Securities and Exchange Commission Historical Society
Telephone Interview with George T. Simon
Conducted on February 23, 2009, by Kenneth Durr

KD: Telephone interview with George T. Simon, February 23rd, 2009, by Kenneth Durr. Well, I do want to start with some background and find out where you went to school, how you got into corporate law.

GS: Sure. I went to undergrad at Trinity College in Hartford, and majored in English and music. And went from there directly to Harvard Law School and graduated in 1972, and worked for two different small law firms in New York, the second of which was a corporate firm that did a lot of what's now called takeover work. The reason I mention the second firm is because there was a fellow there prior to my being there by the name of Andy Klein. And that's how I ended up at the SEC.

KD: Which firm was that?

GS: It doesn't exist anymore, but it was called Lovejoy, Watson, Lundgren and Ashton.

KD: So Andy Klein had been there before you?

GS: That's right. And legend at the firm had it that he had gone to Washington to create what was to be called the consolidated tape. And when I decided to leave New York, it was in the midst of a financial crisis there. I don't know if you remember that, but the city was close to bankruptcy. And it's kind of like it is today, not a fun time. I just decided that I had had enough of New York. And as I was thinking about where to go next, I thought I would give Andy a call, even though I'd never met him, because it sounded very interesting.

KD: What kind of work had you been doing as a lawyer that made you interested in these market-structure type issues?

GS: Absolutely nothing [laughter]. I had nothing in my background that would've prepared me for that. It just sounded interesting. Let's put this in context. This was 1976. And in 1975, Congress had amended the securities laws in a fairly major fashion by adopting the Securities Acts Amendments of 1975, which empowered the Commission to make major changes to the structure of the securities markets. And since the SEC is an agency full of lawyers, it fell to lawyers to do that. And like all lawyers, I wanted to really be an economist [laughter], or something other than a lawyer, so this was really an opportunity to do something very different than drafting contracts and the like.

KD: Okay. So did you go into market reg then?

GS: Yes, I did.

KD: And who did you interview with down there in D.C.?

GS: Well, that's an interesting question. The first person I talked to was a person by the name of Art Friedman. Art was Andy's sidekick, and a very personable guy, and he really sold me on the place and working in the market structure area, which is where Andy was working. I also talked with Shelly Rappaport, who headed up a different area, responsible for exchange filings.

KD: Okay. So he was in corp fin.?

GS: No. They were both in market reg.

KD: Okay. Had the market reg been beefed up at all, given the significance of the '75 Acts Amendments?

GS: Great question. Actually, what had happened was this was during the Nixon era, and what had happened is Nixon had put in some politicos into market reg, a number of whom really didn't have a particularly good idea of what they were doing there [laughter]. So it was a time that market reg needed to be beefed up, but hadn't yet been. And Andy was really the guy who was the person holding the torch for the '75 amendments. The guy who had been there before him, Richard Lewis, who had done that had left, and Andy was really the guy who the market structure programs fell to. Lee Pickard was the director at the time, and this didn't seem to be something that he was particularly focused on.

KD: So was Andy Klein a deputy at that point?

GS: Associate director.

KD: Associate director. Okay. Well, then, did he sit you down and say, "Here's the situation, here's what we're going to do, here's your job"?

GS: Once I got there, you mean?

KD: Yes.

GS: Yes. Well, actually, it was a bit of a winding path because when I first got there, it wasn't clear what Andy wanted anybody to do, so they put me in an area called trading practices, which was not involved in the market structure stuff, but involved in administering rules like 10b-6 and things like that. And so I spent a year, year and a half writing no-action letters until I learned enough to be useful to Andy and his group.

KD: So trading practices, essentially, can you tell me a little bit more about this 10b-6 process and those rules?

GS: Sure. Let's see, 10b-6 is a rule adopted under the anti-fraud provisions of the Act, 10b, and it basically prohibited somebody who was distributing securities from buying the same securities at the same time in order to manipulate the price upward. And the significant case which had been decided probably ten years or so before then was Georgia Pacific, in which court had said that Georgia Pacific had violated that rule by purchasing securities at the same time that it was distributing securities, pursuant to an acquisition.

KD: So the Georgia Pacific case had sort of been the landmark in this, and so you're really looking at sort of routine fraud kinds of things, I guess, is that right?

