatively early before all of these really large changes you talked about, and then you went back in '91, I guess?

LB: 1992.

KD: '92. What was it that brought you back for a second stint?

LB: A number of the members came to me and asked me if I would consider running again for president. The first time I did not have to devote a lot of time to the office. Without

funds, the association had few projects – the one conference a year, and the U4 project with Hugh Makens. Other than a couple of speeches, that was about it. In 1992, I knew I had to be more involved with the association and that it was going to consume all my time. Fortunately for me, I had a great staff in Virginia that I did not have concerns leaving the agency to do NASAA business because I knew the office of the Virginia Securities Division would function correctly.

My deputy was Bob Lewis. The broker-dealer section chair was run by Ron Thomas, who happens to be the director of the agency today. Max Zeckler was my enforcement chief. The registrations program was overseen by Irene Hague, Dan Golden and Linda Bradley. Steve Goldsby was the registration manager for the offerings and deals. Hilda Butler was a great administration person who handled my funding and budgets. I knew the Virginia agency would function smoothly.

I stood for election and won. It was a marked difference the second time around, because there were quarterly board meetings and so many projects. NASAA had the office in Washington and the executive director was Lee Polson, the ex-general counsel for the Texas Securities Board. Lee was a great executive director for NASAA. He came to me right after I became President and told me that his family wanted to move back to Texas before his first child started school. I ask him if he would consider staying until the end of my term. He stayed on, which was certainly a big relief to me, and ran the organization until September, then moved back to Texas.

I functioned as executive director until NASAA could find another person to fill the position, which was in October of the following year. In order to keep the Virginia agency running, Bob Lewis and I would discuss business by telephone while I was traveling. We set up a schedule for matters on appeal from staff decisions to me as director of the agency. I would return to listen to the presentations. I spent time on the weekends with Bob and the other members of the staff, catching up on agency business. The Virginia office never missed a beat. The enforcement program and other business continued on schedule because the people I left in charge were so professional and qualified.

As president, the business of NASAA was massive. There was Congressional testimony, board meetings and many speeches. If I had wanted to, I could have given a speech to some group every week. There were so many requests. There were also meetings with the SEC Chairman, the stock exchange and the president of the NASD.

KD: Were there any subjects that were really big at that point? I mean, were there things that were happening externally that was causing NASAA to focus?

LB: NASAA was beginning to focus on syndications and partnerships. I recall we funded a lot of projects in the enforcement section, reviewing syndications and the regulated syndication issues. NASAA was getting heavily involved in that area. The CRD contracts and the regulation of investment advisors were beginning to consume a lot of time. NASAA published a uniform investment advisor statute, along with the exam, for

states that wanted to get into the program. Virginia was the first one. We passed the model legislation. I set up a regulatory registration program with the NASD just for Virginia to run the registration process, which was run by CRD.

Virginia had a contract with the NASD up until the mid-90s when NASAA completed the investment advisor registration through a system called the IARD for all the states. A lot of criminal prosecution of rogue investment advisors was done by the different states, and Virginia had its share. About this time, I noticed the focus of cooperation between the states and the SEC had started to divide. The project that Mickey Beach did with Reg D would never be done again because the SEC began to work without input from the states. Some of the task forces reviewing the regulated industry and the brokers were worked on jointly between the SEC and states, but the SEC did not seem as close as before. The SEC did not share information with the states like they did in the past. I don't think this divide was supported by SEC staff but the SEC Chairman during this period prevented much of the cooperation.

KD: What did you think the reason was behind that? What had changed over those few years?

LB: Probably the SEC Chairmen didn't like the state regulatory approach. I spent a lot of my time during my presidency in '92, trying to convince the chairman of the SEC that state and Federal regulation should be a coordinated effort.

KD: Yes. Well, eventually, the situation changed with NSMIA. Right?

LB: Exactly. That came in '95. It was after my term in '92. The states were trying to do what they could to maintain their scheme of regulation. However they lost some of it in '95. In my opinion, if the states had not implemented CRD and the automated licensing process, that authority might have been included in NSMIA preemption. The states were very aggressive and always have been very active in refusing to license brokers who have histories of not treating their customers fairly.

KD: Were you still with Virginia in '95?

LB: No. I left and went to Paine Webber in '94.

KD: Okay. And did you stay in Virginia at that point, or where did you work for Paine Webber?

LB: I've always worked in Virginia.

KD: What was your role there?

LB: I was hired by Ted Levine, general counsel of the firm, to be the director of state regulatory policy for Paine Webber.

KD: Ted Levine, formerly at the SEC?

LB: Yes. And that's what I've done ever since.

KD: Was there anything else that we haven't touched on that we should cover? The CRD?

LB: CRD in '80, had some problems. The NASD didn't have enough equipment and registrations weren't getting processed. Firms were complaining to the states about the backlog. One state, Tennessee, withdrew from the system. The NASD called a meeting in D.C. with all of the state commissioners and agreed to spend several million dollars to purchase more hardware. The states were concerned about renewal for the first year. There were a lot of threats by states to pull out of CRD. The NASD stepped up and bought the equipment and backlogs smoothed out. The renewal took place without a hitch and the problem was solved.

KD: And that's the extent of the technical problems that you had with that.

LB: Yes.

KD: All right. And so what year did you go from Virginia to Paine Webber?

LB: 1994.

KD: 1994. So you came back and watched your staff in Richmond do a little more work without you, and then headed out.

LB: Well, it's not the same staff. Ron Thomas is the Director. They still have a great program, and they certainly make me proud to be able to say I was part of it.

KD: Well, terrific. I appreciate your time.

LB: Okay.

[End of Interview]