GS: Exactly. And every company in the world with convertible stock had to get a no-action letter any time they wanted to buy stock in a buy-back program. So there were tons of these letters, and there was a whole lore that had to be learned. You know, it was great background, not what I wanted to do, but great background in terms of learning how the market operated, which was important, because when I went there, I knew absolutely nothing.

KD: Okay. So you did that for about a year.

GS: Yes.

KD: And so at that point, you were ready to start looking into market structure a little more deliberately?

GS: Yes. And by then, Andy had brought Lloyd Feller in, who had been, I think he was in enforcement at that point. Well, I think he was actually in enforcement at the time.

KD: Right. He was early on, yes.

GS: Yes. But he brought Lloyd in. Andy was appointed director when Harold Williams became chairman. And he brought Lloyd in to become associate director in charge of that area, and Lloyd shifted me over to the market structure group, which is where I spent really the bulk of my time the next four years or so.

KD: Okay. What was the issue at the top of the agenda at that point?

GS: At the time, my recollection was, I've got my book here of everything I ever did [laughter].

KD: That must be useful.

GS: It's all these releases that we worked on. At the time, in 1977 we were working on off-board trading restrictions.

KD: So that's Rule 390?

GS: Yes. We published this huge release in the summer of that year, July of 1977, proposing to eliminate 390. That was really my first project, and it was a fascinating one, it was one of these things that you had to really learn everything about market structure in order to understand.

KD: Tell me a little bit about the process of putting this release together and how you worked with other people, how the thing was organized that sort of thing.

GS: Well, you really had Andy, and Lloyd at the very end, and a fellow by the name of Mark Finerman. By then, I think Bart had left. And so it was really the three of them, Andy, Lloyd, Mark and then myself, who worked on it. And the way this would work is you'd do a draft, and Mark would play with it, and Lloyd would play with it, and Andy would completely rewrite it [laughter]. It was not an efficient process.

KD: Was there considerable research on the front end? I mean, did you go out and visit the trading floor, did you talk to people, or how did that work?

GS: At this point, no. Later on, as the process developed, and I can go into that, after we got that major release out, then we actually did spend a fair amount of time talking with people in the industry.

KD: Okay. So the release was sort of on the theoretical level, I guess.

GS: Yes. That's a good way to put it.

KD: Okay. What was the reception, is that 19c-2?

GS: Yeah, that was 19c-2. And the reception was, as you would imagine, the exchange community was outraged, wrote to every single person on the Hill, and so we were constantly getting calls and letters from the Hill that we had to respond to, but there was a pretty concerted campaign, by the exchange community at least, not to adopt the rule. And as it turned out, that was a relatively effective campaign.

KD: Right. But it sounds like you proceeded to some extent anyway.

GS: Yes. Well, the comment process was extensive. I believe we even had hearings, since this was, technically, an abrogation proceeding, because you were abrogating Rule 390. And going to the hearings was fascinating because you got to meet all the people in the industry who came down to talk about them.

KD: Do you remember any highlights of that?

GS: Well, the guy I remember the most was a fellow by the name of Stretch Gardner, who at that point was heading Bear Stearns. That's a name from the past now. And he was just a big guy, that's why they called him Stretch, with a great booming voice. But he, like everybody else, was basically saying, "If you adopt this rule, the exchange will evaporate, and it's way too important an institution to take that risk." Then the other side of that was a fellow by the name of Don Weeden, who had a sidekick named Fred Cecil. And Fred, actually, I think still works with the New York Stock Exchange. He was hired by them after Weeden & Company went out of business. But Don Weeden was the other side, and he was an incredibly smart and witty guy, and had some wonderful, wonderful explanations about the ways the securities market worked, one of which was called the auction bakery.

The auction bakery, which was his description of the way the New York Stock Exchange operated. And he analogized it to a bakery where everybody comes into the bakery and gets a ticket with a number on it, and they all queue up in line waiting for bread. And after the first person on the line gets to buy their loaf of bread, everybody throws away their tickets [laughter], which was a very accurate description of the parody and precedence rules of the New York Stock Exchange.

KD: So you had these hearings, and you said that you went out and did some research. Can you talk a little bit more about that?

GS: Well, it was primarily learning background because, as I said, when I went there, I was really inexperienced. So this involved learning about fixed commission rates, which was a large part of what 390 was all about. So learning about fixed commission rates and how they had, ultimately, been abrogated right before the '75 amendments, and learning about attempts by the New York Stock Exchange over the course of decades to restrict competition in the stocks they listed. There was a case decades before, the multiple trading case where other exchanges wanted to trade New York stock, and New York said its members, you can't trade those stocks on other exchanges, and ultimately, the Commission determined that they could. So there's a really long history to this issue. And a large part of what it did in drafting the first drafts of these things was to learn about that history.

KD: Okay. You talked about the original release, 19c-2. And then there were hearings and some more work. What was the next step after that?

GS: We sidetracked [laughter]. There was so much opposition. And by then, as I said, Harold Williams had come in as chairman, and he really had no appetite at the beginning to take that on since he was just, you know, like the rest of us, learning as he went. So we moved on to other things. And in early 1978, we published two major pieces, one of which was the adoption of the quote rule, which was rule 11Ac1-1. And the other was sort of an agenda piece that described what the Commission wanted to do next in the development of a national market system. And I probably spent six months or so working on the two of those. Really right after the hearings, we moved from – the hearings were in the late summer, as I recall, of '77. Really, all of our time after that refining the quote rule, and developing this agenda, which was really the first roadmap the Commission had ever published on where it wanted to go, the national market system.

KD: Well, that begs the question: if the Commission put aside something like 390, then how did it know where it wanted to go as far as the broader national market system?

GS: Well, it did put 390 on hold for a little while. And so it then turned to other questions. And with the adoption of the quote rule, the principle question really was, now that everybody had to put out their quotes, what good did that do? And the questions really related to were you going to have some kind of inter-market linkage or some kind of nationwide priority, which a lot of people called CLOB. So really, this teed-up the question of where do you go next. Do you have linkages? Do you have nationwide price protection, or do you have nationwide time priority? Different ways of sequencing trades. Linkage basically has you ship orders from one market to another to avoid trading through prices. That's a part of price protection. The alternative was time priority, which said that you couldn't match a price, you just had to satisfy them in the order they were quoted, which was very similar to what the CLOB concept was.

KD: Which one of these alternatives—essentially, I guess, there are two: inter-market linkage and then this Hard CLOB. Of those two was the SEC market reg staff leaning toward?

GS: That's a really good question. I think we all felt the time priority CLOB was the fairest, but that it was a political impossibility. And therefore, the concept of nationwide price protection, which is trade-through, although less thorough or less fair, seemed more politically feasible.

KD: Okay. And you'd, obviously, gotten a big lesson in what was politically possible, having coming out of those hearings and the sort of backlash against 390.

GS: Right. And as I said, Harold Williams was a very cautious guy. Very thoughtful and very smart. But cautious in a very positive way in a sense that, this is very important, and we don't want to mess up here. And so there was always a sense in the market structure program of incrementalism: you know, let's take a step that we feel is going to be acceptable to a large part of the industry and see where that goes. And if it seems like another step is called for, let's take that then.

KD: Okay. So this would still have been a fairly large step. This nationwide price protection, did that go along with the inter-market linkage idea?

GS: Yes. That was a part of that. That was related to it. And I think we called it at that time nationwide price protection, but the markets always referred to it as trade-throughs.

KD: Right. Can you just explain briefly that concept, the trade-through concept?

GS: Sure. The critical piece here was up until the adoption of the quote rule, you had no idea what prices people were willing to buy or sell at. There just were no published quotations. There were representative things—you could call down to the floor and the like, but you really had no idea what prices people were willing to trade at. In fact, certain markets just didn't publish their quotations. So this was a very major step, and once that happens, then you could see that markets began to trade through other quotes.

So if you were bidding twenty on one market, there could be trades at say nineteen and three quarters in other markets, which obviously meant that the person who was bidding twenty would have given a better price to the seller at twenty than at nineteen and three quarters. And that seemed to be totally inconsistent with where Congress wanted to go in the national market system, which was to integrate these various markets.

GS: Now was ITS part of the deal here?

KD: Well, it was just being proposed at the time, and you had really two competing systems. You had the New York Stock Exchange, which had sponsored ITS, and then you had good old Don Weeden back again with something called the regional market system, which was basically his automated trading system, which had been called WHAM, Weeden Holdings Automated Market, and then was converted into this RMS, which was really a part of the Cincinnati Stock Exchange, and that was really the beginnings of the automated version of the Cincinnati Stock Exchange.

KD: Now was that a Hard CLOB model?

GS: Yes.

KD: Okay. And there was opposition to that, I guess, from the industry.

GS: Right. Obviously Weeden thought it was the right way to go, and tried to propagate that by using it as a way of integrating the markets, which was his concept of the regional market system. And, ultimately, the regional exchanges bought into the New York model because it was more consistent with their not wanting a CLOB.

KD: The dynamic here, I guess, is that the SEC under Harold Williams made it very clear that the industry itself was going to sort this stuff out. Is that right?

GS: Yes. There was certainly a notion that the Commission was going to prod and push and say, "If you don't do it, we'll do it for you, but we'd much rather you do it yourself."

KD: So were you, essentially, elaborating on the concepts of national price protection and those sorts of things so that the New York Stock Exchange and ITS could take them up and use them? Was that the idea?

GS: The concept was—and this was really the Andy Klein model [laughter]—propose something really draconian, and then step back [laughter]. And it worked. It worked. Andy proposed, at this point, national price protection, which would've been an absolute prohibition on trading through another market. And New York and the ITS participants came up with what was called the trade-through rule, which was really a half-baked version of price protection because the way that worked is you could trade through another market. The only difference is that if somebody complained, they had to make it up to you, and there's no assurance that the customer would ever get the benefit of that.

So it was a really half-baked solution, but that was what the exchanges came up with. And in this incrementalism model, that's where the Commission went rather than mandating nationwide price protection.

KD: Okay. Now I noticed that you had been involved in the over-the-counter market too, working with NASDAQ a little bit. And I was interested to see that there was something going on at that point where they had a representative price, and an inside spread price. And, of course, being naïve, my first question is how did they get away with that representative price?

GS: Well, NASDAQ, of course, was a huge advancement in the over-the-counter market when it first came out, and it came out of the special study, 1963, where the people who wrote that said, "You really need to do something about this market. It's totally fragmented and nobody knows what's going on there." And with a bunch of prodding, the NASD came up with this computer system, NASDAQ, but don't forget the context here was there was no last-sale reporting for over-the-counter stocks, and there still wouldn't be until about 1979.

KD: What were the implications of that, no last-sale reporting?

GS: You didn't know what price securities were trading at. You had no idea. And don't forget, there were a lot of big stocks traded over-the-counter because most of the bank stocks were traded over-the-counter at the time. So there was no last-sale reporting, and there were no published quotations. And when NASDAQ decided they were going to put out quotations, there was a huge segment of the over-the-counter industry that said, "No, you can't do that because that'll just give away the game." So they came up with this concept of the representative bid and offer. And don't forget, this was at a time prior to the time that the NASD had to file rules with the SEC [laughter]. There were a lot of changes that came about at this period of time.

KD: Was that a '75 Acts change?

GS: Yes. So NASDAQ was developed in the context before then. And the representative bid and offer was the median spread, and the median bid, and then a median spread was added to the median bid to come up with an offer. So it was purposely much wider than the actual inside market. It was calculated to be. And that's how over-the-counter market-makers felt they could continue to keep their spreads. So there had been some consternation about this for some number of years, and the NASD was rabid about not doing it [laughter], and we kind of snuck it in.

I think it was Lloyd who decided to do this. We'd been asked to come up with a proposal, which was called the keystroke proposal. Talk about micromanaging, about regulating the number of keystrokes that somebody had to hit to pull up a quote. The regional exchanges had said that that was a disincentive as any competitive because when you hit “T” to get a quote for telephone, you always got the New York quote. And they were saying, "That's not the national market system. You should get the consolidated quote for the consolidated last sale." So, you know, we went about drafting this arcane rule that required that when you press “T”, you got the consolidated quote rather than just the New York quote. But we kind of snuck in there, doing away with the representative bid match [laughter].

And amidst all of the furor about the keystroke rule, that kind of got lost in the shuffle. And it was, once again, one of these things that ultimately NASDAQ saw the wisdom to it, although they complained, and complained, and complained. Ultimately, they felt that it would be better for their market, and, in fact, they were right. So that was adopted in—I think it was '78 or 9, probably '79. And shortly thereafter, the Commission required last sale reporting to be over-the-counter market. So that was a huge shift.

KD: So you snuck in a rule, I guess. Is that how it worked?

GS: Yes, we snuck in a rule that, basically, said as a part of this equal keystroke rule, that you couldn't make available a quotation other than the best bid or offer.

KD: So did Gordon Macklin get on the phone and call you up and say, "What the heck is this?"

GS: Well, ultimately, as I say, they came around realizing that they could market the heck out of it.

KD: Right. But you'd think there would've been some excitement at first.

GS: There was less than you thought. I remember being interviewed by, it was either the *Times* or the *Journal*, I can't remember, and they were all hot to trot about the keystroke rule. And I said, "You know, you're missing the boat here because the real important rule is doing away with the RBA."

KD: All right. And were you involved in that last sale reporting?

GS: Oh, yes. It was called the Qualified Securities Relief. And, basically, what it did was, the '75 amendment said that the Commission could designate securities to be national market system securities. And the question then became what was going to be a national market system securities? And this is where Gordon was brilliant, Gordon Macklin, as we proposed making NASDAQ securities national market system securities, realized that that sounded really good [laughter]. You know, NASDAQ securities were going to be national market system securities, not these terrible listed securities. And as the rule came out, it designated the national list, which was the top tier of NASDAQ securities as national market system securities. And the NASD filed a trademark for the term and started using national market system as a part of their marketing campaign.

KD: Now what did it mean to be a national market security then?

GS: The only thing it really meant was that you were subject to last-sale reporting. It was a way of giving Gordon something to sell in exchange for forcing him to have last sale reporting.

KD: I see. But again, you would think that something like last sale reporting would ultimately be beneficial by making people more comfortable trading on NASDAQ.

GS: That's right. And he understood that, that more transparency was, ultimately, good for the market. But also, he wanted the term, and he marketed the heck out of it. NMS securities meant NASDAQ securities for years.

KD: Now also, something else that was going on at that point was linking up ITS and NASDAQ. Tell me a little bit about that.

GS: Well, the exchanges really didn't want to deal with the NASD, with NASDAQ or over-the-counter market makers, the Don Weedens of the world, because they had been their nemesis for years. Weeden was really the guy who broke fixed commissions by offering discounted commissions. So he was widely perceived as just a cousin of the devil. And there was a mechanism that had developed over the years in the over-the-counter market that, actually, provided some really good ammunition for the exchange community to avoid it, and that was what was called net printing.

Part of the strange way the over-the-counter market worked was since everybody was operating as a dealer, they didn't technically charge commissions, rather they charged what was called a markup, which was economically the same thing. But when you looked at your confirmation that you got, it didn't say $25 commission; it just said, this is what you paid, and you didn't know what the markup was. So the exchange community, rightfully, said, "Look, how can you have a trade-through rule that says you can't trade through a price," when the price that we're using is what was called the gross price, which is the price without the commission.

And the price that they're using is the price with the commission built in. You're comparing peaches to pears, and you're going to create all sorts of trade-throughs that don't exist because, economically, the two are non-equivalent things. And that was a real problem and one that the Commission spent—I remember spending over a year working that one through. And it was a real thorny one because the over-the-counter market makers didn't want to disclose their markups, and yet, they wanted to be a part of this system. And, ultimately, the NASD caved and permitted, at least on the surface of things, the Commission to adopt a rule that said that you had to report a trade at what was the gross price, the price without the markup built in, and separately, disclose the markup to the customer. That was a huge give-up on their part, but it was critical and essential to their becoming a part of ITS.

KD: What would the alternative have been? You thought about this for a year. What else were you considering?

GS: There really weren't any alternatives, and it was something we wanted to do very much anyway, because we wanted customers to know what the markups were. And so it was a lever we had, and we used to get the NASD to begin to disclose the markups. Now they snicker at us a bit because they put enough leeway in the rules such that there were situations in which you could print the net price and, in fact, it became fairly common, for at least institutional trades, to print net, even though the rule said otherwise. So it took quite a while for that, actually, to work its way through, probably eight, ten years, before it finally, ultimately, was worked out the way it was intended, which was to unbundled, if you will, the markup. And, you know, part of that, interestingly enough, all fell into soft dollars.

KD: Tell me about that.

GS: Okay. Soft dollars are a way of money managers using commissions to buy research. When fixed commissions were eliminated, the money manager community said, "Look, you can't force us to get the lowest commission here because we use these commissions to buy research which is helpful to our customers." And that was incorporated into the '76 amendments and included in the 34 act, and so it's a huge, huge business where a money manager will pay slightly more than the lowest commission, and the broker who receives that will buy research or provide research to the money manager in exchange for that. Well, 28(e), on its face, is limited to commissions, not to markups. And so the over-the-counter market, you couldn't, technically, have soft dollar arrangements in the over-the-counter market. And so, ultimately, what pushed the last sale reporting to be accurate was the applicability of soft dollars to the over-the-counter market.

KD: Okay. So that was the over-the-counter market's equivalent of soft dollars, I guess, in some respects.

GS: Right, right.

KD: Okay. So, ultimately, if you get rid of soft dollars, you can get rid of the –

GS: No, no, no. Ultimately, if you adopt commissions, you can use them for soft dollars. And the other side of it was some institutions didn't want to show commissions. Mutual funds had to disclose their commissions, and if they were dealing net, they didn't have commissions to disclose. So it's interesting how all of these rules get impacted by the self-interest of the financial community to try and serve their own interests.

KD: Yes. Not terribly surprising, though.

GS: No, not at all. It's what every American is taught to do.

KD: Right. Well, tell me a little bit about how your work in the Commission changed over the years. You came in in '76, and you spent a lot of time just sort of learning and writing these no-action letters. Did you move up, get more management responsibility over time? How did that work?

GS: Yes. After Lloyd came in, I was promoted to be a branch chief. We began to hire, which was, as you had pointed out, really important for this process. And this is going to sound very strange. Three of our first hires, one was Rick Ketchum, another was Brandon Becker, and the third was Bob Colby [laughter].

KD: Pretty good hires, I guess.

GS: Yes. And so we ended up with this really, really talented group of people. And it was my luck to be branch chief when we hired Rick and, ultimately, Brandon. And that gave us some depth in order to expand the program. And as you can see, the frequency and the number of rules significantly increased in '78, '79 and '80, and that really was a reflection of hiring up. So I was a branch chief for a year or so, and then became an assistant director when Doug Scarff, who was the assistant director, replaced Lloyd as associate director. Lloyd went into private practice. And then when Doug became director, I took his job as associate director.

KD: Now as you're moving up from assistant to associate, is your portfolio getting broader? Are you looking at a wider range of issues?

GS: Yes. When I became associate director, there was a realignment of the division because I had been really Mr. Market Structure, and the position that I was moving into was what was called OSRO, I think it was called, Office of Self-Regulatory Organizations, or something like that. OSRO, that was it, OSRO. Office of Self-Regulatory Organizations. And, basically, what they did is approve or disapprove exchange and NASDAQ rule filings. The market structure group was folded into that, and so when I became associate director, the portfolio consisted of the market structure piece as well as oversight over the exchanges, the MSRB, and the clearing corporation, of which there were a lot more then than there are now. So it was a huge portfolio.

KD: So oversight of all the self-regulatory organizations.

GS: All the exchanges, yes. All the self-regulatory organizations.

KD: What were the big challenges there at that time?

GS: Well, the MSRB was a relatively young organization at the time.

KD: That came out of '75 as well, right?

GS: Yes, that's right. And in trying to get them to adopt rules that promoted transparency in that market was something that we really needed to focus on. And the other piece was the options exchanges where we had made a lot of progress in the stock area, and had really made no progress in national market systems or options. And, in fact, there had been a moratorium on the expansion of options which got lifted in, I think it was '78 or so, '78, '79, and there was, at that point, a lottery program that was implemented to avoid any competition on listings. So we recognized that we had a tremendous hill to climb in the options area, which still lags behind stocks in terms of where it's moving in terms of market integration.

And then in clearing, the problems in clearing were less obvious because it's the back office [laughter], everything is in the back. But the issues there really related to was there ability to have any real competition. There had been a court case shortly after the adoption of the '75 amendments, which basically, the court said that the national market system mandate for competition amongst exchanges was not equally applicable to clearing corporations. And the perception was that DTC and NSEC were engaged in some pretty anti-competitive practices to keep the regional clearing corporations out of business. But the regional clearing corporations had historically provided some really, really important things.

The way securities are cleared today is something called continuous net settlement. And that was developed by the Pacific Clearing Corporation. And it became the way the world worked, and it was a brilliant, brilliant mechanism for assuring that there weren't fails in clearing. And it never would've happened had there not been regional clearing corporations.

Similarly, the Midwest Clearing Corporation developed what was then called NBS Clearing Corporation, which is mortgage-backed securities clearing corporation, which there had been no clearing for mortgage-backed securities until then. So the regional clearing corporations had done some really interesting things, but they were very much on their heals because of the size and economic power of DTC and NSCC. So the areas that were the biggest challenges were the ones that had the least attention in the three to four years before, and really needed some work.

KD: So were you able to put resources into doing that?

GS: We tried. Ultimately in the clearing side, as the world now proves, there's really only one clearing corporation left. Whether that's a good thing or not is subject to some debate. NASDAQ has just bought the Boston Stock Exchange in order to get its clearing corporation because it wants to compete with NSCC. So there seems to still be some notion that competition may be helpful in that, but we were clearly unsuccessful in promoting it, in part because of the court case that said that the standards were different.

KD: You're getting to an issue that's in the background, any time you talk about the national market system, and that's the whole idea of competition, whether you want lots of markets competing against each other, or you want to have one big national market. Was that concept considered all the time? Was that sort of the basis of a lot of discussion?

GS: Yes. And I think, although there was this sense in the financial community that the SEC wanted a CLOB, it wasn't true. We recognized that competition brought about all sorts of positive benefits. Partially, it was price, but more importantly was the benefit of competition for service. In other words, that you could provide new and additional services. And that's, of course, how so many things in the market develop is that a new entrant says, "Why don't I do this?" And we recognize that if you had just one single monolithic market, that you would lose the benefits of that competition.

KD: Right. Innovation.

GS: Right. And so you see today every time there's consolidation, as there was when, basically, New York and NASDAQ became the two dominant markets, now you see new markets developing like BATS, who we represent, because that's the way America works. Whenever you have a consolidation like that, you create opportunities for new entrants, and that's what keeps the economy vital.

KD: Okay. So there was some understanding of that within the Commission at that time.

GS: Absolutely.

KD: Yes. I guess Harold Williams at the top probably had some sense of that.

GS: Yes.

KD: Did you sit in on Commission meetings at any time?

GS: Yes. This is a funny story. You know, the thing that you always wanted to do is get to the Commission table. That showed you had advanced to the Commission. And I remember the first one I went to, and your job is to just sit there and smile [laughter]. You're not supposed to say a word the first time you're up there. So I'm sitting there next to Shelly Rappaport, and nodding and smiling, and Shelly asks me—I've got a water pitcher sitting next to me—asks me for some water. And so I get a cup, tip over the pitcher, and it's not one of these ones that you screw off and the top stays. So the top fell off and, of course, water fell everywhere [laughter], and that was my first time at the Commission.

KD: So they probably remembered you.

GS: Well, I don't know. But more important than sitting at the Commission table at the time was meeting with the commissioners. It was a great Commission. It was a wonderful Commission, the Harold Williams Commission. You had Steve Friedman, and John Evans, and these were really, really smart guys who really cared. And in my thought, really the most interesting and best part was sitting down with them and trying to explain something to them, and getting their thoughts and having them understand it. And that was really a tremendously fulfilling part of the job.

KD: Would that have been a routine, or was that something that was exceptional?

GS: Well, any time you had a proposal that was going to be controversial, you'd want to go up there and prep your way, because if you surprised them, you knew that that was just not the way to go. So we would always, any time there was a major initiative, spend time first with the legal assistants, briefing them, getting them up to speed, and then with the commissioners. And, you know, I don't have the same insight today that I did back then in terms of the inner workings, but I'm not sure that that there's that degree of intercourse between the staff and the commissioners today.

KD: And it sounds like since you were, you talked about bringing on these new people and doing these new rules and releases. It sounds like you would've been doing this on an increasing frequency then.

GS: Yes.

KD: Okay. Any other highlights of your time in market reg. that we haven't talked about?

GS: No. I think, you know, you've gone through most of it. Just looking at my little book of all these releases. I think you've covered a lot of it, most of it.

KD: Well, tell me about the decision to leave the SEC.

GS: I think one of the great parts about the SEC is bringing in new blood. And Andy left and went to Schiff, Hardin & Wade, and Lloyd left and went to Morgan, Lewis, and Doug Scarff left after I did. But it was something that you expected to do. And one thing I had decided was I didn't want to go back to New York because I had just really had it with the city, and so chances were really Washington or Chicago. And, interestingly, we forget today what the world looked like back then, but there was very little SEC practice in Washington at the time.

KD: That is funny to hear.

GS: It's so different today. But back then, the only firm that really had an SEC practice in Washington was Wilmer, Cutler. And that was primarily enforcement practice. So my sights quickly turned to Chicago which had the options exchanges and a really vibrant exchange community, and I knew I needed to be in a city that had that. So I ended up in Chicago, and it's been, you know, a great, great town to practice law in because there's so much opportunity here to bring fresh blood.

KD: Have you been able to use these insights into market structure that you got during your time with the SEC?

GS: Absolutely. I represented almost every exchange in the country. I represented New York, and the AMEX, and the Chicago Stock Exchange, and Philadelphia and the Pacific Stock Exchange. In fact, I think the only exchange we didn't do work for was Cincinnati.

So it’s been great. My practice has been very heavily oriented towards that. In fact, one of the people who had been at the Philadelphia Stock Exchange, been their general counsel, is now at Davis Polk I ran into at “SEC Speaks.” He was with a guy from the Bank of New York, and he introduced me as, "This is George Simon. He's the Yoda of market structure," [laughter] which was very nice to hear, but I've spent a lot of time working on it, and it continues to be a fascinating subject.

KD: What have you learned in these years representing the exchanges and working on the other side? What have you learned that you didn't see when you were at the SEC?

GS: Well, that's a hard question to answer. Well, let me answer a different question than you ansked [laughter]. I think what you've seen today is the unbelievable volatility in the market, and the contraction in the number of markets, and now the growth of dark pools is a reflection of a market that's ultimately become tipped to the professional investor. And that's probably unhealthy in the long term. The notion of a dark pool was something that we never would've even begun to contemplate, and yet there are fifteen of them or so now today.

Penny pricing was designed to do some very important things, but it has increased the volatility and made the short-sale rule an ineffective rule, which is why it was done away with, but that's not necessarily a good thing. So I think what you have today is a world that you can't go back to the old one, but it has its set of challenges today that are probably far greater than in 1975.

Part of the concern in 1975 was the New York market share had gotten down to 60-odd percent, and that was a concern. And the regionals were of concern in terms of how they were going to be integrated. Well today the New York Stock Exchange has 25 percent of the market in its own stocks, which is really unbelievable. And that creates similar kinds of problems to what we had in 1975, but the solutions are totally different. Because today, we're in such a highly technical environment where speed is such an important part of it. The ratio of professional trading to institutional or investment – I should say ratio of professional trading to investment trading, if you will, has gotten way skewed where a huge portion of the trading today is purely professional.

KD: Do you think that the kind of system that you were in back in the 1970s and early 80s can be adapted to handle that?

GS: No. That's the beauty of what needs to be done going forward is I don't think you can go backward. You can't decide to go back to floor-based trading. It's just not going to happen. But you do need to find ways to decrease volatility and to put a little bit more friction in the market because having 3 to 5 percent movements every day is probably not a good thing. You know, the '75 amendments start with this notion that the capital markets are an important national asset. And the concept there was it's a critical part of capital raising.

And that was, I think, an accurate concept. And it's still true. And the problem that you have is that the markets depend on investors, not traders. You need investors for the markets to operate. And when the ratio of professional to investment gets this out of line, and the volatility increases this much, you create incentives not to invest, which is probably not a good thing for the market. So there's a big challenge ahead of us.

KD: Right. And, I guess, the question is whether the SEC can adapt itself to handle those challenges, or help handle them.

GS: Yes. And they have to.

KD: Yes. All right, well, is there anything else that we haven't touched on?

GS: No. I said what I wanted [laughter].

KD: Well, terrific. I really appreciate talking to you. It was a lot of fun.

GS: Yes, I enjoyed it too.

[End of Interview]